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TO: Directors & Members **FROM: John Kaczor**

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE		
Blocks	*+$.0250*	$1.6500
Barrels	*+$.0400*	$1.6750
Weekly Average, Cheddar Cheese		
Blocks	*+$.0295*	$1.6490
Barrels	*+$.0685*	$1.6720

CHICAGO AA BUTTER		
Weekly Change	*+$.0075*	$1.5275
Weekly Average	*- $.0140*	$1.5215
DRY WHEY		
Dairy Market News	w/e 06/29/12	$.4875
National Plants	w/e 06/23/12	$.4968

NON-FAT DRY MILK		
Week Ending 6/22 & 6/23		
Calif. Plants	$1.0755	18,977,806
Nat'l Plants	$1.1090	35,599,624
Prior Week Ending 6/15 & 6/16		
Calif. Plants	*$1.0890*	*23,581,190*
Nat'l Plants	*$1.0997*	*29,697,756*

CHEESE MARKET COMMENTS: Cheese prices continue to indicate sustainable demand. This week on the CME block prices gained $.025 per lb and barrels gained $.040 per lb. The spread between the two, supposedly reflecting equal values at about $.03 per lb, rose to $.135 per lb on June 13th was squeezed down to $.01 per lb on June 20th, and went upside down the next day. Yesterday the negative spread widened to $.025 per lb when blocks lost $.0025 per lb. Total price changes over that eleven trading day period saw blocks losing $.05 per lb and barrels gaining $.11 per lb. Trading this week seemed to reflect confidence from both sides of the transactions. *Dairy Market News* says cheese production is steady to slightly lower and sales remain good, "better than expected." There is some apparent interest on the part of buyers to begin to build stocks against possible lower milk and cheese production later in the year, but so far *DMN* says the very hot temperatures have not noticeably affected production. Present low prices for nonfat dry milk encourages maximum vat fortification. Cheese makers also seem to sense a possible tightening in milk supply later this year and some are looking to build stocks. With milk prices showing some improvement, concerns about rising feed costs may be the one remaining factor which would cause producers to shed cows. Get this: *DMN* is being fed the story line by some western exporters that fluctuating prices is making it difficult for them to serve, or be seen, as a reliable international supplier. That is talking point 1A straight from the IDFA story line. Have they not heard of the growing number of viable hedging tools offered by the CME? Of course they have, and the good ones are using them to the maximum. Despite the strong cash prices, Class III milk futures lost an average of $.38 per cwt this week. Prices are fairly flat from August through December. Cheese futures added an average of $.034 per lb.

BUTTER MARKET COMMENTS: Lower milk production with lower components and heavy usage of cream for other purposes is helping butter manufacturers to keep production in line with current orders. Retail sales remain good and orders from food service accounts associated with vacation locales are strong. Despite continuing high stocks of butter, the butter market continues to surprise; trading was light; prices held steady all week until Friday when two sales moved the price up by $.0075 per lb. The butter market appears to reflect the same cautious view of the Fall landscape that cheese interests are sensing. Prices reported to AMS for shipments last week continue to lag CME prices by about $.13 per lb. Futures prices were fractionally lower for week for all months in 2012.

POWDER MARKET COMMENTS: Prices for nonfat dry milk moved higher this week in all regions, says *DMN*, as demand appears to be improving. With milk production on a downward seasonal path, some production is shifting to medium heat and high heat powders, which buyers have been wanting. Huge shipments of NFDM have been reported over the past eight weeks but still have not risen to the level of production. Buyers in the eastern and central regions appear to accept that the market lows have passed, and prices are edging upward each week. In the West some skepticism seems to remain, says *DMN*, as buyers note the differences in production volumes and shipments. The average price reported to AMS for shipments last week rose a bit, but prices reported by California plants fell to below the low price of the full range. Strange, how that can happen. The difference between the two price series has widened to $.034 per lb. No plant capacity issues were reported anywhere. The market for dry and condensed buttermilk has strengthened, from regular users as well as buyers who are taking advantage of the lower price per lb of solids vs. NFDM. Prices are reported to be higher, in line with changes to NFDM in all regions.

WHEY PRODUCTS MARKET COMMENTS: Production of dry whey is fairly steady throughout the country. Sales are somewhat higher and prices moved up in all regions. However, the average price reported to AMS for last weeks' shipments was about $.01 per lb lower than the week before. The availability of raw product for DW and WPC remains linked to cheese production, which has been steady for the past several weeks. The market for both product lines appears to be in good balance. Prices for edible, non-pharmaceutical lactose were unchanged, averaging a wonderful $.87 per lb. Dry Whey futures prices were mixed, but mostly higher this week, gaining strength in the last quarter of the year, and peaking in November, at $.545 per lb.

