Milk Producers Council

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TO: DIRECTORS & MEMBERS **FROM: John Kaczor**

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks	*+$.0350*	$1.5150
Barrels	*N.C.*	$1.5050

Weekly Average

Blocks	*+$.0467*	$1.5130
Barrels	*+$.0157*	$1.5070

CHICAGO AA BUTTER

Weekly Change	*-$.1357*	$1.3300
Weekly Average	*-$.1054*	$1.3790

DRY WHEY

WEST MSTLY AVG	w/e 1/22/10	$.4050
NASS	w/e 1/23/10	$.3866

NON-FAT DRY MILK
Week Ending 1/22 & 1/23

Calif. Plants	$1.0542	33,354,052
NASS Plants	$1.0917	36,378,056

CHEESE MARKET COMMENTS: The U.S. cheese market has been looking like a disorganized scrimmage over the past several months. The game seems to be without rules – or with rules that are largely ignored. Cheese production continues to increase as the total supply of milk decreases. Domestic sales are holding up surprisingly well despite the nation's financial woes, but cannot keep up with the steady increase in the amount of cheese that is produced each month. Cheese stocks at the end of November and December haven't been that high in twenty-five years. Prices rose fairly steadily from mid 2009 to a high for the year in December, then fell by $.30 per lb, and are now again rising while international prices are falling. That really isn't a picture of an informed, organized, stable market, is it? Nonetheless, based on trading activity this week on the CME, it seems buyers and sellers are in agreement about fair prices. Blocks added $.035 per lb this week and barrels were unchanged. Short term needs for winter time activities and recreation have helped to keep retail sales steady to strong, but not many major buyers seem willing to commit themselves to major purchases at current price levels. Future milk supply continues to be a key indicator for future cheese prices and there is little agreement at this time on what that supply may be. Class III futures prices on the CME for the Spring months are now lower than current levels, but rise to the equivalent of about $1.70 per lb for cheese by September.

BUTTER MARKET COMMENTS: Opinions and speculation abound about why butter prices jumped by $.18 per lb two weeks ago and why they are now back to where they were at the beginning of the year. Those reports which began last October about interest from international buyers and about the production of butter to fill expected orders for export certainly contributed to the general market support since that time, but recent price decreases reported for Western Europe may have substantially altered the likelihood and impact of those sales. Current domestic usage of butter has been keeping up with current production, and the amount of butterfat products in storage at the end of December was about equal to the level four years ago. The fundamentals for the butter market continue to look okay. Some buyers are said to be betting the butter supply this fall will be tight, and are willing to buy now for sale later. Speculate or hedge, just keep buying.

POWDER MARKET COMMENTS: Hints of possible weakness in the powder markets had been popping up in the press over the past several weeks, but the clearance sale that occurred last week caught almost everyone by surprise. We understand the export market for U.S. powder is weak and the prices available for those sales are not strong, and until recently cheese plants didn't have much incentive to use powder to fortify their vats. The volume reported last week by California plants was a record high, and the price was almost $.25 per lb below the week before. The average price reported by NASS fell "only" by about $.19 per lb – which indicates the lowest prices for the week again come from California plants. The hints of weakness included stories about concern over when and how European regulators would begin to release the huge amount of skim milk powder they have in storage; last month's small drop in whole milk prices on Fonterra's internet auction; the price decreases reported for international prices; re-sales of some product; and the weak sales in October, November, and December (60 million fewer lbs of nonfat dry milk were produced in October and November than in the same months a year earlier, but the inventory dropped by only 8 million lbs over those two months). Does any of that warrant dumping this huge amount of powder on the market at cut rate prices? Won't that simply depress sales over the next several weeks, or even months? Is that kind of "slash and burn" marketing which affects all producers consistent with the stewardship that supposedly comes with a position of leadership? Aren't plants reimbursed (through the make allowances they receive) for costs associated with manufacturing and marketing their products? If California producers are looking for someone to complain to, give Land-o-Lakes and California Dairies, Inc. a call. Their California plants produced almost 69% of all nonfat dry milk that was produced in the U.S. in October, and 59% of what was produced in November. Ask them if they even heard about whole milk powder (*Dairy Market News* this week reported that whole milk powder is in short supply in the U.S. and that some is even being imported from Australia to fill buyers' current needs). Ask them if they have something they call a marketing plan, and if they claim they have one you might ask to have them explain if what they did last week was part of the plan, and what affect that sale may have on maintaining good customer relations, price transparency, and industry stability. Surely, some public explanation will be forthcoming, won't it? While you're at it, you might also give National Milk Producers a call to inquire on how they're coming along on developing that great export incentive program that was first mentioned almost three years ago.

WHEY PRODUCTS MARKET COMMENTS: The market for whey-based products is steady, but buyers are aware of what is happening to the market for major U.S. protein powder, and DMN reports that some are expecting discounts for dry whey. Production of dry whey and whey protein concentrate is growing and exports continue to remove a large percentage of the output. Prices for WPC held steady for the week but average price for dry whey reported to NASS dropped a bit this week (for the first time since August), and the West's "mostly" price lost $.0025 per lb.

