



# Milk Producers Council

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DATE: August 14, 2015  
 TO: Directors & Members

PAGES: 4  
 FROM: Rob Vandenheuvel, General Manager

## MPC FRIDAY MARKET UPDATE

### CHICAGO CHEDDAR CHEESE

Blocks - \$.0575 \$1.6925  
 Barrels - \$.0200 \$1.6975

### Weekly Average, Cheddar Cheese

Blocks - \$.0165 \$1.7200  
 Barrels +\$.0010 \$1.7025

### CHICAGO AA BUTTER

Weekly Change +\$.0750 \$2.0650  
 Weekly Average +\$.0305 \$2.0205

### DRY WHEY

Dairy Market News w/e 08/14/15 \$3.000  
 National Plants w/e 08/08/15 \$3.551

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### NON-FAT DRY MILK

#### Week Ending 8/7 & 8/8

Calif. Plants \$0.7703 12,581,970  
 Nat'l Plants \$0.7453 16,796,802

#### Prior Week Ending 7/31 & 8/1

Calif. Plants \$0.8846 6,015,355  
 Nat'l Plants \$0.8021 18,291,300

## FRED DOUMA'S PRICE PROJECTIONS...

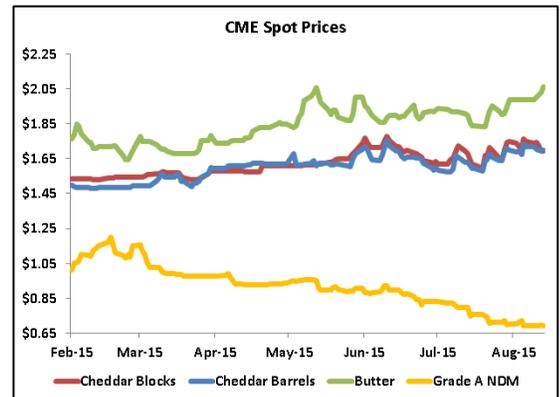
Aug 14 Est: Quota cwt. \$16.24 Overbase cwt. \$14.54 Cls. 4a cwt. \$13.00 Cls. 4b cwt. \$15.71  
 Last Week: Quota cwt. \$16.49 Overbase cwt. \$14.79 Cls. 4a cwt. \$13.25 Cls. 4b cwt. \$16.10

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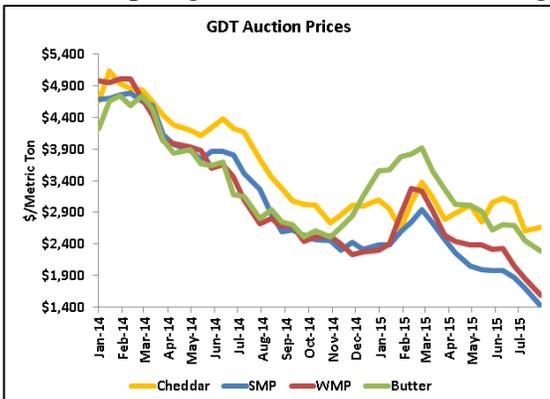
## MARKET COMMENTARY: (By Sarina Sharp, Daily Dairy Report, [sarina@dailydairyreport.com](mailto:sarina@dailydairyreport.com))

### Milk & Dairy Markets

The butter market just keeps climbing. On Friday the spot price surpassed its May peak, reaching \$2.065/lb., up 7.5¢ after a steady performance last week. Even at new heights, “demand does not appear to be deterred,” according to *Dairy Market News*. In contrast, the milk powder market continues to languish. Last week spot nonfat dry milk (NDM) dropped a penny to 69¢, and it closed there again today. Strength in the butter market propelled Class IV futures upward. Nearby contracts were particularly buoyant; September futures gained more than 60¢ in the past two weeks.



Spot Cheddar prices rallied last week only to fall back. Cheddar barrels closed Friday at \$1.6975, exactly where they started the month. At \$1.6925, Cheddar blocks have fallen 5.5¢ in the past two weeks, and they slipped below the barrel market for the first time since May. Whey futures contracts plunged to new lows. Following the cheese markets, Class III futures climbed last week and retreated this week.

