Milk Producers Council

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

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks	*- $.1250*	$1.9000
Barrels	*- $.2175*	$1.8625

Weekly Average

Blocks	*- $.0980*	$1.9840
Barrels	*- $.1300*	$1.9810

CHICAGO AA BUTTER

Weekly Change	*+$.0150*	$2.0875
Weekly Average	*+$.0165*	$2.0870

DRY WHEY

WEST MSTLY AVG	w/e 08/19/11	$.5925
NASS	w/e 08/13/11	$.5648

NON-FAT DRY MILK
Week Ending 8/12 & 8/13

Calif. Plants	$1.6005	13,236,092
NASS Plants	$1.5889	16,755,158

CHEESE MARKET COMMENTS: After two weeks with lower prices on the CME, this week began with a good first two days of activity (price increases) and with some pretty good looking market signs supporting those prices. However, cheese sellers on the CME midweek showed once again that it doesn't take much to turn things around. Support for cheese prices included signs that milk production should not increase by sizable amounts through the rest of this year, exports appear to be at least steady, and the re-opening of schools should begin to move about 4% of milk production into bottling plants. However, as of three weeks ago the futures markets for cheese and class III milk had been discounting the cash prices at a rate of close to $3.00 per cwt. The price decreases in the past two weeks plus the sales and offers this Wednesday through Friday trimmed away most of that difference. Both styles are now below the $2.00 per lb level for the first time since the first week in June. Differences between the futures prices and the spot prices for September and October have narrowed to the equivalent of about $.08 per lb of cheese. Cheese futures prices from November through next Spring bottom out at $1.75 per lb. This time, at least for a short while, the futures traders won out, possibly because the domestic economy simply is not healthy enough to convince buyers that sales will be sufficient to keep inventories under control. Time will tell.

BUTTER MARKET COMMENTS: It appears butter prices may withstand buyers' and consumers' wishes for lower prices. For most months since January butter prices have been setting records not seen before – even in the "bubble" years of 2007-2008. Retail prices typically are in the mid to high $3.00 per lb range, but domestic sales appear to be holding up reasonably well, although inventories have shot up the past two months as production amped up in response to the strong prices. If the comments made by Dairy Market News reporters are correct, we should see a leveling off in butter production for July and a substantial drop off this month, which should take inventories back down to where they were earlier this year. CME futures prices for butter for September and October increased this week by an average of $.07 per lb, showing solid support to the cash market. International prices for butter f.o.b. ports are at or above current CME prices while prices bid for anhydrous milkfat in Fonterra's auction this week continue their rapid decline. That simply doesn't figure, but it is.

POWDER MARKET COMMENTS: DMN reports a tightening in supply of nonfat dry milk in the west as production of skim milk powder has increased. There's certainly no shortage of milk in the west so that could be the reason why something happened last week that rarely happens – the California average price for shipments of NFDM last week was higher than the price reported to NASS for current sales for the same week. Welcome, welcome. DMN reports production of powders throughout the rest of the country has slowed which is raising questions about proper levels of price. Some buyers appear to have ample supplies on hand in the central region and are said to be satisfied to work from them rather than to commit to further purchases. International prices for skim milk powder are no more than competitive with current U.S. prices for NFDM. Prices for buttermilk powder are sagging as ice cream production begins to slow. Buyers are also expecting a short term bump in the BMP supply as bottling plants sell excess cream, which means more butter, which means more buttermilk.

WHEY PRODUCTS MARKET COMMENTS: Domestic and export demand for dry whey continues to clear away current production. Prices are firm and slowly moving higher. The market for whey protein concentrate-34, on the other hand, appears to be unsteady, as low quality or adulterated (but marketable for animal feed) product is taking market share from some regular suppliers in some parts of the country, and is affecting price levels.

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FRED DOUMA'S PRICE PROJECTIONS…

Aug 19 Est:	**Quota cwt. $21.27**	**Overbase cwt. $19.57**	**Cls. 4a cwt. $20.17**	**Cls. 4b cwt. $18.79**
Last Week:	**Quota cwt. $21.38**	**Overbase cwt. $19.69**	**Cls. 4a cwt. $20.08**	**Cls. 4b cwt. $19.09**

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JULY'S MILK PRODUCTION CONTINUES TO SHOW EFFECTS OF WEATHER AND UNCERTAINTY: *(By J. Kaczor)* USDA reported this week that U.S. milk producers added 7,000 cows to their herds in July, which brought the total to 80,000 more than were on hand a year earlier. Production per cow was 3 lbs lower than last July. Total milk production was 117 million lbs higher than a year ago, an increase of 0.71 percent. That year over year increase in total production continues the steady string of months that began last October with lower increases than the month before.

