

MPC WEEKLY FRIDAY REPORT

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 TO: DIRECTORS & MEMBERS
 FROM: KEVIN ABERNATHY, GENERAL MANAGER
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MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE		CHICAGO AA BUTTER		NON-FAT DRY MILK	
Blocks	+ \$.0800 \$1.9875	WEEKLY CHANGE	-.0650 \$2.6900	WEEK ENDING 02/12/22	
Barrels	+.0250 \$1.9350	WEEKLY AVERAGE	+.1870 \$2.7650	NAT'L PLANTS \$1.7225 19,772,163	
WEEKLY AVERAGE CHEDDAR CHEESE		DRY WHEY		LAST WEEK ENDING 02/05/22	
Blocks	+.0710 \$1.9725	DAIRY MARKET NEWS	W/E 02/18/22 \$.8000	NAT'L PLANTS \$1.6944 27,329,790	
Barrels	+.0530 \$1.9380	NATIONAL PLANTS	W/E 02/12/22 \$.7787		

CALIFORNIA FEDERAL MILK MARKETING ORDER PRICE PROJECTIONS

PRICE PROJECTIONS	CLASS I ACTUAL (RANGE BASED ON LOCATION)	CLASS II PROJECTED	CLASS III PROJECTED	CLASS IV PROJECTED
FEB 18 EST	\$23.24 - \$23.74	\$23.67	\$20.90	\$23.90
LAST WEEK	\$23.24 - \$23.74	\$23.37	\$20.80	\$23.80

JANUARY 2022 CA FMMO STATISTICAL UNIFORM PRICE ANNOUNCEMENT

JAN '22 FINAL	CLASS I	CLASS II	CLASS III	CLASS IV	STATISTICAL UNIFORM PRICE (BLENDED PRICE)	NET PRICE AFTER QUOTA ASSESSMENT*
MINIMUM CLASS PRICE	\$21.31 (TULARE) \$21.81 (L.A.)	\$22.83	\$20.38	\$23.09	\$20.75 (TULARE) \$21.25 (L.A.)	\$20.385 (TULARE) \$20.885 (L.A.)
PERCENT POOLED MILK	22.1%	5.3%	68.9%	3.8%	100% (1.83 BILLION LBS. POOLED)	

*QUOTA RATE OF \$0.365/CWT. AS OF JUNE 2020 MILK

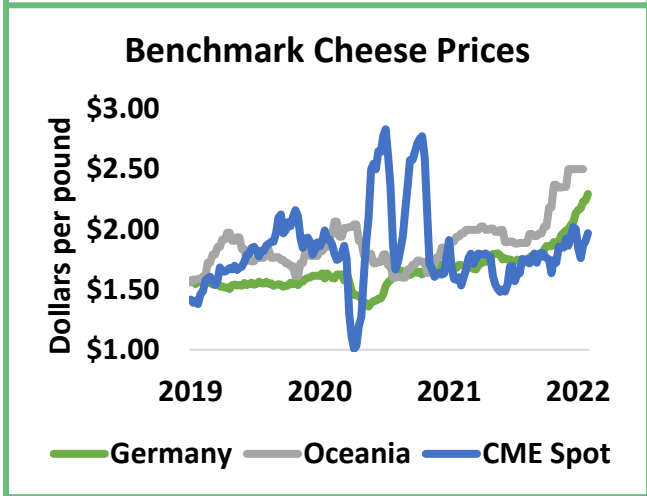
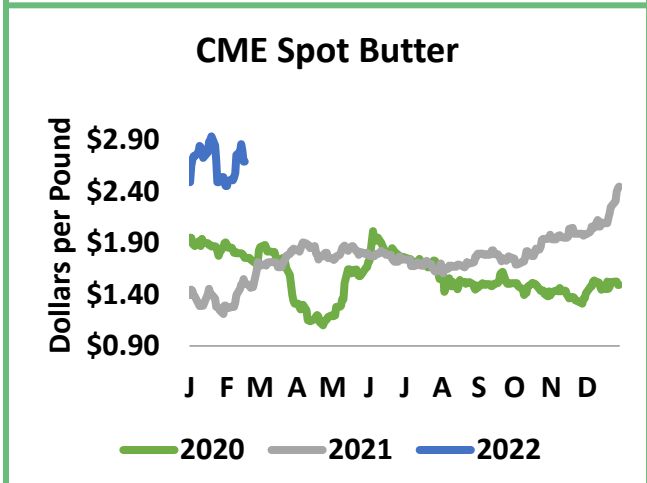
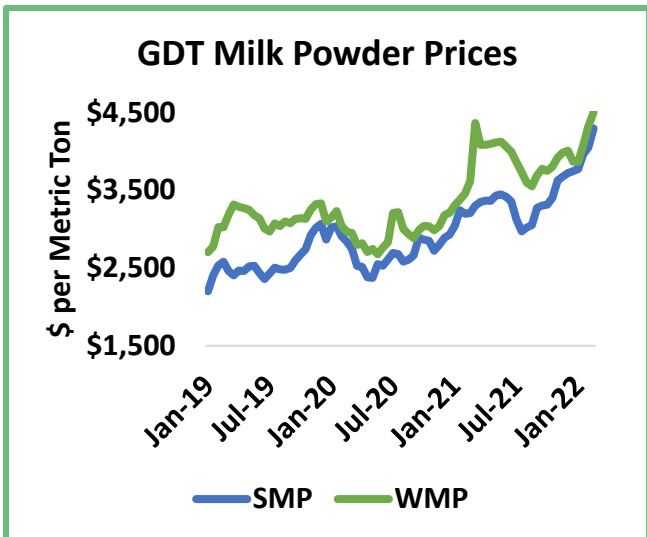


