

Milk Producers Council

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MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks +\$.0550 \$1.1450
Barrels +\$.0500 \$1.1400

CHICAGO AA BUTTER

Weekly Change +\$.0275 \$1.2500
Weekly Average +\$.0535 \$1.2490

NON-FAT DRY MILK

Week Ending 7/10 & 7/11

Calif. Plants \$.8156 13,680,592
NASS Plants \$.8450 17,184,984

Weekly Average

Blocks +\$.0030 \$1.1120
Barrels +\$.0095 \$1.1055

DRY WHEY

WEST MSTLY AVG w/e 07/16/09 \$.3200
NASS w/e 07/11/09 \$.2926

CHEESE MARKET COMMENTS: Much to virtually everyone's surprise, prices for blocks and barrels on Thursday on the CME jumped to above USDA support levels. It took only two trades and a bid for blocks and a single bid for barrels to do the trick. The day before blocks increased by \$.0075 per lb and barrels fell a half-cent. Analysts at *Dairy Market News* (DMN), in their rounds of discussions with the industry, reported they found nothing but weakness and uncertainty. "Under pressure," "most buyers are reluctant," and "buyers . . . don't anticipate the upswing anytime soon," are samples of what they had been hearing. Things calmed a bit today when blocks added another \$.0025 and barrels lost that amount. This time, the thinness of the CME trading, speculation, and perhaps some good old fashioned forward thinking may have ruled the day.

BUTTER MARKET COMMENTS: The string of daily butter price increases on the CME ended today with a two cent per lb drop. DMN reports that butter production is expected to continue to decrease as cream usage for current sales of frozen desserts, cream cheese for storage and, of course, lower milk production is keeping some churning plants from running full schedules. Retail sales are reported to be moderate, but additional exports of butterfat products are expected once USDA announces the levels of DEIP bonuses for the new year that began July 6th. [The level of subsidies offered by Europe for exporting products was not changed, but their program was extended beyond its normal cut-off date, to next January.]

POWDER MARKET COMMENTS: The market for dry products is described as steady in the central region and unsettled to weak in the West. DMN reports that **manufacturers in the central region are expecting sharp declines of nfdm production within weeks.** This week another 2 million lbs of nfdm was approved for export through September with DEIP subsidies of about \$.08 per lb. Sales to the CCC are continuing, but in decreasing amounts. Exports continue to be low. China has chosen Fonterra as their powder supplier; their volume from the U.S. is down by 86% from last year's level, through May (contrast that to their purchases of dry whey, reported below). The latest California plant average price continues to lag about \$.03 per lb below all other plants in the country.

WHEY MARKET COMMENTS: DMN reports that buyers and sellers seem to believe that prices for dry whey have reached a level where they may stay for a while. Domestic demand is holding steady and export sales appear to have leveled off. The average for the West's "mostly" price series was unchanged this week, but the central region's price moved up by \$.0075 per lb. While prices may have stalled, the market is described as being strong: stocks are low to moderate, export sales continue to exceed last year's levels (China's imports of dry whey from the U.S. over the first five months of the year is 88% higher than that a year ago), and production through May is more that 6% below a year earlier. The market for whey protein concentrate is strong. Exports are rising and DMN says manufacturers are not able to accommodate buyers' requests to increase their contracted volumes – which may or may not be true.

FRED DOUMA'S PRICE PROJECTIONS...

July 17 Est:	Quota cwt. \$ 11.22	Overbase cwt. \$ 9.53	Cls. 4a cwt. \$9.97	Cls. 4b cwt. \$ 9.32
Last week:	Quota cwt. \$ 11.15	Overbase cwt. \$ 9.46	Cls. 4a cwt. \$9.85	Cls. 4b cwt. \$ 9.27

MILK PRODUCTION IN JUNE CONTINUES ITS DOWNWARD TREND: (By J. Kaczor) USDA reports there were 86,000 fewer cows being milked during June than last year. Production per cow increased by 13 lbs for the month. Total milk production was 29 million lbs less than a year earlier (-0.2%). Considering that by the end of June most of CWT's recent herd retirement program was already completed, a bigger drop in cow numbers might have been expected. But it is what it is. The difference in numbers of cows between this year and last year is increasing each month; April's herd was 26,000 smaller, May's was 49,000 smaller, and June saw another 37,000 drop. It looks like, at this rate, it will take another three months to get to where one can reasonably see prospects for substantial and sustained milk price improvement – the target being about the number of cows that were being milked in 2006. Many observers believe the industry has to go all the way back to the number of cows that were on hand in 2005, which would require a total of 150,000 to disappear. [Less milk production isn't the full answer; USDA also reported today that sales of packaged fluid milk in May reversed course and fell by 3.2% below where it was last year. It's also the wretched economy.]

Among the 23 largest milk producing states, ten produced less milk than a year before and two produced the same amount. Seven of the twenty-three were reported to be milking more cows than last June. The increase in production per cow could be the logical result of the massive culling that has been ongoing over the past nine months. The latest report on culling came out today and is current through June 27th. A total of 198,400 more dairy cows were slaughtered this year than in 2008. Considering the many reports of producers cutting back by reducing their herds and modifying dairy rations (not counting the 150,000 cows that left via the CWT programs), it's surprising to not see a greater net decrease.