Weather once again played a major role in how much milk was produced in various parts of the country. The West and Northwest again had conditions favorable to production. Considerably more rain fell throughout the Midwest and much of the Eastern parts of the country during July and temperatures abated somewhat, but very high humidity affected cow comfort and milk output per cow. Texas and areas immediately to the north continued to suffer with record or near record high temperatures and no precipitation. Seven of the largest milk producing states, all in the Midwest or eastern parts of the country had lower production than the year before for a fourth straight month. Major exceptions to what was expected are Florida (milk production up by 8.0%) and Texas (milk production up by 8.3%) whose producers have been adding cows and increasing production per cow under conditions not at all conducive to growth. The weather pattern in August so far is virtually unchanged from July.

High and rising milk prices have been signaling producers, who can, to expand production even as virtually all signs point to high and rising feed costs and continuing issues with adequate financing. Not helping to clarify matters, last week USDA updated its monthly projections for dairy product prices for next year which they say should lower the average all milk price by about $2.10 per cwt from this year's average.

California continues to do well with 11,000 more cows than in March (22,000 more than a year ago), and production per cow continuing to increase. July's production was 149 million lbs higher than last July, an increase of 5.7%. Among the 23 largest milk producing states, only Colorado, New Mexico, and Washington had PPC higher than California's.

PRICES CONTINUE TO SHOW WEAKNESS IN FONTERRA'S GLOBAL AUCTION: *(By J. Kaczor)* Winning prices were lower again for all three major products in Fonterra's August 16st global auction. Prices for **whole milk powders**, averaging $1.535 per lb, are now lower than they were a year ago (August 2010) – and have fallen in each of the last 4 sessions by a total of $.24 per lb. Prices for **anhydrous milkfat**, averaging $1.938 per lb, are now at their lowest level since March 2010 – and have fallen in each of the last 5 sessions by a total of $.65 per lb. They are now a $1.00 per lb lower than the high reached in this February's auction. Prices for **skim milk powders**, averaging $1.559 per lb, have fallen in each of the last 5 sessions by a total of $.42 per lb, but are still more than $.20 per lb higher than their lowest points of last year.

The price inversion (at least from the U.S. point of view) between WMP and SMP represents prices for the first two contract periods in this auction (October-January); prices for WMP for the February-April delivery period were bid $.012 per lb higher than SMP for that period. The $1.938 per lb for AMF seems unreasonably low when compared to prices reported by *Dairy Market News* for a lb of butter f.o.b. ports in Oceania, Europe, and the U.S. – all presently above $2.00 per lb, containing about 8/10ths of a lb of butterfat.

Prices aside for a moment, it's interesting to note how the auction has grown and operated since July 2008 in terms of products offered, bidders participating, and volumes sold. Over that period, the number of bidding rounds has ranged from a low of three to a high of 15. However, the average time for each round, about nine to twelve minutes, has changed little. Credit Fonterra and CRA International for having the foresight to structure the "mechanics" of the auction in such way as to manage the interests of more than 155 participants bidding for more than 80 million lbs of products scheduled for delivery over a seven month period. The forecasted volumes now reported for WMP and AMF have more than doubled from their initial levels. The volume for SMP, after a recent increase, is still slightly below what was first offered.

Another, possibly big expansion to the auction, is the entry in October of Dairy America as a seller. Dairy America is set up with their own separate contract period, the month immediately following the auction (November deliveries for October's two auctions, for example). DA intends, at least initially, to offer only regular and "upgraded" low heat and medium heat SMP. The specifications call for a minimum of 34% protein and a maximum of 4% moisture.

In what could be a strategic move or merely "house cleaning," Fonterra recently removed high heat skim milk powder from their product line offered in the auction, leaving high heat stable milk powders which are said to be needed in many parts of Asia to ensure quality of end products made from milk powders.

Stories from New Zealand on why the auction prices have been falling cite a combination of concerns about the expected growth in milk supply from the southern hemisphere, slower growth in demand from the Western world and whether China will continue to buy at their recent level, and what appears to be global financial uncertainties. Some satisfaction was expressed by the slowing of the price decreases, which may be a sign that a support level has been reached. Overall, 84.3 million lbs of product were sold in this auction; the weighted average price from the previous auction was $.025 per lb lower.

IT'S THAT TIME OF YEAR AGAIN…TIME TO REVIEW YOUR MILC CONTRACT: *(By Rob Vandenheuvel)* October 1st marks the start of a new fiscal year for the Federal Government, and therefore a new fiscal year for the Milk Income Loss Contract (MILC) program. While we've written numerous articles in this newsletter about efforts in Congress to reform and improve our "safety net" programs, as it stands now, the MILC and the Dairy Price Support programs continue to be our main safety nets for U.S. dairy farmers.

As a reminder, the MILC program provides cash payments to dairy farmers when the milk price drops below specific thresholds. There is no indication that the milk price will be low enough to trigger a payment under the MILC program in the near future. However, given the volatility in dairy markets, we simply don't know whether the program will trigger in for any of the months between October 1, 2011 and September 30, 2012.

The MILC program limits the payments made under the program to 2.985 million lbs. This is only about 3 months worth of milk production for a 500 cow dairy producing 65 lbs/head/day. Therefore, since these larger dairies may only be collecting payments for weeks or months, it's important to choose months with the highest payment rates in order to maximize the amount received under this program.