Milk, Dairy and Grain Market Commentary

By Sarina Sharp, Daily Dairy Report
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Milk & Dairy Markets

The dairy markets soared to historic heights early in the week. Butter and Cheddar reached all-time highs at the Global Dairy Trade (GDT) auction on Tuesday, while both skim milk powder (SMP) and whole milk powder (WMP) prices climbed to fresh seven-year highs. The GDT Index advanced 4.2%, its third straight increase above 4%.



The milk powder markets got off to a strong start in Chicago as well. For the first time since 2014, CME spot nonfat dry milk (NDM) traded at \$1.90 per pound. Traders exchanged three loads at that price on Monday and two more on Tuesday. Rising NDM values propelled March and April futures to the highest Class IV price ever, at \$25 per cwt. But after a brief spell at those dizzying heights, the markets faltered. March and April Class IV settled at \$24.40 and \$24.32, respectively, not far below the peak set in 2014. Most Class IV contracts finished 40 to 65¢ lower than the life-of-contract highs they scored a week ago. Spot NDM finished at \$1.85, down 4.75¢ from last Friday.

While U.S. milk powder prices edged carefully back from the peak, butter slipped and fell. Spot butter closed today at \$2.69, down 6.5¢ for the week. Although butter remains tight, high prices have shaken some loose. Butter makers brought 17 loads to Chicago last week and another 28 this week. Cream is reportedly a little more available as well, although multiples remain high. The *Daily Dairy Report* warns that butter could be harder to come by later this year. “Unseasonably high cream multiples, labor and trucking shortages, and an inverted futures market are all encouraging butter sales and discouraging output at a time when production is usually at its peak.”

The cheese markets bucked the trend and moved higher. Spot Cheddar blocks leapt 8¢ to \$1.9875. Barrels rallied 2.5¢ to \$1.935. Anecdotal reports suggest that exporters are fielding a few more calls. Some cheesemakers are switching their production lines to meet export orders and making less commodity Cheddar. U.S. cheese looks like a bargain compared to European or Oceanian product, so exports are likely to remain a vital outlet that will help to prevent formidable U.S. cheese output from becoming burdensome.