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FRED DOUMA'S PRICE PROJECTIONS…

June 29 Final:	**Quota cwt. $15.66**	**Overbase cwt. $13.96**	**Cls. 4a cwt. $13.14**	**Cls. 4b cwt. $14.65**
Last Week:	**Quota cwt. $15.72**	**Overbase cwt. $14.03**	**Cls. 4a cwt. $13.34**	**Cls. 4b cwt. $14.64**

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THE FACTS TELL THE STORY – IT'S ABOUT THE MILK PRICE, FOLKS: *(By Rob Vandenheuvel)* Implementing fundamental policy changes in Congress is a difficult task, no matter what industry you're talking about. When in comes to dairy policy changes, "difficult" is putting it lightly. Yet, as we stand here today, the U.S. dairy industry has in front of us an opportunity to make dramatic improvements to our Federal safety net policies with a strong national coalition of dairy organizations and cooperatives supporting the policy proposal being discussed. For regular readers of this newsletter, you know what I'm talking about: the dairy provisions included in the recently-approved U.S. Senate version of the 2012 Farm Bill, which closely follow a bill introduced last year called the "Dairy Security Act" (a.k.a. the "Peterson-Simpson Bill").

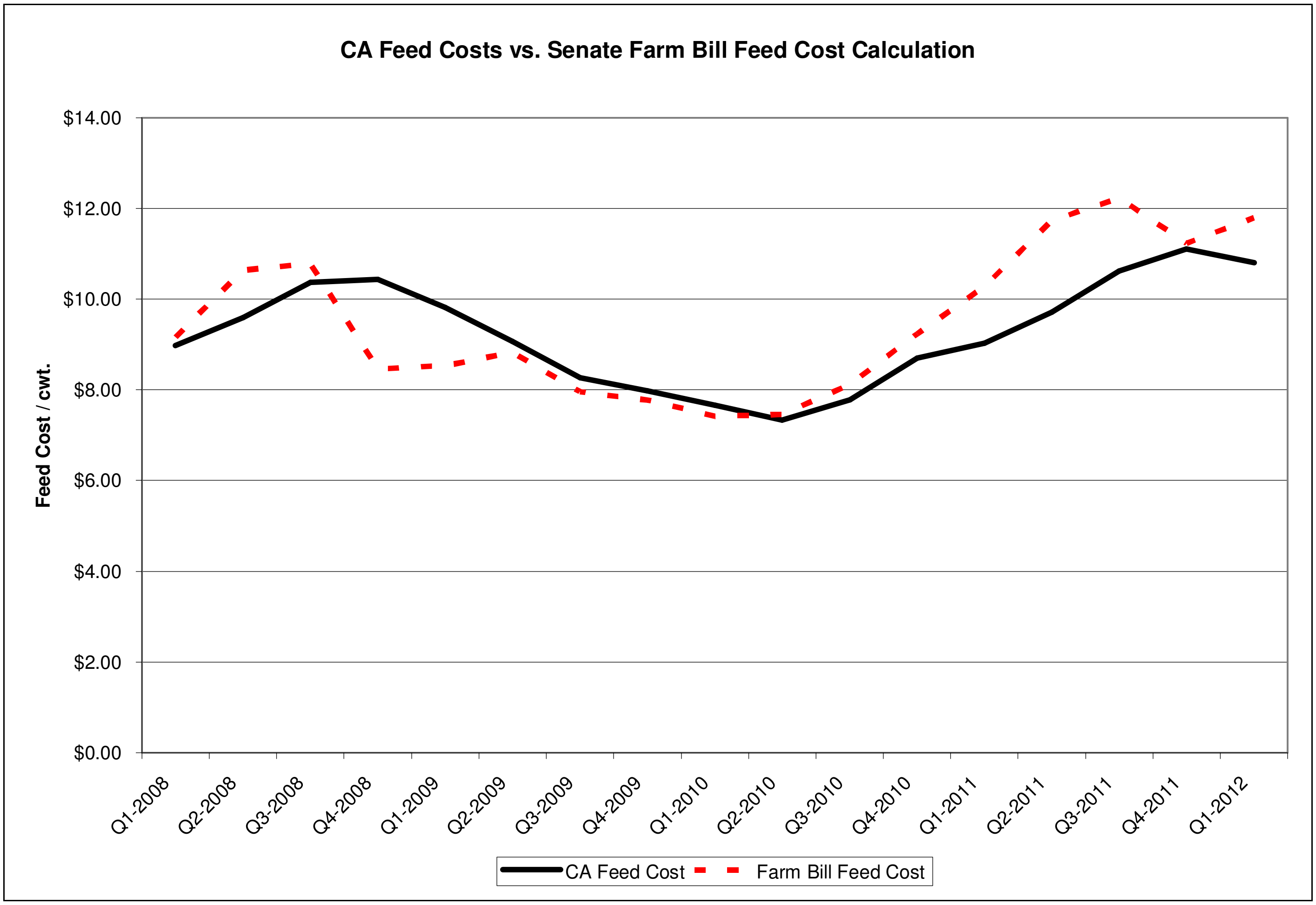
Of course, a strong national coalition of support doesn't mean that support has been unanimous. For starters, a unified processing sector (largely represented by the International Dairy Foods Association, or IDFA) has pulled out all the stops to try and torpedo the effort. This opposition from the processors has been entirely predictable. They are understandably very nervous about a policy change that would empower the U.S. dairy producers to collectively respond to negative on-the-farm margins by addressing the fundamental driver of those negative margins – an oversupply of raw milk in the country.

