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DATE: November 22, 2013
TO: Directiors & Members
FROM: Rob Vandenheuvel, General Manager

MPC FRIDAY MARKET UPDATE

<table>
<thead>
<tr>
<th>CHICAGO CHEDDAR CHEESE</th>
<th>CHICAGO AA BUTTER</th>
<th>NON-FAT DRY MILK</th>
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<td>Blocks</td>
<td>Weekly Change</td>
<td>Week Ending 11/15 &amp; 11/16</td>
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<td>+$.0150</td>
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<td>Calif. Plants $1.8727 6,196,969</td>
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<td>Barrels</td>
<td>Weekly Average</td>
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Weekly Average, Cheddar Cheese

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<td>Barrels</td>
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DRY WHEY

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<th>Dairy Market News w/e 11/22/13</th>
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FRED DOUMA’S PRICE PROJECTIONS...

Nov 22 Est: Quota cwt. $20.28 Overbase cwt. $18.59 Cls. 4a cwt. $20.52 Cls. 4b cwt. $17.29
Last Week: Quota cwt. $20.25 Overbase cwt. $18.55 Cls. 4a cwt. $20.42 Cls. 4b cwt. $17.28

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MARKET COMMENTARY: (By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)

**Milk & Dairy Markets**

Class III futures and CME spot Cheddar put in a mixed performance this week. Blocks closed 1.5¢ higher at $1.835/lb. Barrels lost 0.25¢, settling at $1.755. In contrast, Class IV futures were consistently higher. January through April contracts added 20¢ or more. Spot butter rallied 3¢ to $1.68. Grade A nonfat dry milk (NDM) added a penny and Extra Grade NDM jumped 7½¢. Judging by spot market activity and this week’s reports, there is no reason for the Class IV premium to fade. The spread is widest in January and February, where Class IV futures exceed corresponding Class III values by more than $3/cwt.

Dairy product prices were mixed at the Global Dairy Trade (GDT) auction. The GDT index rose 0.1%. The average winning prices for anhydrous milkfat, buttermilk powder, casein and whole milk powder declined, while more closely followed products like butter, Cheddar, and skim milk powder moved higher. It is worth noting that Fonterra sold butter at an equivalent price of $1.58/lb., well below the CME spot butter price on the same day at $1.65. Dairy America bested CME spot traders, selling butter for delivery next month at $1.70.

U.S. butter stocks on October 31 were an astounding 25.5% lower than at the end of September, according to USDA’s Cold Storage report. The nearly 60 million lb. decline is the largest September to October
drawdown on record and the largest monthly withdrawal in at least a decade. A combination of tight U.S. cream supplies, increased domestic demand ahead of the holidays, and booming export trade fostered the impressive decline. Still, at 173.8 million lbs., butter inventories exceed October 2012 volumes by 19.8%. Despite the impressive reduction in supplies last month, there is clearly no shortage of butter.

U.S. cheese stocks dropped 46.5 million lbs. in October. This compares to an average reduction of 18.2 million lbs. over the past five years. At 1.02 billion lbs., cheese inventories were 4.3% lower than in September but 2.9% greater than October 2012.

Chinese whole milk powder (WMP) imports reached 54,012 metric tons (MT) in October, the highest monthly total since March. The Chinese were clearly happy to see New Zealand return to the market. New Zealand supplied 82% of Chinese WMP imports, and they sent more WMP to China in October than they have in six months. Chinese imports of SMP fell from the record levels of September, but remained at historically high levels. The U.S. represented about one third of the total, but the U.S. share of SMP exports to China will likely diminish in the months to come as New Zealand takes back much of the market. Over the past three years, the U.S. has supplied about 15% of Chinese SMP imports. But China’s growing demand for milk powder will help to absorb much of the milk out of Oceania and leave room for U.S. exports elsewhere.

October milk production totaled 16.43 billion lbs. This was 1% higher than October 2012 and suggests that the equally modest gains in September were not a one-off event. The milk cow herd contracted a little, extending the more pronounced declines of August and September. Still, there were 13,000 more milk cows than in October 2012, and output per cow was 0.8% higher. U.S. milk production is likely to grow given lower feed costs and improved profit margins. But the data has not yet proven this case, and the markets did not feel any pressure from this week’s Milk Production Report.