CME spot dry whey slipped 1.25¢ to 81¢. Whey demand remains healthy, and supplies are not as scarce. *Dairy*

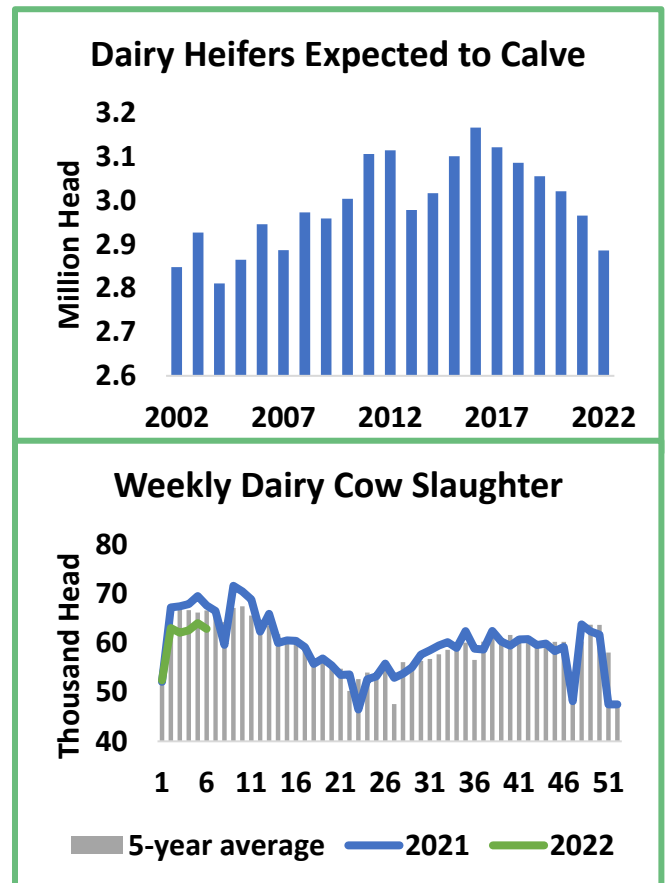
Market News reports, “Producers are more actively offering edible dry whey loads.” Still, they aren’t feeling any pressure to discount whey to keep it moving. Regional prices inched upward.

Strong spot cheese prices boosted the February Class III contract. The other Class III futures tested life-of-contract highs last Friday or early this week, but then fell back. Most contracts settled 15 to 30¢ lower than last week’s close. March through June Class III milk averaged \$22.38 when the closing bell rang. Class IV averaged an astounding \$24.10 for the spring flush months.

The best cure for high prices is high prices, and the dairy markets seem to be tasting this medicine for the first time in years. Buyers are a little less aggressive to purchase expensive products, and dairy merchants are pushing a little more product out the door. But as long as demand holds, prices will remain high.

Lofty milk prices will surely elicit a response from dairy producers, but for now, global milk production remains in decline. Assuming steady output in Spain, European milk collections were 1.6% lower than the prior year in December. Annual output in the Eurozone and the United Kingdom fell 0.7% short of the 2020 total. Aussie milk collections were also 0.7% lower in 2021 than in 2020, and December milk output fell 1.2% below that of December 2020. Smaller dairy herds and mounting environmental restrictions will likely keep growth in check in Europe and Oceania, leaving more room for U.S. dairy exports.

In the United States, higher milk prices are likely already prompting better output, but there are major barriers to rapid growth. Pricey feed, energy, freight, and labor have raised costs on the farm. After years of red ink, several large dairy operators in California and the Southwest are taking advantage of rising asset values and cashing out. Many of their peers are looking to add cows, but they may face several major hurdles, including tapped out processing capacity, construction delays, and scarce heifer supplies. USDA estimates there were 4.45 million dairy heifers when the year began, 3.4% fewer than the year before and the smallest total since 2009. The number of heifers expected to calve and enter the herd over the next 12 months is smaller than in any year since 2005. Dairy producers will still be able to add cows by lowering cull rates, and they are clearly trying to do so. Through early February, dairy slaughter is 6.4% behind the 2021 pace and 4% lower than the five-year average cull rate. U.S. milk output is starting to climb, but structural issues suggest growth will be modest.



