# Milk Producers Council

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**TO: Directors & Members** **FROM: Rob Vandenheuvel, General Manager**

*MPC FRIDAY MARKET UPDATE*

| **CHICAGO CHEDDAR CHEESE** | | |
|---|---|---|
| Blocks | +*$.0500* | $2.3600 |
| Barrels | +*$.0450* | $2.3200 |
| **Weekly Average, Cheddar Cheese** | | |
| Blocks | +*$.0576* | $2.3370 |
| Barrels | +*$.0515* | $2.2990 |

| **CHICAGO AA BUTTER** | | |
|---|---|---|
| Weekly Change | *- $.0100* | $1.8800 |
| Weekly Average | *- $.0065* | $1.8935 |
| **DRY WHEY** | | |
| **Dairy Market News** | w/e 01/31/14 | $.6100 |
| **National Plants** | w/e 01/25/14 | $.6087 |

| **NON-FAT DRY MILK** | | |
|---|---|---|
| **Week Ending 1/24 & 1/25** | | |
| Calif. Plants | $2.0085 | 7,686,998 |
| Nat'l Plants | $2.0434 | 17,701,815 |
| ***Prior Week Ending 1/17 & 1/18*** | | |
| *Calif. Plants* | *$2.0044* | *10,490,218* |
| *Nat'l Plants* | *$2.0362* | *21,888,317* |

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**FRED DOUMA'S PRICE PROJECTIONS…**

| | | | | |
|---|---|---|---|---|
| **Feb '14 Est:** | **Quota cwt. $23.95** | **Overbase cwt. $22.25** | **Cls. 4a cwt. $23.03** | **Cls. 4b cwt. $22.45** |
| **Jan '14 Final:** | **Quota cwt. $22.49** | **Overbase cwt. $20.79** | **Cls. 4a cwt. $22.06** | **Cls. 4b cwt. $20.31** |

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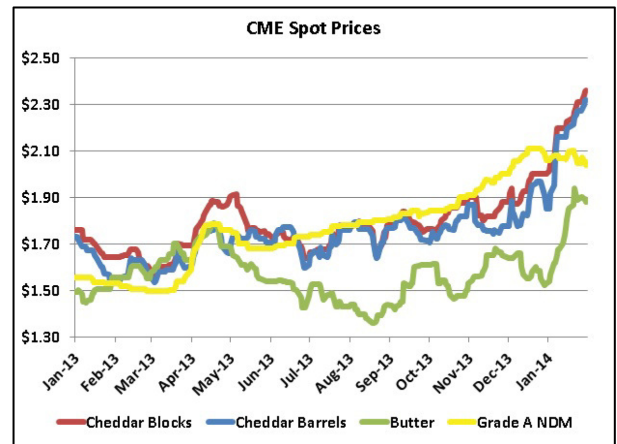
**MARKET COMMENTARY:** *(By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)*

*Milk & Dairy Markets*

Cheese is hard to come by and the Cheddar market is marching inexorably upward. Cheddar blocks set a new record this week at $2.36/lb., up a nickel from last week. Barrels added 4.5¢ and also reached record highs at $2.32. Nearby Class III futures followed the cheese market to all-time highs although they pulled back a little on Friday. February Class III settled at $23.11. March futures added more than a dollar this week. Gains were less impressive in the later contracts, but they still managed to rise by double digits this week.

Extra Grade nonfat dry milk (NDM) ended its tenure at the CME and will no longer trade in the pit. After some back and forth, Grade A NDM lost 1¢ this week on heavy trading volume. Butter also closed a penny lower although it spent Monday through Thursday above last Friday's close. Class IV futures shook off the ambivalence of the spot market and continued to climb. July through December contracts were particularly strong.