California produced 3.34 billion lbs. of milk in October, up 1% from a year ago. The dairy herd was 3,000 head larger than October 2012 at 1.781 million head, steady with September. The Golden State dairy industry has not entirely recovered from years of high feed costs and forced liquidations. October 2013 milk production was 89 million lbs. lower than in October 2011.
While most states reported year-over-year milk production growth, it is interesting to note those that did not. Idaho and Missouri reported the steepest declines, down 2.7% from a year ago. The Idaho herd lost 7,000 cows over the past year, despite an increase in processing capacity there.

With the exception of Minnesota, the other states to report lower production – Ohio, Illinois and New Mexico – also reported lower cow numbers. This suggests that the dip in output in these states is likely to persist. The declines in the Midwest stand in marked contrast to the recent trend of widespread and consistent production increases in the heartland. The fact that Class III prices are significantly lower than Class IV and year-ago levels is cutting into the advantage the traditional cheese states have enjoyed for years.

Weekly dairy cow slaughter totaled 60,146 head. While slaughter over 60,000 head is nothing to scoff at, this was 5% lower than last year, extending the eight-week streak of dairy culling below year ago levels. Slaughter in Region 9 has fallen short of the prior year for 13 of the past 15 weeks.

The fact that the milk cow herd is contracting – albeit modestly – despite the slowing cull rate and rising profit margins suggests that heifers may be in short supply. Heifer prices are rising, which is likely due to a combination of tighter supplies and improving dairy profits. Dairy producers may have to slow cull rates further to maintain or even expand their herds while compensating for the waning availability of replacements.

**Grain Markets**

December corn futures closed at $4.22¼; nearly unchanged from last week after an early-week fade and late-week rally. Supplies are plentiful, but both export and ethanol demand have impressed. While the downtrend in this bearish market is likely to continue, the recent bounce may be sustained until corn exports begin to fade.

November soybean futures are back over $13/bushel after adding nearly 40¢ this week. Exports of soybeans and soybean meal have been extraordinarily strong. While favorable weather in South America could eventually result in abundance, the U.S. remains the only consistent soybean supplier for the time being.

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**NEGOTIATIONS ON THE FARM BILL CONTINUE; IDFA AND THEIR ALLIES CONTINUE THEIR ASSAULT ON THE DAIRY SECURITY ACT:** *(By Rob Vandenheuvel)* Reports out of Washington, DC this week indicate that the negotiations on the Farm Bill have made progress, but are now on hold until after Thanksgiving. As a reminder, the previous Farm Bill expired on September 30th. The House and Senate have each approved different versions of a new Farm Bill earlier this year, and now a final bill must be agreed upon that can be approved by both the House and Senate and signed by the President.

As you all know, most of the media attention has focused on the level of funding for food stamps – or the “Supplemental Nutrition Assistance Program (SNAP). The House of Representatives’ Farm Bill included about $40 billion in reductions to the program over the next 10 years, while the Senate’s Farm Bill included about $4 billion in reductions. Adding to the drama, the SNAP program recently saw about $11 billion in reductions due to a previously implemented budget measure.

However, behind the scenes, there continues to be heavy lobbying on the dairy provisions in the bill. Regular readers of this newsletter are well aware of the differences being negotiated, but as a quick summary:

- Both bills include a “margin protection program” that operates like an insurance program, with government-subsidized premiums paid by the participating dairy farmers, and indemnity payments made to those farmers when national margins drop below pre-set levels.
- The main difference between the two bills is that the Senate also includes a “dairy market stabilization program,” or DMSP, which is designed to be a seldom-used, but valuable tool to coordinate modest reductions in milk production when we are producing more milk than we can profitably sell. The House
Agriculture Committee also approved the DMSP in their version of the bill, but it was stripped out when the bill was considered by the full House of Representatives.

None of us know exactly what final dairy provisions will come out of the negotiations currently being conducted by the “Conference Committee,” which means the lobbying both for/against the DMSP continues to rage on.

MPC has been part of a coalition representing dairy farmers throughout the country in supporting the two-pronged approach included in the Senate Bill. We see significant value in having a DMSP that creates a temporary, yet critical economic signal to slightly cut back milk production for a few months when on-the-farm margins drop below certain levels.

We’ve pointed out many times in this newsletter that when we get in those types of situations, and our national cold storage reports are showing more production than demand can absorb, we’re all-too-often left hoping that production drops by some means, such as weather (as long as it’s not the weather in your region), heavier culling, or some dairymen in a region you don’t know liquidating their herds. We’ve pointed out that it would be far better to have a stand-by program that empowers us to collectively cut back milk production for a few months and get ourselves back on track.