Grain Markets

The feed markets were buffeted by global forces this week, as the world watched the buildup at the Ukrainian border. Both Russia and Ukraine are major wheat exporters, and Ukraine grows a lot of corn as well. The wheat markets, and to a lesser extent the corn markets, moved wildly back and forth as the headlines declared that an invasion was imminent, only to reverse course hours later and assert that it was all a Russian ruse. Meanwhile, dry weather in South America boosted soybean prices. The forecast calls for some showers next week, but it will take more than that to break the drought.

May corn futures settled today at \$6.5275 per bushel, up almost 3¢ from last Friday’s close. May soybeans climbed 17.25¢ this week to \$16.035. May soybean meal futures dropped almost \$9 to \$445.70 per ton.



The Logic Behind Federal Milk Marketing Order Pricing

By Geoff Vanden Heuvel, Director of Regulatory and Economic Affairs
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There seems to be an uptick in complaining about Federal Milk Marketing Orders (FMMOs), with a fair amount of calling for “reform” of the FMMO system. I have read some of this commentary, as maybe you have, and would like to respond to it.

There is a rap on the FMMOs that they are complicated. They are. But that does not mean there is no logic behind them. The logic is simple: because milk is perishable, dairy farmers must sell it every day to a buyer who doesn't have to buy it every day. In a normal market, you have a balance between the buyer and seller, but because of the perishability of milk, producers are inherently vulnerable. The FMMOs function as a referee. They establish milk prices based on what milk is ultimately used for according to a classification system. Class I is fluid milk, which is the most perishable dairy product. The logic of the FMMO is that Class I should be the highest-priced milk. If the FMMOs did not price fluid milk, who do you think would? The producers? Or the big box stores?

To establish the value of milk, the FMMOs discover what the price of cheese, dry whey, butter and nonfat dry milk is in the unregulated and competitive market. It then converts those market prices for dairy products into a milk value, which is then used to establish the Class I price. The logic of this system is that Class III and IV represent the base commodity value of milk and Class I is then priced at a differential above that.

You might wonder why there is not just a single manufacturing class instead of separate Class III and Class IV prices. The reason is that they are different markets. While each uses milk, the equipment needed to make cheese and whey products, or butter and powders, is not interchangeable. It was decided a little over 20 years ago, as consumers began to eat more of their dairy products rather than drink them, that the FMMO system should recognize the unique equipment and marketing needs of the two major dairy commodity uses and have a separate class for each. This was a logical conclusion, but it did have tradeoffs. If we only had a single manufacturing price, then there would theoretically be increased incentive for milk to flow to the higher-valued use. That incentive still exists but it is less dramatic than if there was only one manufacturing price. The costs of creating excess processing capacity to accommodate the free movement of milk between the two uses would be very high. Establishing separate classes enabled very efficient, single purpose manufacturing plants to be constructed. Over the past 20 years this is what has happened, and efficient new manufacturing plant capacity continues to be constructed under the current FMMO system.

There seems to be three main reasons usually given for why we need major FMMO “reform”:

- 1) Fluid milk consumption is dropping, so the system no longer works as designed;
- 2) Exports are the key to future dairy industry growth and the FMMO system impedes that; and
- 3) The FMMO system is based on low value commodity products, so that hurts milk prices.

Fluid Milk

The fact that the fluid milk share of a much bigger dairy market is shrinking does not mean it is unimportant. Price elasticity in Class I still exists. It is true that per capita consumption of Class I milk

has dropped for the past 25 years. Consumer preferences change all the time. [A recent study on fluid milk](#) points out there are a whole variety of reasons why fluid milk consumption is dropping, with the drop in breakfast cereal consumption being one of them. The impact of an average Class I price differential on a cup of fluid milk is less than 2 cents. It is hard to believe that making Class I milk a little cheaper would change these trends.

