MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE
Blocks -$.2050 $1.8650
Barrels -.1025 $1.8675

Weekly Average
Blocks -$1.645 $1.8995
Barrels -$.0835 $1.9250

CHICAGO AA BUTTER
Weekly Change +$.0725 $1.3225
Weekly Average +$.0965 $1.3145

NON-FAT DRY MILK
Week Ending 2/29 & 3/01
Calif. Plants $1.2265 22,034,564
NASS Plants $1.2440 37,767,639

DRY WHEY
NASS w/e 3/01/08 $.2366 WEST MSTLY AVG w/e 3/06/08 $.2350

CHEESE MARKET COMMENTS: Last week, concern about day-to-day price volatility of cheese prices on the CME was mentioned. This week it's the week-to-week volatility that hurts. The only practical way to control the kinds of day-to-day and week-to-week price changes that we have seen over the past 18 or so months is to have the CME place daily limits of price movements – but that would not be advisable. As it is, the CME is volatile and subject to manipulation, supposedly has satisfactory oversight, and theoretically is accessible to anyone who wishes to back up a position with cash or sufficient credit. But the trading floor is littered with the corpses of would-be reformers. So the advice that is most often heard is to ignore the short-term changes and focus on the fundamentals of supply and demand for cheddar cheese or maybe all cheese. It also helps to get a good night's sleep.

BUTTER MARKET COMMENTS: More price increases this week (14.5 cents in two weeks), with nothing in the way of news to support what is happening. No letters, no calls, no visits. Ice cream manufacturers are taking in more cream, seasonally, and butter sales tend to strengthen as the Easter/Passover week approaches, and the berry season is almost in sight. But butter manufacturing plants are being inundated with milk and cream, and the Spring flush has not yet arrived. Dairy Market News does pass on the belief that this week's price increases may be short term, in response to a cut-off date for selling "old" butter. Perhaps that’s it.

NONFAT DRY MILK: Prices in this category have all the signs of a train without breaks on a 6-degree incline. Here we are again. There is an apparent worldwide net shortage of nonfat dry milk and skim milk powder, the U.S. has a huge surplus of the stuff and, according to some reports, U.S. exporters are out there looking for the lowest price sales opportunities. Based on recent prices, it looks like they are finding what they're looking for. The California plant average price lost another 5.2 cents last week, almost 30 cents over the past 5 weeks, and almost 40 cents over the last 7 weeks. The CWAP is now within 12 cents of where it was last year. The heavy sales volumes in January and February appear to have been clearance sales at prices below cost.

WHEY MARKET COMMENTS: There are more signs that prices for dry whey may be about as low as they will go. Some manufacturers reportedly are in a position to make a price rather than take a price, but not all. The export market continues to absorb most of what is produced, but prices are very soft. What is now needed is for some of the customers who gave up on dry whey last year to return. The prices are right; they appear to be competitive with just about any alternative that is worth considering. Prices for other whey-based products continue to lose ground, but may be near the point where their protein cost is equivalent to other sources. Inventories of dry whey are higher than last year but do not appear to be prohibitive.

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DAIRY PRODUCT PRICES PLUNGE AS JANUARY'S MILK SURPLUS GOES TO BUTTER AND POWDER:  (By J. Kaczor)

Well, the deep plunge in cheese prices in late January is past and prices have returned to the $1.90 - $2.10 per lb range. Monday's report on January's dairy product production pretty much followed the pattern of 2007's 4th quarter. That means the cheese sector was again outstanding but all other sectors continued to wave warning flags.

First, the good news. According to USDA, production of all cheese was 1.9% below last January, and 4.0% below December. California's production decrease accounted for about a fifth of the change from December. Cheese inventories at the end of January also were lower than a year earlier. This production and sales pattern over an extended period of time when milk production is increasing is unusual to say the least. Cheese plants continue to control their output to avoid storage costs and the risk of price decreases. Buyers also have the same interests and concerns. Short term, the outlook is for cheese prices to continue to be strong. However, the closeness of production and sales means that it won't take much of a production change to create a belief that a buyers' market is on the way. If that happens, all the money that Cooperatives Working Together has in the bank will not help. Why not use it now? Any desire to wait until prices collapse should be suppressed.