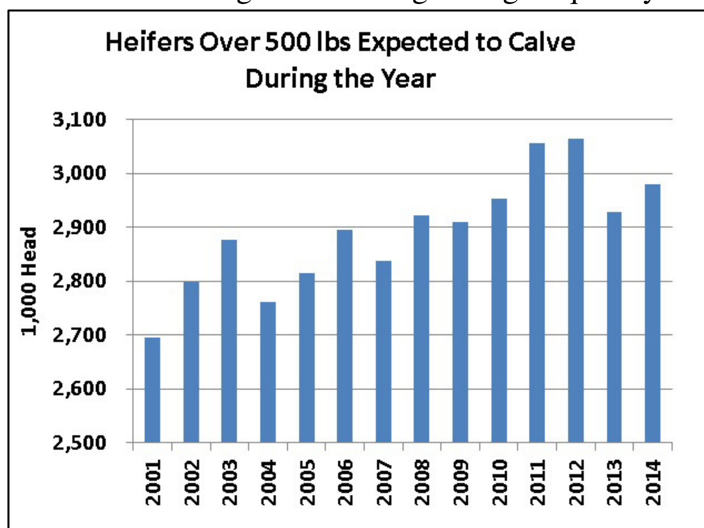

U.S. milk powder prices are converging as CME spot prices have plateaued and survey prices continue to rise. The California Weighted Average Price for NDM rose to $2.0085/lb. last week, and National Dairy Product Sales Report prices averaged $2.0434. European and Oceanian milk powder prices rose over the past two weeks, according to *Dairy Market News*. U.S. prices remain at a discount to global milk powder prices, but the gap is not large and the strengthening dollar is not helping.

Cheese prices have stagnated in Oceania at an average of $2.22/lb. according to *Dairy Market News*. Fortunately for U.S. exporters, New Zealand has made very little cheese, focusing instead on milk powder production. However, U.S. cheese prices are roughly even with European prices, a prospect that has led to sharp declines in cheese exports in the past. Indeed, cheese manufacturers already report waning interest from importers. A decline in export volumes is likely once outstanding orders are filled.

Butter prices are rising in the U.S. and New Zealand, but falling in Europe. *Dairy Market News* reports that the European butter market dropped 4.6% in the past two weeks. U.S. butter remains the best option, but the decline in European butter prices is a concern, and European milkflows continue to impress.

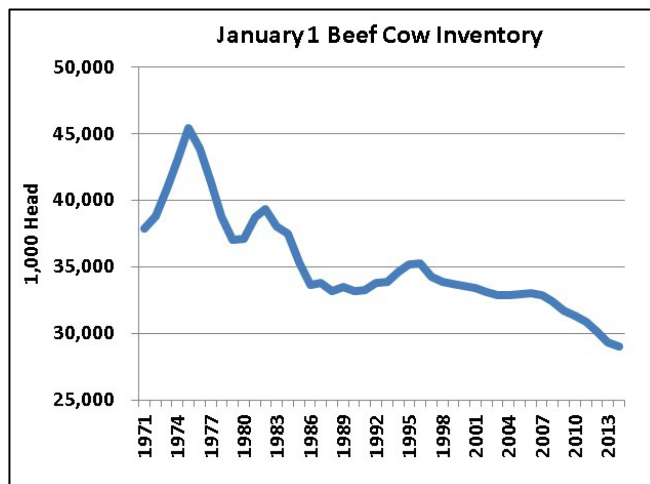
The U.S. dairy industry should be congratulated on the success of its burgeoning export program. Dairy exports have been record large in nine of the last ten years, and the industry expanded its offerings in 2013 to better meet global preferences, laying the foundation for continued growth. Exports have broadened dairy's horizons and added much to the bottom line. But export demand is volatile and today's eye-popping prices depend on sustained growth in the global appetite for all things dairy. As prices rise ever higher, export prospects can become more tenuous.

Global dairy demand has been truly astounding and will help the market to absorb increased global milk volumes in 2014. However, broader economic trends could dampen dairy consumption. Emerging markets have been a key driver of dairy demand growth, but the outlook for developing economies is mixed. The Federal Reserve is slowing its printing presses, and investors are fleeing the world's riskier markets. Reports from China suggest that manufacturing there is not growing as quickly as it once did, and banks have lent too freely. Interest rates are rising amidst a liquidity crisis. Closer to home, the polar vortex and energy shortages are raising heating bills. Consumers will have less to spend on other goods and may be dining out less, kept at home by their budgets and icy roads.