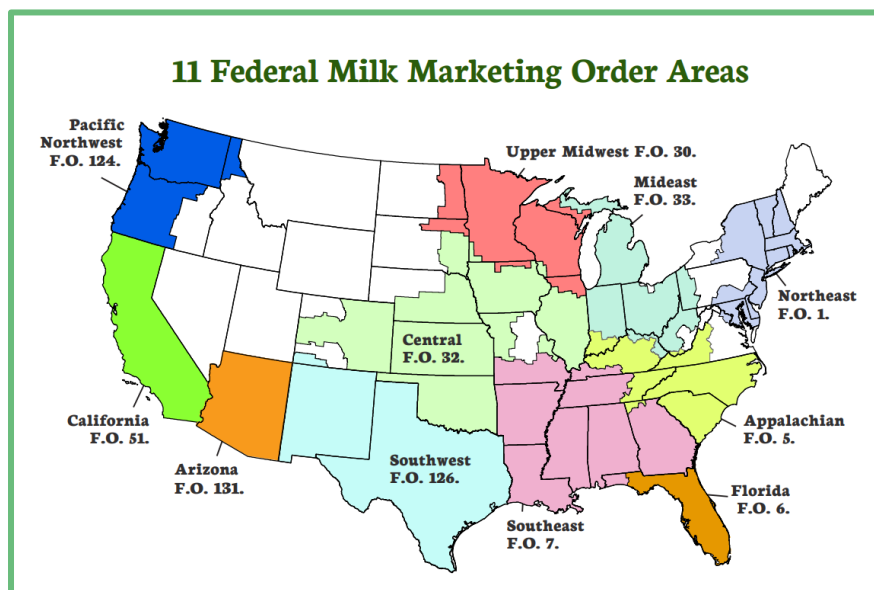
Exports

The U.S. now exports almost 20% of milk production. Remember, that happened – and is continuing to grow – under the current FMMO system. No evidence here of failure.

Commodity Products

And yes, FMMO Class III and IV formulas are based on commodity values, but making commodity products is never a high margin enterprise whether we are talking about dairy products or widgets. That market reality drives processors and producers to move up the value chain if they want to earn more money for their milk. There is plenty of evidence of this happening around the country. Millions of daily pounds of processing capacity have come online in the last few years in the U.S. and much more capacity is on the way.

The secret to the success of the FMMO system is that, other than Class I, it is a **VOLUNTARY** system. No Class III or IV usage is required to pay regulated minimum prices unless it voluntarily associates with the FMMO pool. **The FMMO provides structure, but does not limit or restrict innovation in product mix or pricing of any other dairy product other than fluid milk.** If you are in a region that has almost no Class I usage, there is no reason to be part of an FMMO. Idaho is not in the FMMO system and there is no pressure on them to join. If you want to make products for export, as long as it is not a Class I product, you can operate complete outside of the FMMO system. However, the presence of the FMMO system gives producers a benchmark to assess if the price they are paid for milk is competitive.



When we look at the 85 years that the FMMO system has been around, it has not prevented different regions of the country from benefiting from comparative advantages they might have enjoyed. When FMMOs were established, New York was the largest milk producing state. Then Wisconsin figured out how to take advantage of their natural resources and industry ingenuity to develop as America's Dairyland. The fact that New York always had more people and more Class I sales did not prevent Wisconsin from succeeding. Then California emerged, exploiting a state order to incentivize the expansion of plant capacity to accommodate a huge cost of production advantage that came from large scale dairy operations, made possible by mild weather and ample feed supplies. Then urbanization pressure scattered southern California dairies. They headed to Idaho, Washington, New Mexico, Texas, back to Wisconsin, Illinois, Michigan, Iowa, Indiana and even South Dakota, Nebraska and Kansas along with lots of others. Each area is having its growth spurt – all under the FMMO program.

The success of government economic regulation should be judged on whether it significantly hindered what the market forces would have produced if the regulation had not been in place. In other words, does the regulation stabilize, but otherwise not interfere with, where market forces would have taken the industry.

My view is that the FMMO system, while not perfect, is a remarkably successful program. The success of government economic regulation should be judged on whether it significantly hindered what the market forces would have produced if the regulation had not been in place. In other words, does the regulation stabilize, but otherwise not interfere with, where market forces would have taken the industry.