Now, the other news. All that additional milk that was produced had to go somewhere, and the weak U.S. economy is not supporting strong dairy product sales. Until a recovery is underway, maybe later this year, the typical consumer will much more likely fill his gas tank than buy butter, cheese, and restaurant meals. The collective action of 50 million families in a recession can be powerful. In January, the dairy industry did what was expected. The surplus milk was converted to butter (+12.7% above last January, 21% above December) and nonfat dry milk and skim milk powders (+32% above last January, 9% above December). Butter inventories continued to increase. But a faint bit of good news about milk powders is that the huge amount of production in January, which was a four-year high, was more than offset by huge sales, although the prices charged continued to move sharply lower. There are opportunities for continuing strong butter and powder exports, but the present prospects for decent prices from those sales does not look good.

UNDERSTANDING MILK PRICES FOR CHEESE PRODUCTION:  (By J. Kaczor) In an earlier article on differences between California and federal order prices it was said, because market values for the same basic products (butter, powder, cheddar cheese, and dry whey) are used in setting the "market clearing" milk prices in both systems, the month-to-month price changes could be expected to be reasonably similar. And then it was shown that the prices, particularly for cheese milk, sometime just don't seem to follow the rules. The January-February changes, which were reported last week, are a case in point. The federal order price fell by $2.29 per cwt while the California 4b price rose by $.63 per cwt. About a third of the $2.29 drop in the F.O. price came from the continuing drop in prices for dry whey and butter. The other two-thirds of that decrease – and the increase in the 4b price – resulted from the different approaches used to arrive at the monthly market values for cheese that are used in the milk price formulas.

The table below compares the two approaches used to arrive at monthly market values for cheddar cheese.

<table>
<thead>
<tr>
<th>California</th>
<th>Federal Orders</th>
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<tbody>
<tr>
<td>Cheddar blocks</td>
<td>Cheddar blocks and barrels</td>
</tr>
<tr>
<td>Chicago Mercantile Exchange</td>
<td>National mandatory price surveys</td>
</tr>
<tr>
<td>Prices determined daily</td>
<td>Weekly prices, 1 + week time lag</td>
</tr>
<tr>
<td>Daily prices weighted equally</td>
<td>Weekly prices weighted by volume</td>
</tr>
<tr>
<td>Prices can change by a single bid or offer</td>
<td>Prices determined by actual sales</td>
</tr>
<tr>
<td>Specific number of days are used</td>
<td>Varying number of weeks are used</td>
</tr>
</tbody>
</table>
The size of the total net change for February ($2.93 per cwt) in the cost for cheese milk between supposedly competing areas is unusual. It's worth looking into the reasons why one approach can arrive at an increase of 6+ cents in the monthly market value for cheese on the CME, for California's February 4b price, while the national survey of weekly sales shows a decrease of 16 cents, for February's Class III price in federal order areas. Following is a brief explanation.

- One reason is that prices on the CME can be volatile, changing daily, by substantial amounts, without a sale being made. The CME average is no more than simple arithmetic. The national price survey, on the other hand, is much more complex and stable in that it includes all plants that sell at least 1 million lbs of blocks or barrels per year to a diverse number of buyers for a variety of uses.

- A second reason has to do with the mechanics of pricing. Sales reported to NASS are said to be made up of a combination of spot sales based on current CME prices, contracted sales of blocks and barrels made to domestic buyers that are based upon a combination of the previous week's CME average price and a plant's prices charged during weeks before, and prices for export purposes – all of which contribute to a weekly average that is much more "sticky" than the CME weekly average.

- A third reason is the inevitable time lag. Prices on the CME can change by large amounts within a matter of days, while weeks pass before the national survey reflects CME activity.

It's easy to follow what happened by looking at the week-to-week changes in market values for cheddar cheese for the 8 weeks that went into the January and February formulas for cheese milk prices. The prices in this table reflect simple averages of block prices on the CME and weighted averages of blocks and barrels (+ 3 cents) for the NASS survey.

<table>
<thead>
<tr>
<th>Chicago Mercantile Exchange</th>
<th>NASS Weekly Survey</th>
</tr>
</thead>
<tbody>
<tr>
<td>(For California)</td>
<td>(For Federal Orders)</td>
</tr>
<tr>
<td>1st week</td>
<td>$2.053</td>
</tr>
<tr>
<td>2nd week</td>
<td>1.968</td>
</tr>
<tr>
<td>3rd week</td>
<td>1.741</td>
</tr>
<tr>
<td>4th week</td>
<td>1.650</td>
</tr>
<tr>
<td>Jan</td>
<td>1.873</td>
</tr>
<tr>
<td>1st week</td>
<td>1.739</td>
</tr>
<tr>
<td>2nd week</td>
<td>1.931</td>
</tr>
<tr>
<td>3rd week</td>
<td>2.006</td>
</tr>
<tr>
<td>4th week</td>
<td>2.061</td>
</tr>
<tr>
<td>Feb</td>
<td>1.935</td>
</tr>
</tbody>
</table>

There it is. While not an "apples to apples" comparison, the table shows the numbers that were developed and used in the two systems for the 2 months. The federal order system valued cheddar cheese in January almost 13 cents higher for its price formula than California's system. In February the "correction" that resulted from the time delay in the NASS survey brought the federal order valuation to 9.5 cents lower than California's. Those changes, plus the decrease in dry whey values in February explain just about all of the $2.93 net change in cheese milk prices between California and everywhere else, except Idaho.