In order to combat this unified opposition by the well-funded lobbying machine of the nation's processors, it is imperative that the producer community stand as unified as possible behind the pro-producer changes being proposed. While that unified support is being realized by many of the dairy groups and cooperatives around the country, there continues to be individual organizations that voice opposition to the legislation for one reason or another.

One particular argument being made against the dairy provisions in the Senate's 2012 Farm Bill is a criticism of the way the bill would calculate a national milk-price-over-feed-cost margin. As we've discussed many times in this newsletter, the Senate Farm Bill sets up a two-pronged approach to a Federal dairy safety net. Those two separate-but-interrelated programs are the "Margin Protection Program" and the "Dairy Market Stabilization Program." Both programs rely on a monthly calculation of a national milk-price-over-feed-cost margin to determine when they trigger in and out.

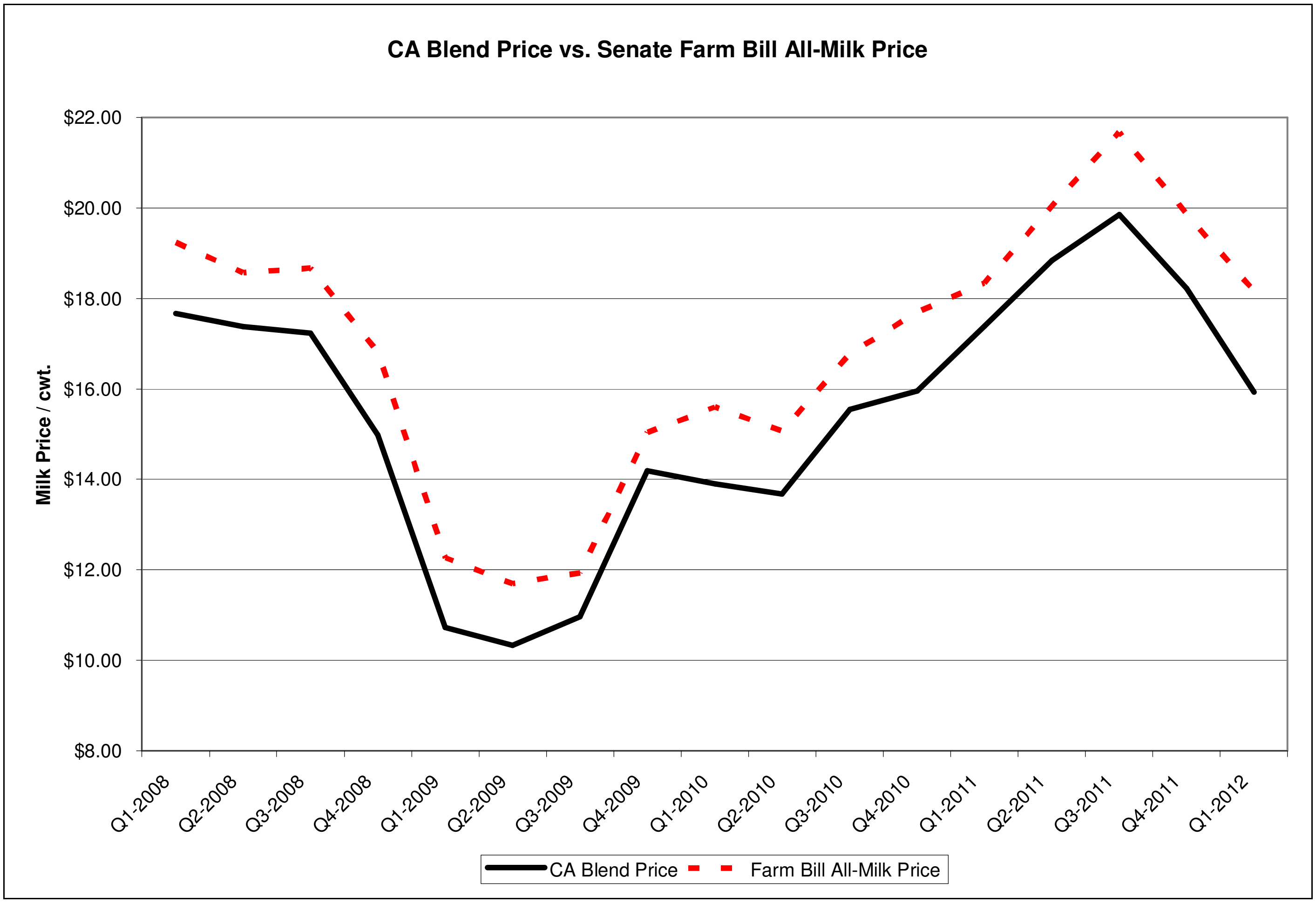
An argument that has continued to crop up is an attempt to paint the milk-price-over-feed-cost margin calculation in the bill as "unfair" to one region or another. Regional politics are unfortunately a classic barrier our industry faces when trying to implement fundamental change to our Federal safety net policies. But are those arguments based on the facts? Fortunately for California, we have the benefit of some very reliable data being generated by the California Department of Food and Agriculture (CDFA) as to how our feed costs and milk prices have compared to what is being calculated in the Senate's 2012 Farm Bill.