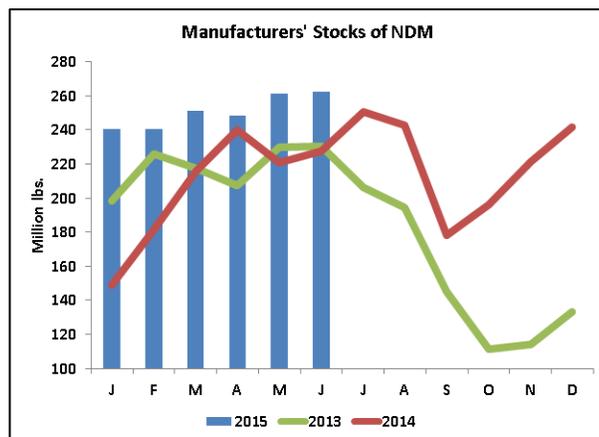


Once again, prices plummeted at the Global Dairy Trade (GDT) auction. The trade-weighted index fell 9.3% to a new all-time low. Skim milk powder (SMP) prices dropped 14.4% to a new record low, and whole milk powder (WMP) fell 10.3%. Butter lost 6.1% and anhydrous milkfat fell 11.7%. Cheddar managed to eke out a 0.2% gain.

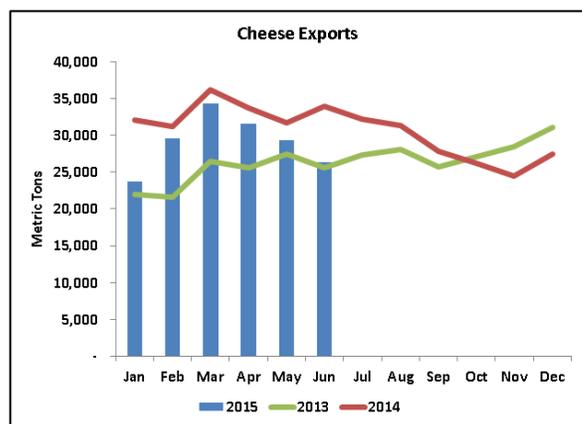
Persistent weakness in the powder market is particularly bad news for dairy producers in New Zealand, as WMP makes up a huge

portion of their milk checks. Last week Fonterra lowered its farmgate milk price forecast for the 2015-16 season by 27% to \$3.85/kg of milk solids. This is Fonterra's lowest forecast in a decade and, at roughly \$8.35/cwt. after dividends, it is far below the average cost of production. Fonterra expects milk collections to fall 2-3% as farmers rein in supplemental feeding. Given New Zealand's primarily pasture-based dairy industry, the weather will be the final arbiter.

Perhaps to reinforce its lower production outlook, Fonterra reduced the volumes of product it will offer at the GDT in the next few months. This is little more than a weak breeze on a sultry August day. Global milk powder inventories continue to rise. In the U.S., manufacturers' stocks of NDM reached an all-time high of 262.3 million pounds at the end of June. In Europe, manufacturers are selling milk powder to the government rather than to end users. Cooperatives in New Zealand reportedly failed to empty their warehouses before the advent of the new season. Stocks continued to build even as merchants managed to step up sales to nearly every buyer outside of China. What will happen now that those customers have been satisfied?



As for China, its milk powder demand once seemed worthy of Ecclesiastes. "All streams flow into the sea, yet the sea is never full." But the market was misled. China was not suddenly devouring staggering volumes of milk powder. It consumed some and stored the rest, much of which is still warehoused. Those hoping that Chinese demand will resurge and rescue the milk powder market are "chasing after the wind." This week China allowed its currency to fall against the U.S. dollar. Coming as it did on the heels of the stock market collapse, this move highlights concerns about the health of the Chinese economy. The weaker yuan makes imported milk powder more expensive and so this new policy could weigh on demand for dairy products even if China does manage to export its way to greater prosperity.