Could the FMMOs benefit from some tweaks and updating? Yes. A mistake was made in 2018 when Congress accommodated a request from National Milk Producers Federation and the International Dairy Foods Association to change the base price for the Class I formula from using the “higher of” either the value of milk for cheese/whey, or butter/NFDM, to using an “average of” plus 74 cents calculation. This change would not normally be a problem, but, in retrospect from a policy standpoint, since FMMOs are voluntary and the incentive to associate with the FMMO pool is access to Class I revenues, then it is important to set Class I prices at a level where they will almost always be the highest milk price in the area. As we saw during the pandemic, the “average of” formula can spectacularly fail under an extreme circumstance. This should be fixed, but if the price to fix it is to open up the FMMO rule making process, then I am

not sure that risk is worth it. There are processors who want to increase make allowances because the current allowances are based on costs from 15 years ago. But I wonder if the product yields don't also need a look since the yields in the formulas are based on processing technology from a couple of decades ago. It is possible that increases in costs per unit could be canceled out by increases in yields and the net effect would be not much change in regulated milk prices.

Despite the grumbling about FMMOs, there is no consensus in the industry on what should be done. USDA Secretary Tom Vilsack recently told the industry that he wanted to see more agreement in the industry before USDA would consider holding a hearing on FMMOs. I take comfort from these comments. Right now, I see more downside risk for producers than upside potential from opening up the FMMOs to change. But if we are going to have change, then we need to be careful what we ask for.

MPC at 2022 High Plains Dairy Conference

By Geoff Vanden Heuvel, Director of Regulatory and Economic Affairs
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If you're attending the 2022 High Plains Dairy Conference in Amarillo, I'll be presenting along with Ryan Miltner, Scott Brown and Jeremy Witte on the **Impact of Federal Farm Policies on Western Dairies**.

If you would like to attend and haven't signed up already, early bird registration rates (\$325) are still available. More information about registration can be found at <http://highplainsdairy.org>. After February 21, the general registration fee increases to \$375. We hope to see you there!

California Department of Food & Agriculture Denies Quota Petitions

The California Department of Food & Agriculture (CDFA) today denied two petitions submitted by Stop QIP related to the termination and reapproval of the Quota Implementation Plan. Read CDFA's official notice to the dairy industry [here](#).

NMPF Update: Senate Shipping Legislation, Make Allowance Study

*By Jim Mulhern, President & CEO
[National Milk Producers Federation](#)*

NMPF Issues Call to Action to Support Senate Shipping Legislation

With the picture clear that shipping- and ports-related challenges impacting our dairy exports will remain for some time, we need our members to voice support for passage in the Senate of legislation that would help alleviate the problem by addressing bottlenecks and discriminatory shipping practices.



You can use [this link](#) to our website to sign a note to your two senators in support of the Ocean Shipping Reform Act, (S. 3580), introduced by Sens. Amy Klobuchar (D-MN) and John Thune (R-SD) on Feb. 3rd. The bill would help alleviate delays and disruptions at U.S. ports that have been a critical weak link in the export supply chain.

Importantly, the bill requires ocean carriers to certify that all fees comply with Federal Maritime Commission guidelines. The bill also prohibits ocean carriers from unreasonably declining opportunities for U.S. exports and improves transparency into carrier practices.

The House passed a similar bill last December, but the Senate needs to follow suit in order to rectify the shipping delays and disruptions that have cost the dairy industry over \$1.3 billion in 2021. Please voice your strong support for the bill, and share the link with others in your organization.

AMS Releases Make Allowance Study

USDA's Agricultural Marketing Service this week released the long-awaited dairy plant survey of costs to manufacture cheese, whey, butter and nonfat dry milk. The survey, conducted by University of Wisconsin dairy economist Dr. Mark Stephenson, was done at the request of AMS and is the first cost survey update in many years.

USDA is planning to hold an industry-wide webinar, to be conducted by Dr. Stephenson, at 11:00 am ET next Wednesday, February 23. You can find a link to the study [here](#).

NMPF's FMMO Task Force is examining the study and one of the Task Force's "working groups" will be meeting next week to discuss make allowance issues. This is one of a number of issues the Task Force is looking at. The full group is planning to meet in mid-March where it may finalize recommendations for consideration by the NMPF Economic Policy Committee.