For many years, CDFA has conducted a survey of hundreds of California dairy farms to determine the cost of producing milk in the State. The recent results of those surveys can be found on CDFA's website at: http://cdfa.ca.gov/dairy/uploader/postings/copcostcomp/Default.aspx. At the same time, we also have the ability to go back in time and determine what the calculated feed costs would have been under the Senate Farm Bill language. The graph below provides a glimpse into that comparison:



As you can see, there is a pretty close correlation between the feed costs reported in CDFA's survey and the feed cost calculated in the Senate Farm Bill. Are they identical? No. There are times when the estimated feed costs in California are higher than the feed costs calculated in the Senate Farm Bill. There are other times when the estimated feed costs are lower. But on balance, over the past 17 quarters shown in the chart above (which covers the past 4+ years since the Congressional energy policies started dramatically impacting our nation's feed costs), the average feed cost calculated in the Senate Farm Bill has averaged ***$0.27 per cwt above*** the estimated feed costs in California. Notably, since 2010, the average feed cost calculated in the Senate Farm Bill has been ***$0.77 per cwt*** above the estimated feed costs in California. So what exactly is it about the feed cost calculation in the Senate Farm Bill that is so "unfair" to California?

Now let's look at the other side of the equation. Included in the Senate Farm Bill's milk-price-over-feed-cost margin is the "U.S. All-Milk Price," announced each month by USDA. This is a national average price that includes premiums, but doesn't include hauling/marketing costs. For comparison purposes, we can easily use a very similar calculation made by CDFA called the "Statewide Blend Price." So how does California's statewide blend price compare to the national average milk price?



The graph above shows a very different picture than the feed cost comparison in the first graph. As you can see, California's milk price is chronically and significantly ***below*** the national average milk price. In fact, over the same 17 quarters we looked at earlier, California's statewide blend price averaged ***$1.45 per cwt below*** the national average milk price.

So what can we draw from this and why is it important? One obvious conclusion we can draw is that when comparing the margins being calculated in the Senate Farm Bill vs. the margins being realized here in California, the differences between the two calculations is almost ***exclusively*** driven by California's price of milk, not our feed costs. In fact, California dairy farmers have actually seen lower feed costs in recent years than those being calculated in the Senate Farm Bill. So what should we be doing about it? **We should be exploring ways to generate more dairy farmer revenue from the milk we sell!** We had a hearing at CDFA just last month looking at that specific issue, and efforts like that must continue. **Bottom line: We absolutely need the policy changes in the Farm Bill to help us with national milk price volatility, but Congress isn't going to fix California's milk price with the Farm Bill. <u>That's up to us to fix ourselves</u>.**

Opportunity like this to make much-needed positive changes to our Federal policies are few and far between. We cannot afford to create some perceived inequity on the feed cost calculation in the Senate Farm Bill (despite clear evidence that it's our ***milk price*** that is driving California's competitive disadvantage with our fellow U.S. dairymen) and allow that policy fiction to stand in the way of much-needed fundamental change. Our nation's processors and IDFA have been benefiting from a successful "divide-and-conquer" strategy for years, and the results have been a **river of red ink for dairy farmers**.