We’ve also pointed out the fairness of a policy that says, “If you're going to rely on a government-subsidized insurance program, you ought to be willing to help solve the underlying problem by participating in the DMSP.” Of course, on the other hand, if you have no desire to participate in the government-subsidized margin insurance program, you shouldn’t have to participate in the DMSP either.

As you all know, that’s only one side of the equation. On the other side, the opponents of the DMSP have their own line of arguments. Those opponents are led by the International Dairy Foods Association (IDFA) – the main lobbying organization for the nation’s dairy processors (a.k.a., the buyers of our nation’s milk). One of the primary focuses of the processors’ lobbyists is to keep their main input cost – milk – as low as possible, and their lobbying efforts are aimed directly at that goal.

This week, IDFA continued their assault with a one-page flyer accusing supporters of the DMSP of creating a “hidden tax” on “families with children, particularly those with low or fixed incomes.” (You can find the full one-pager at: [http://www.idfa.org/files/756idfa_snap_111813.pdf](http://www.idfa.org/files/756idfa_snap_111813.pdf))

We’ve seen some pretty shameless propaganda coming from IDFA over the past couple years, but this one – which has shown up before, and obviously is effective (which is why they continue to go back to it) – is really one of the more pathetic arguments they use. The folks they’re targeting with these flyers are Legislators from urban areas, who represent lots of consumers, but don’t have a real dairy farmer presence in their districts.

Let’s think about what IDFA is really saying through this flyer. They claim that the DMSP, if triggered in, could raise milk prices by “as much as 33%” (they provide absolutely no data in the flyer to back this claim up). They go on to point out that an increase like this would force the 47 million SNAP recipients to spend “an extra $94 million per month to put a full meal on the table.”

**Wow.** Let me say that again – **Wow.** The only reason IDFA gets away with this ridiculous argument is because the folks they’re targeting clearly don’t have a background of knowledge on the dairy industry and how it works. That’s our job as a coalition – to make sure the facts are out there so IDFA cannot get away with this.

But just to set the record straight, let me just give you the main reason why IDFA’s arguments are pathetic and misleading. For starters, let me respond with a simple series of questions:

- When SNAP recipients purchase their food, where are they doing that? Grocery stores?
- Who’s manufacturing those products that are on the grocery store shelves?
- Are those dairy manufacturers – many of whom are represented by IDFA – selling those products as a
loss, in an effort to provide more affordable food to SNAP recipients?

Let me answer that last one: **Of course not!**

Remember, the DMSP only triggers in temporarily during periods when dairy farmers are not able to cover their own costs. So what IDFA is really saying here is, “I don’t care whether dairy farmers can cover their costs or not…those farmers have a moral responsibility to sell their milk at a loss if necessary, to keep our dairy products cheaper on the shelves.” And while IDFA is trying to “shame” the nation’s dairy farmers, they themselves are PROFITTING from the sale of those products, all while the SNAP program provides subsidies on the purchase. **What a great deal!**

A couple months ago, the House of Representatives voted to strip the DMSP from the Farm Bill, largely due to this ridiculous propaganda spewed by IDFA and their allies in Congress. They did everything they could to convince Representatives from urban districts that dairy farmers were just trying to jack up the cost of milk at the stores. They obviously left out the part that they – as the manufacturers of those dairy products – are profiting from the sale of those products, whether or not the dairy farmers are even able to cover their costs.

There is evidence that this propaganda continues to be effective, as 28 House Democrats signed a letter last week to the Conference Committee members urging a rejection of the Senate version of the dairy provisions. The letter claims that the DMSP is designed to “periodically spike milk prices and increase the cost of healthy and nutritious dairy foods for all Americans.” (The full letter can be found at: http://www.idfa.org/news-views/headline-news/details/8616/) It continues to be our job, as supporters of the common sense, two-pronged approach included in the Senate Farm Bill, to shine a big spotlight on exactly how hypocritical this line of arguments is. **We have an opportunity to establish a safety net program that empowers our dairy farmers to demand a market-based milk price that covers our on-the-farm costs, and we are hopeful that common sense will prevail in this critical negotiation of a new five-year Farm Bill.**

*Due to holiday traveling, we will be unable to publish a newsletter next week.*
*The MPC board and staff want to wish all of you and your families a wonderful Thanksgiving!*