So why does that matter right now? If your dairy is enrolled in the MILC program and you've chosen October of each year as your "start month," it's possible that you'd benefit from changing that. If you keep your start month as October, and payments begin later in the fiscal year, you will have no choice but to begin collecting the subsidy payment as soon as it's available, regardless of whether it's an optimal month for your operation to do so. And if you'd like to change your month from October to a later month, you have only until September 14th to make that change. If you have any questions about the MILC program or your dairy's specific MILC contract, feel free to contact either your local Farm Services Agency office or Milk Producers Council at (909) 628-6018.

NATIONAL MILK PRODUCERS FEDERATION ADDRESSES QUESTIONS ABOUT WHEN THE "DAIRY MARKET STABILIZATION PROGRAM" WOULD TRIGGER IN: *(By Rob Vandenheuvel)* This week, the National Milk Producers Federation (NMPF) sent out the following press release addressing questions they've been getting during their "Summer Grassroots Tour" with regard to when the "Dairy Market Stabilization Program" would trigger in under the draft legislation released by Rep. Collin Peterson (D-Minn.):

Rumors to the Contrary, Foundation for the Future's Market Stabilization Plan Would Not Have Taken Effect During 2010 or 2011, By National Milk Producers Federation (http://nmpf.org/files/press-releases/FFTF-DMSP-in-2011-081711.pdf)

The market management element of the dairy legislative package being readied for introduction in Congress would not have been active in 2010 or 2011, according to the National Milk Producers Federation (NMPF), which helped develop the Foundation for the Future program on which the legislation is based.

NMPF made the announcement today to clarify misconceptions that farm-level margins would have been tight enough in the past 18 months to activate the proposed Dairy Market Stabilization Program (DMSP), one of three elements of NMPF's Foundation for the Future program. The DMSP is intended to send quick market signals to dairy producers when milk prices drop, feed prices escalate, or the combination of those factors compresses the margins between milk and feed prices to the point where a severe imbalance has developed.

As originally drafted by NMPF, the DMSP's calculation of margins used futures settlement prices found on the Chicago Mercantile Exchange (CME) for corn, soybeans and alfalfa hay. But under the legislative draft proposed by Rep. Collin Peterson (D-MN), and now also endorsed by Rep. Mike Simpson (R-ID), the DMSP margin calculation will use the feed costs reported by two USDA agencies – the National Agricultural Statistics Service (NASS) and the Agricultural Marketing Service (AMS) – in order to accommodate USDA reporting requirements for implementation of the program. NASS currently reports the average corn and alfalfa prices received by farmers in the U.S., and AMS currently reports soybean meal prices at seven specific locations within the U.S.

NASS corn price reports are generally lower than the prices used in the CME corn contract settlements, according to NMPF. During the period January 2009 through June 2011, for example, the NASS U.S. corn price averaged $0.41/bu. lower than the CME-derived corn price. While using the AMS reports, instead of CME prices, for soybean meal would tend to have the opposite effect, the overall impact of using USDA's NASS and AMS calculations of feed costs in 2010 and the first half of 2011 would have meant margins would have been wider under the legislative draft, and thus the Market Stabilization Program would not have been activated.

"The use of USDA feed price reports again demonstrates that the Dairy Market Stabilization Program will act only in those rare instances when margins are so bad that catastrophic losses of producer equity are at hand, as was the case in 2009," said Neal Rea, a dairy producer from Cambridge, NY, and a member of the NMPF task force that developed the DMSP.

The chart indicates what the margins would have been last year, and through the first seven months of this year, using the feed calculations as proposed in Peterson draft legislation. Current projections for prices in the remainder of 2011 are also included.

Because the DMSP only activates when the margin between the All milk price and the feed cost calculation is $6 per hundredweight or less for two consecutive months, at no point would farm-level milk or feed prices have triggered the program in 2010 or 2011.

FFTF Milk Price-Feed Cost Margin
Actual / Forecast

2010		2011	
January	$7.37	January	$5.84
February	$7.49	February	$7.36
March	$6.46	March	$8.79
April	$6.37	April	$6.78
May	$6.57	May	$6.29
June	$6.97	June	$7.85
July	$7.28	July	$8.54
August	$7.81	August	$8.57
September	$8.34	September	$8.23
October	$8.80	October	$7.81
November	$7.80	November	$6.98
December	$6.12	December	$6.08

MANAGERS NOTE: ***(By Rob Vandenheuvel)*** **MPC appreciates this clarification from NMPF. However, as Neal Rea noted in the press release, this change would *not* have affected how the Dairy Market Stabilization Program would have responded to 2009 dairy farmer margins. Under Rep. Peterson's draft bill, this valuable tool, designed to empower dairy farmers to collectively and temporarily cut back milk production, would have begun in March 2009, which is exactly the same month it would have triggered in under the original NMPF. The MPC Board is supporting Rep. Peterson's legislation, which would give us a valuable tool that would trigger in and empower dairies to quickly bring supply back into line with demand during times when our dairy farmers greatly need it.**