Idle Comments And Questions Raised By The Preceding Review. Because the low point in the NASS series came in the 2nd week in February, two weeks after the bottom in the CME series, the table does support the belief that the NASS prices lag behind the CME prices by about 2 weeks, although the relationship is far from exact. Can anyone say whether the real market value of cheddar cheese in February rose by 6.2 cents per lb as California would have it, or fell by 16 cents per lb as the national sales survey reported? Did sales of California cheese increase when California plants had a 26 cents per lb cost advantage over their competitors during the 3rd and 4th weeks of January – and decrease when they were faced with a cost disadvantage of about the same size just 4 weeks
later? Did those price differences really exist, or are we being mislead by averages? Are prices like these a sign of a sound and stable market? Does the value of all cheese really change by the precise amount that prices on the CME change on a single day from a single offer, bid, or sale? Which system is more correct? If the CME market for cheese did not exist, would cheese makers find a way to effectively price their products?

NEXT SET OF WDR WORKSHOPS IN THE CENTRAL VALLEY HAS BEGUN: (By Rob VandenHeuvel)
As our Central Valley dairy members all know, December 31, 2007 was only the first of many deadlines to come under the new Waste Discharge Requirements for dairy operations. The next major deadline is July 1, 2008, when a number of reports will be due, including an updated “Dairy Facility Assessment”, your 2007 manure tracking forms and the results from your well samples. You should all have received a flyer from the California Dairy Quality Assurance Program (CDQAP) summarizing the key items in the next set of requirements, but in case you haven’t, I’ve posted it on our website: http://www.MilkProducersCouncil.org/WDRSpringFlyer.pdf.

Similar to the workshops that were held last fall, CDQAP has begun hosting workshops up and down the Central Valley to explain “phase 2” of the new requirements. As many of you know, these workshops are very informative and the staff that lead the discussion are well equipped to answer many of the questions you may have. I encourage every dairy to have someone attend one of these workshops.

Next week, workshops will be held in Stanislaus, Kings and Merced Counties:

**Tuesday, March 11th – Stanislaus County**
9:30 am – 12:30 pm & 1:30 – 4:30 pm
Stanislaus County Ag Center, 3800 Cornucopia Way, ABC Room

**Wednesday, March 12th – Kings County**
9:30 am – 12:30 pm & 1:30 – 4:30 pm
Kings Art Center, 605 N. Douty Street, Hanford

**Thursday, March 13th – Merced County**
9:30 am – 12:30 pm & 1:30 – 4:30 pm
Merced County Cooperative Extension Office, 2145 W. Wardrobe Avenue, Merced

*** And as always, if you have any questions or need assistance with any part of the new water regulations, please feel free to contact myself (909-992-9529) or Betsy Hunter, our Central Valley Representative (661-205-6721).

AN UPDATE ON AQMD’S POLICY TOWARDS EMERGENCY GENERATORS ON DAIRIES: (By Rob VandenHeuvel) In January, this newsletter reported that the South Coast Air Quality Management District (AQMD), which has jurisdiction over dairies in both the Chino/Ontario and San Jacinto regions, had ended the requirement that dairies obtain a permit for their emergency generators. (http://www.milkproducerscouncil.org/updates/011108.pdf) At that time, MPC informed our readers that if you receive an invoice from AQMD for “renewal of your permit,” you are not required to pay the portion applicable to your emergency generator.

While most people (including a few individuals I spoke with at AQMD) were not aware of this policy, this change was not new – it was actually made in 2006! That means any “permit renewal” fee you’ve paid since then was not necessary, and is therefore refundable. For most dairies, this is about $250 per generator per year. If you are interested in getting a refund of the fees you paid, you will need to send a copy of the invoices you paid along with a letter explaining why you are requesting a refund. For help in drafting a brief letter, I have posted a sample letter on our website (http://www.milkproducerscouncil.org/aqmdrefund.pdf). If you’d like MPC to assist you, please call the office at (909) 628-6018.