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FRED DOUMA'S PRICE PROJECTIONS…

Jan 29 Final:	**Quota cwt. $ 15.21**	**Overbase cwt. $13.52**	**Cls. 4a cwt. $13.91**	**Cls. 4b cwt. $12.69**
Last week:	**Quota cwt. $ 15.52**	**Overbase cwt. $13.84**	**Cls. 4a cwt. $14.90**	**Cls. 4b cwt. $12.67**

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AN INTERESTING TAKE ON THE GLOBAL MARKETS: *(By Rob Vandenheuvel)* Last month, Dr. Mark Stephenson from Cornell University's Program on Dairy Markets and Policy wrote an article in Hoard's Dairyman after spending some time down in Australia. For those of you who didn't see the article, I've posted an excerpt from the article below. These excerpts are reprinted with permission from the December 10, 2009 issue of Hoard's Dairyman.

> **New world auction forecasts milk prices**
> By Dr. Mark Stephenson, Cornell University's Program on Dairy Markets and Policy
> *(excerpts)*
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> It's getting on toward Christmas as I write this article, and it's going to hit 90 degrees here again today for the fourth day in a row. No, I'm not in Florida or Arizona. I'm in Australia where I have been for a couple of months working on a project. I'm not here because the climate, travel, and research sounded like a nice change (although I have enjoyed the people and my experiences very much). I am here because the U.S. dairy industry can no longer enjoy the relative simplicity of living within its domestic markets.
> We have outgrown them, and a price forecast today requires consideration of world markets.
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> Twenty years ago when I was first thinking about milk and dairy product prices, our domestic prices for cheese, butter, and nonfat dry milk were more than double the so-called world prices at that time.
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> Today, our prices reflect the opportunities that exist to sell the product domestically or overseas. Over the past two decades, our prices haven't really come down to world prices. What has happened is that world prices have come up to intersect with our own.

For a very long time, Oceania (Australia and New Zealand) and Europe had been the major suppliers to the world. Occasionally, we had an opportunity to sell some powder — or perhaps the need to reduce inventories — but we were only a bit player.

Europe basically set the tone of world prices for commodities with policies that kept their domestic prices high by selling surplus product with export incentives. As low-cost milk producers, Oceania followed by selling product at the market clearing prices. When the European Union no longer could afford the post World War II agricultural policies, it began a process of embracing the WTO (World Trade Organization) goals of removing trade distorting policies. As less product was offered to the world market, world prices came up.

What are the implications?

As low-cost producers, Oceania responded to rising world milk prices over the past two decades by expanding production about as quickly as they could. New Zealand has wonderful pasture-based resources for producing milk, but they are quite land constrained. Land was bid up, making Oceania a high fixed cost, low variable cost producer of milk.

The United States has a very different milk production system based on intensive management and confinement. This is a high variable cost, relatively low fixed cost production system. The total cost of production in both areas is about the same and so is the milk price.

Let's think about operating a system with those different kinds of cost structure. Our own electrical grid provides a good example. A power company will operate its nuclear plants at full capacity all of the time. These are very high fixed, low variable cost plants. The generators that are powered by natural gas are low fixed, high variable cost plants, and they are used to balance the electrical demand on the grid. Both plants receive the same price for the electricity sold.

The implication is that Oceania is going to produce all of the milk that it can all of the time. The U. S. is going to bear the brunt of balancing world supplies and demand for milk and dairy products. Indeed, we seem to be able to respond with astonishing speed when milk prices are high. But it really hurts when we need to contract as during the past year.

Oceania operates a large-scale internet auction for dairy products. This new auction sells whole milk powder and anhydrous milkfat. The auction takes place once monthly and, although the auction is for the actual sale of products, it is for the delivery of products in the future. At each auction, there are three delivery time periods. Within the third month after the auction, delivery over a three-month time period starting in the fourth month, and for delivery over a three-month time period starting in the sixth month after the auction. Five days before the auction, the trading manager posts forecasts of future quantities, and, perhaps most importantly, information on the actual quantities and starting prices of the upcoming auction. Bidders don't bid on price — they bid on the quantity of product that they want to purchase at the announced prices. When the auction begins, buyers submit their quantity bids. If all the product is bid for, then a new round is begun at a higher price and bids are taken again. This continues until all of the product that was offered for sale just clears the market at the highest price possible.

The auction is of real value to buyers and sellers in determining a market price for dairy products. It also provides an element of risk management for buyers and sellers. It also helps the U. S. to understand where our future milk prices may be headed.

MANAGER'S NOTE: (By Rob Vandenheuvel) This article really helps us better understand the differences between the U.S. and Oceania dairy industries. But even more than that, this article reinforces the need for our industry to embrace a tool like the Dairy Price Stabilization Program. As Dr. Stephenson points out, the very nature of how U.S. dairy operations are set up gives us opportunities to quickly meet global demand when

there is a need (and therefore a higher price). However, the flip side of that is when we have drops in demand (like we saw first-hand in 2009), the U.S. will bear the brunt of those needed production decreases. Without a tool to bring supply back in line with demand, we are destined to go through painful production contractions like we are seeing now.

MPC'S SOUTHERN CALIFORNIA OFFICE RELOCATES: *(By Rob Vandenheuvel)* Effective February 1st, MPC will be moving it's Southern California office. Many of you will recognize our new address – it is the same office MPC occupied for decades. The new address is:

13545 S. Euclid Avenue, Unit B
Ontario, CA 91762

All other contact information remains the same. In addition, MPC continues to maintain a field office in Bakersfield.