Last week's Dairy Products Report held no surprises. U.S. butter production totaled 142.8 million pounds in June, up 1.7% from the year before. California butter production fell 8.2% from last June, but output in other western states was strong. At 959 million pounds U.S. cheese output was 1.5% greater than last year. Cheddar production rose 4.3%, which suggests that there will be plenty of cheese available at the spot market in coming months. Combined production of NDM and SMP totaled 199 million pounds, 1.3% lower than last June due to a drop in SMP output.

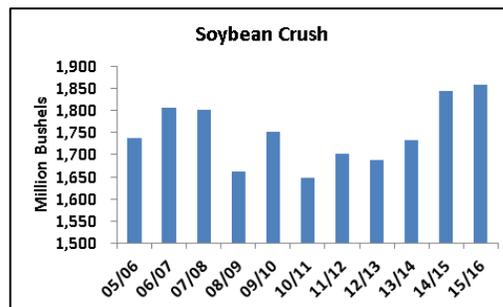
Domestic demand for cheese and butter remains strong, but export demand is another story. June cheese and curd exports dropped to 58.1 million pounds, down 22% from last year. In the first half of 2015, cheese exports lagged 2014 by 12%. Over the same period, butter exports fell 74%. Given the spread between U.S. and overseas markets, U.S. cheese and butter exports are not likely to rebound anytime soon. Milk powder exports also slipped in June to 102.8 million pounds, down 23.2% from last year.

### Grain Markets

USDA stunned the markets Wednesday with its monthly World Agricultural Supply and Demand Estimates and Crop Production reports. In its first assessment of crop yields after surveying farmers, USDA forecast the corn yield at 168.8 bushels per acre, much larger than the trade anticipated. Similarly, USDA's call for the soybean crop to average 46.9 bushels per acre exceeded pre-report expectations. Both of these yield forecasts were larger than USDA's June estimates. Persistently high crop ratings had suggested that increased yields were possible, but the trade had expected excessively wet conditions in Missouri and the Eastern Corn Belt to weigh on national production prospects.

Official confirmation of the very large crops pushed December corn futures below \$3.60 on Wednesday. They settled at \$3.755 on Friday. November soybean futures closed at \$9.165, nearly 35¢ lower than where they began the month. The trade will continue to argue the size of the crop until harvest and perhaps beyond.

Meanwhile, demand for U.S. crops is eroding. Crops in South America are large, and their weak currencies are attracting imports. USDA lowered its outlook for both corn and soybean exports. It also raised its estimates for both old-and new-crop soybean crushing. As the *Daily Dairy Report* noted this week, “this is good news for dairy producers and other end users who had been paying hefty premiums for a tight supply of soybean meal.”



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**PART THREE IN THE SERIES ON THE CA-FEDERAL ORDER – THE PRELIMINARY ECONOMIC ANALYSIS:** (By Rob Vandenheuvel) As our readers know by now, the U.S. Department of Agriculture (USDA) announced earlier this month that a hearing on proposals to create a California Federal Milk Marketing Order (CA-FMMO) will begin on September 22<sup>nd</sup> in Clovis, California. While much of the attention was paid to the scheduling of the hearing, USDA also released a “Preliminary Regulatory Impact Analysis” at the same time, which to date has not gotten as much attention. However, rest assured that as individuals and organizations prepare for the upcoming hearing, that analysis will receive more and more attention.

As you page through USDA’s initial analysis (which can be found on USDA’s website at: <http://www.ams.usda.gov/sites/default/files/media/Preliminary%20Impact%20Analysis%20-%20Final.pdf>), there are many things we could focus on, but for this article I will hone in on two specific areas of interest.

First, the analysis attempts to estimate the impact on milk prices and producer revenue both in California and around the country. The analysis projects the impacts in the eight year period of 2017-2024, presumably the first eight years the new CA-FMMO would be in place. According to the analysis, under the Cooperative’s proposal (which has the support of not only the authors California Dairies Inc., Dairy Farmers of America and Land O’Lakes, but also the three California producer trade associations of California Dairy Campaign, MPC and Western United Dairymen), California’s all-milk price will increase an average of \$1.03 per hundredweight, which equates to approximately \$700 million in additional revenue for California producers per year.