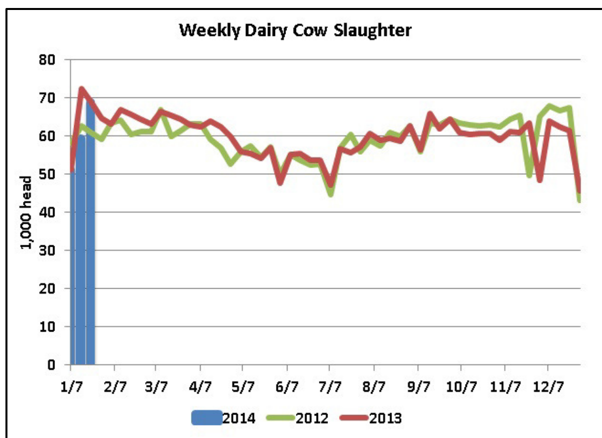



That is not to say that 2013's export boom necessitates a crash in 2014 similar to the 2008-2009 boom and bust. There is plenty of good economic news, including a recovery in U.S. GDP growth. Given lower feed costs, it will be easier for milk prices to find equilibrium at levels that please both producers and consumers. This time around, the industry may be able to enjoy the party without the hangover.

The 2009 crash was particularly painful because of its longevity. It took nearly a year to cleanse the industry of a surplus of heifers. Not so this year. USDA estimates January 1 dairy heifer inventories at a four-year low of 4.54 million head, down incrementally from 2013. Curiously, USDA estimates that 2.98 million heifers will calve in 2014, up 1.8% from 2013. Vast expansion is unlikely overseas as well. Quota is ending, but European dairy producers will have to pay up to add cows. New Zealand's dairy producers lack the pasture to expand en masse and will have to increase production by supplementing with grain. With these constraints, it is unlikely that milk production can overwhelm the market and depress prices to the extent that it did in 2009.




Beef cattle inventories fell to their lowest level on record, and beef cow inventories fell to the lowest level since 1962. The beef industry is finally retaining heifers and beginning to rebuild the herd, a process that will take years.




Slaughterhouses are having trouble sourcing cattle and National Beef announced that it would close its Brawley, California, packing plant in April due to the lack of cattle supplies. Dairy producers should continue to enjoy excellent prices for cull cows and bull calves.

Weekly dairy cow slaughter totaled 68,860 head. It looks like producers had a lot of cows to cull following the reduced New Year schedule and then a week of terrible weather in the Midwest. Dairy cow slaughter trails 2013 by 6.7% in the first three weeks of the year.

*Grain Markets*

Corn futures added a nickel since last Friday. The corn market remains range-bound, although a very strong export sales report supported prices this week. Soybean and soybean meal futures were basically steady.

There are signs that export business is shifting south. The first large vessel of soybeans left Brazil's Paranagua port headed for China. And a soybean crushing facility in Raleigh, North Carolina, announced that it would not crush this spring due to the impending South American crop, which promises to be large. Argentine farmers have been holding onto last year's crop as a hedge against inflation, but their bins won't hold two years' harvest and they will soon be forced to sell. The next ten days look pretty dry in Brazil and very wet in Argentina. More moderate rains in both countries would be welcomed.

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**FINAL FARM BILL AGREED ON BY KEY NEGOTIATORS; NOW MOVING THROUGH CONGRESS:** *(By Rob Vandenheuvel)* After several years of hearings, debates and false starts, a new five-year Farm Bill finally appears to be on the verge of becoming law. The House of Representatives has already approved the compromise legislation by a vote of 251-166. The agreement is now in front of the U.S. Senate, which is expected to vote on the issue very soon. Assuming they approve the bill as well, it moves to the President for final signature into law.

**So what does the bill do for U.S. dairy farmers?** We've already discussed some of what it does NOT do in recent issues of this newsletter. The bill does not create a Dairy Market Stabilization Program that would create incentives to temporarily cut back milk production when our on-the-farm margins drop below certain levels. **But what the bill DOES do is replace the Milk Income Loss Contract (MILC) and Dairy Price Support programs with a new "Margin Protection Program" (often referred to as a "margin insurance program").**

The National Milk Producers Federation (NMPF) has put together a three-page summary of the dairy provisions, which can be found at: http://www.milkproducerscouncil.org/2014farmbilldairy.pdf. In short, the new program, which is slated to begin no later than September 1, 2014, would create a new Margin Protection Program that would:

- Calculate a "national feed cost" based on reported prices for corn, soybean meal and alfalfa, and compare that cost to the U.S. "all-milk price," resulting in a monthly announced milk-price-over-feed-cost margin *(we'll be discussing this calculation in more detail in future issues of this newsletter)*.
- Provide an opportunity for any individual dairy to protect a portion of their production at a certain margin level. Dairies can choose to protect from 25%-90% of their "production history" (which is determined by the highest of your dairy's 2011, 2012 or 2013 annual production).
- Dairies can also choose to protect as little as $4.00 in milk-price-over-feed-cost margin or as much as $8.00. The higher the margin, the higher the premiums a dairy must pay *(table below)*.
- A reduced premium is available on the first 4 million pounds of milk that every dairy produces per year.

- Coverage Premium options in the Margin Protection Program:

| Production Under 4 Million Pounds | | Production Over 4 Million Pounds | |
|---|---|---|---|
| ***Coverage Level*** | ***Premium*** | ***Coverage Level*** | ***Premiums*** |
| $4.00 | None | $4.00 | None |
| $4.50 | $.01 | $4.50 | $.02 |
| $5.00 | $.025 | $5.00 | $.04 |
| $5.50 | $.04 | $5.50 | $.10 |
| $6.00 | $.055 | $6.00 | $.155 |
| $6.50 | $.09 | $6.50 | $.29 |
| $7.00 | $.217 | $7.00 | $.83 |
| $7.50 | $.30 | $7.50 | $1.06 |
| $8.00 | $.475 | $8.00 | $1.36 |

*In future issues of this newsletter, we'll delve into more detail about these protection options.*

**So what should we make of all this?** It would be easy to be disappointed by this Farm Bill, particularly for those of us who have been fighting hard to include the Dairy Market Stabilization Program. But as this is going to be the new law of the land for the next five years, let's take a look at the positives to take out of this.

When you look at the last five years – particularly the challenging periods in 2009 and 2012 – U.S. dairy producers have borne virtually all the financial risk associated with the ups and downs of the dairy industry. What do I mean by that? If you look at the impact that low milk prices have on producers, processors and taxpayers, you see that when the milk prices plummeted in 2009:

- Processors continued to get the milk they needed, with an available margin, courtesy of end-product-pricing and the make allowances in California and the Federal Orders. They got their milk whether the dairy farmer selling them the milk was making money or losing it.
- Taxpayers had some financial liability due to low milk prices, as the MILC program made some payments. But given the limited milk volume on which the program pays out, that liability was nothing compared to the loss in equity on the farm.
- Producers, on the other hand, felt the brunt of the downturns, producing milk at a loss month-after-month, forfeiting billions of dollars in hard-earned equity, and witnessing thousands of dairies exiting in the industry due to the financial challenges.

**So how does this new Farm Bill start to change that equation?** Processors continue to be protected, but taxpayers are now on the hook for a much larger potential liability if dairy farmer margins drop. Every dairy in the U.S. – regardless of size – has the opportunity to get government-subsidized margin protection on up to 90% of their production. So when dairy margins drop, the government payments won't be limited to just the 2.985 million pounds that the MILC program paid out on. Their exposure will be exponentially larger than that.

Of course, regular readers of this newsletter know that the Dairy Market Stabilization Program was designed to help spread some of this price risk to processors as well, and in doing so, reduce the exposure that taxpayers have. Under that proposal, when margins dropped and the government started making margin protection payments, the Market Stabilization Program would have given each participating dairy a direct financial incentive to temporarily cut back milk production *(a processor's worst fear)*, thereby helping to quickly realign supply and demand. This result would have been good for producers (who would be able to get back to a market balance that provides a profitable price) as well as for taxpayers (since a return to supply/demand balance would shorten the periods they were making margin protection payments).

In the end, the decision was made – largely due to the demands of House Speaker John Boehner – that the government was comfortable assuming the additional financial liability that comes with a margin protection program that has no provisions aimed at restoring supply/demand balance. In five years, when this program is up for renewal, we'll have an opportunity to evaluate whether that was a wise choice or not. In the meantime, we operate in an industry that now exports about 16% of our production, and is therefore vulnerable to global shifts completely outside of our control like dollar valuations, global weather patterns or political unrest. We all hope for the best, but it is a very positive thing to have some of our downside price risk shared beyond just the 50,000 U.S. producers.