In the coming weeks, the House Agriculture Committee will be debating and voting on their version of the 2012 Farm Bill. The dairy provisions in that bill are expected to mirror the dairy provisions in the Senate Farm Bill. **We need as many dairy families and dairy organizations as possible voicing their strong support for that package of reforms to their elected officials on that Committee.** And in California, we need to continue exploring ways to close the gap between our milk price and the prices received around the country. **Our future depends on what we do today.**

QUESTIONS: FEED CROPS, PRICES, AND FALLING FLUID MILK SALES: *(by J. Kaczor)* Numerous questions, issues, and concerns about the immediate and long-term prospects for U.S. milk prices and industry profitability appear on various web sites every single day. Where future feed costs will be is number one on the list. Today, USDA released its benchmark report on estimated acreages for wheat, corn, and soybeans which usually provides solid guidance for important decisions that could determine financial success or failure for an entire year's work for U.S. dairy producers. However, as is so often the case, concerns about very hot temperatures and too little moisture throughout the major growing regions in the U.S. and throughout the world only raise more questions about ultimate production, and contribute to wide and even wild speculation about this year's crops. In this case, more facts and informed opinion is welcome; better too much than too little. More informed opinions should result in less uninformed speculation and unfair advantages for those who might otherwise control what is reported. USDA is the objective reporter in this case but expert crop analysts provide a wide range of views which should help make sense from what seems to be ever changing possibility.

While most of the industry's attention is presently focused on crop supplies and prices, most reports on milk usage seem to focus on dairy commodities and the export market. Those are important matters. Because of their involvement, some seem to believe exports are the most important issue facing this industry and care little for whatever else may be happening. Others believe far too little attention is being paid to what is happening to what was once the most important market for U.S. milk producers, namely fluid milk usage. Several articles have recently been published in this weekly *Update*, and elsewhere, on long-term and short-term trends in fluid milk sales. In short, fluid milk sales have been decreasing at an increasing rate, and no one seems to know why. There seems to be no answers to what can be done to possibly level out those sales much less turn them around. This is the opposite of reports on crop production where opinions abound. Here is one suggestion: perhaps Congress should be reminded that one sure way to contribute to even lower fluid milk sales in the future would be to sharply cut back on the food stamp program, which is one of the proposals being demanded for passage of the House's version of the Farm Bill. Instead, maybe they should be given a copy of Will Roger's "bacon and beans and limousines" speech given on national radio in 1931 as part of President Hoover's Organization on Unemployment Relief broadcast. It was relevant then and, almost to a word, is relevant today.

Fluid milk processors are among those most directly affected by these lower sales and are shocked and stunned by what is happening. Despite maintaining an extremely high level of quality (which begins at the farm level), increasing points of sales, introducing new products with enhanced nutritional benefits, extending shelf life, improving carton and label designs, and sponsoring advertising and promotional programs, per capita sales of fluid milk products in the U.S. continue to fall faster than the increase in population. USDA estimates fluid milk sales in 2010 were 776 million lbs lower than in 2009; sales in 2011 were 932 million lbs lower than in 2010; and sales in the first four months this year sales were already 503 million lbs lower than the same four months last year. As noted in the earlier articles, these changes are net losses which include fairly significant increases in sales of organic milks.

People are not consuming less fluids, only less fluid milk, which happens to be the most nutritious beverage available. Here's to bi-partisanship in the U.S. House of Representatives to use the opportunity to enhance and expand food programs designed provide to the many millions of people in this country who realize milk is an essential food for their children but who are presently unable purchase it.

A HEARTFELT THANKS TO PAUL MARTIN FOR HIS YEARS OF SERVICE TO THE INDUSTRY: *(By Rob Vandenheuvel and Kevin Abernathy)* After many years of exceptional service on behalf of the California dairy industry, we've received word that Paul Martin, Director of Environmental Services at Western United Dairymen, is retiring. Paul has been an outstanding advocate on producers' behalf on the increasingly-important environmental issues that face the dairy industry. MPC has enjoyed an excellent working relationship with Paul and his expertise in California's dairy industry will be impossible to replace. On behalf of the MPC board and staff, we send our heartfelt thanks to Paul for his hard work and commitment to the California dairy families.