The analysis, however, does not stop there. It goes on to assume that the increased revenue for California producers would result in an average increase in California milk production of 540 million pounds per year. That projected increase is assumed in the analysis to result in modest reductions in average milk prices in most of the other regions of the country (all areas with the exception of the “Former Western Order,” which is largely the milk producing regions of Idaho and Utah, which are no longer in the FMMO system). The milk price reductions range from \$0.06/cwt in Hawaii/Alaska to \$0.22-\$0.24/cwt in Florida and the Southeast Order. At face value, this analysis could cause a producer outside of California to suddenly pay much closer attention to this upcoming hearing.

Now typically this is where I would begin to vent the frustrations I have whenever I read an analysis that simply assumes that if you give producers a single penny more per hundredweight, they will indiscriminately start increasing their milk production. Instead, I will remind our readers that this is just the reality of economic modeling. These models don’t think; they simply react to assumptions that are built into them. And a long-term historical look at the dairy industry would certainly support the argument that more on-farm revenue would encourage additional milk production. However, we are not living in the “long-term historical” California, but rather in the 2015 and beyond California. In order to really analyze whether or not this projected milk production growth is likely, we need to look at many other factors, such as:

- The fact that all three major California cooperatives – which market approximately 80 percent of California’s milk production – have base plans in place for their producer members to kick in whenever their milk supplies grow beyond their ability to market it.
- The environmental and other business-related regulations that not only make dairying in California difficult for existing dairies, but promise to continue to stifle any real future growth in our State’s industry.
- The competition our dairies face for the fertile Central Valley agricultural land with permanent crops such as almonds and pistachios. The dairies getting sold and torn down to be replaced with these trees will not be converted back to dairies in the future.
- The uncertainty of our water availability, which in turn adds uncertainty to our ability to grow the crops we need to feed our animals.

After a year like 2014, with milk prices well-above \$20/cwt for most of the year, you would expect California’s milk production in 2015 to be strong, especially with the extremely mild winter we had. But what did we see instead? 650 million pounds less California milk produced in the first six months of 2015 compared to last year. This is a new California reality; one that cannot be measured under the same metrics economists have historically used.

And of course, all these arguments are simply in the background, while the real issue continues in the forefront, which is that California’s producers are simply seeking to be put on a level playing field with our fellow producers in the rest of country. **If the rest of the country’s success really depended on California dairy families going broke, we have a very different discussion we need to have as an industry.** Fortunately, I don’t believe any rational person could make that argument with a straight face.

Flipping the page to the Dairy Institute’s proposal, the USDA analysis shows a similar impact, but to much smaller degrees. The analysis indicates that California’s producers would see their all-milk prices increase by \$0.10/cwt under the manufacturer’s proposal, which the model indicates would inspire an average increase in California’s milk production of 60 million pounds per year. A net impact of \$0.10/cwt – if nothing else, this is certainly confirmation of producers’ claims over the years that our manufacturers are quite happy with the status quo and looking to keep California as the low-cost-leader for milk in the U.S.

One other interesting note from USDA’s analysis is in the area of Class I sales (milk sold as fluid products) in a proposed CA-FMMO. Under both the cooperatives’ and the Dairy Institute’s proposals, the new CA-FMMO would have the ability to include Class I sales from out-of-state producers and handlers that market their raw and packaged milk in California (there are details on how it is determined whether or not a sale is included in the California pooling calculations, but that’s a separate article for another day). USDA’s analysis shows that under these proposals, California’s Class I sales would increase by about 850 million lbs per year. While much of the focus on the CA-FMMO effort has been on the impact it would have on California’s Class 4b/III prices (which certainly makes sense, given the significant “California Discount” our producers have had on this milk sold to California’s cheese plants), it is worth pointing out that a Federal Order has the ability to regulate the sale of milk across state lines, something that our State’s pricing system is simply unable to do under the U.S. Constitution.

As I said earlier, there are many interesting things we could explore in this USDA analysis, and I strongly encourage California producers to read through the report. As we move forward in this series of articles, I am sure we will come back and reference other aspects of this report. In the meantime, MPC is continuing to work with our California industry partners to prepare the best case we can in support of the cooperative’s CA-FMMO proposal. The future of our industry depends on it.