In June, the heavy lifting was done by Arizona, California, Idaho, Missouri, Ohio, Oregon, Pennsylvania, Utah, Vermont, and Washington. New Mexico was level. That's a fine showing by the Western States. Perhaps the state and federal legislators in the eleven states that increased production should tell their producer constituents to "put up or shut up." California is certainly doing its part; USDA reports that California had 37,000 fewer cows on hand in June, with 40 lbs less production per month, for a total decrease in milk production of 141,000,000 lbs, which amounts to a 4.1% reduction.

RESPONDING TO SOME OF THE RECENT CRITICISMS OF THE HOLSTEIN ASSOCIATION PLAN: (By Rob Vandenheuvel) As I mentioned in last week's newsletter, Milk Producers Council will be joining the Holstein Association USA and Dairy Farmers Working Together (a dairy group out of Vermont) in presenting the "Dairy Price Stabilization Program" or DPSP (a plan that's virtually identical to the Growth Management Plan) to the National Milk Producers Federation "Strategic Planning Task Force." That presentation will take place next Monday. In preparation for that meeting, I thought it would be valuable to respond to some of the concerns about the program that have been raised in the past couple months.

(As a reminder, the Holstein Association is compiling a list of supporters for the Dairy Price Stabilization Program. For those of you interested in seeing that list and/or adding your name as a supporter, the website is: <http://www.holsteinusa.com/association/dairyprice.html>. And for more information on the plan, check out our website at: <http://www.milkproducerscouncil.org/GMP.htm>.)

Concern: Wouldn't the DPSP reduce the overall value of herds? And won't this reduced value then hurt dairymen's balance sheets, their access to credit lines, and ultimately producer income?

The value of any asset (in this case, cows) is dependant on that asset's ability to generate revenue. That is why the current value of cows is dramatically lower than what they were six months ago. To the extent that the DPSP is successful in keeping supply and demand in better balance (thereby maintaining a stable, profitable price for your milk), why would that lead to a dramatically reduced value of your cows?

Ask your bankers how this volatility has changed the way they view cow values and their willingness to loan money based on those values. We are on the path of being an un-bankable industry, and unless we do something to take the “booms” and “busts” out of this industry, it won’t matter what you think your cows are worth – the banks will be increasingly hesitant to invest in this industry.

Concern: Why doesn’t the plan doesn’t do anything to guarantee a higher income for farmers?

The goal of the DPSP is not to increase farm income over the long term. The goal is to keep supply and demand in better balance, which will take the massive boom/bust cycles out of our industry. This is about getting rid of the sharp peaks and valleys.

With that said, a more stable price should allow the industry to maximize our market opportunities. While the “busts” of \$9 milk hurts dairy producers, the “booms” of \$20+ milk kills demand. If we were able to keep supply and demand in better balance, and thereby keep the price of milk more stable, it is likely there are huge market opportunities available to us, both domestically and internationally. More market opportunities mean more income for dairy farmers.

Concern: I’m a “free market dairyman.” A program like this would be government intrusion into our industry.

First off, this program relies on everyone being on the same playing field. It does nothing to dictate what each individual dairyman does on his operation, but the incentives must apply to everyone. The only way to achieve this is by an act of Congress.

Secondly, the U.S. dairy industry is already a highly-regulated industry. Producers have supported many of those regulations – such as the way milk is “pooled” in the federal and state orders – because of the justifiable fear that if we went back to the pre-pooling days and direct contracts with milk plants, processors would exploit producers. However, if we are going to continue operating under those regulations, which prevent – or at a minimum, severely mute – real market signals from being felt by individual dairies, we need to create an incentive for each dairy to watch and manage their milk production.

Finally, the authors of the DPSP recognized the concern of too much control by the government, and have incorporated a “Producer Advisory Board” that will oversee the program. This board would serve a role similar to that of the National Dairy Board, which oversees the national advertising assessment and promotion activities.

Concern: By making the “base” a use-it-or-lose-it asset, won’t the buyer of a farm will have to pay a “tax” on populating that farm even if that dairy is milking the same animals.

The DPSP does allow a dairy farmer who sells his facility to another dairy farmer to transfer that facility’s production history to the new farmer.

But outside of that limited exception, an important feature of the DPSP is that base cannot be bought and sold. Anyone can enter into the industry or expand their current production – they merely have to consider and budget for the market access fee in their first year. Compare that to a program like Canada that relies on the buying and selling of “production quota,” which currently costs more than \$30,000 per cow.

Concern: It seems like the DPSP will especially hit smaller, retiring farms. Their animals will be worth less than with a dynamic market and opportunities to sell will be reduced.

If a dairy farmer wants to retire right now, what are his cows worth? A cow is only worth whatever revenue it can generate. With the boom/bust cycles that are becoming commonplace in the dairy industry, does a dairy really want to just hope that when he is ready to retire, the industry is in a “boom period?”

Concern: It seems like this program would ensure that we only produce enough to meet our domestic demand – eliminating our ability to participate in world markets. When global demand comes, the U.S. will not have the milk.

A program like the DPSP would actually have the opposite effect. There are global opportunities out there, and the U.S. is very well-equipped to take advantage of those markets. But what kind of exporter do we want to be? Do we want to develop long term relationships with foreign markets and cultivate a real export demand? Or do we want to just be an opportunistic seller like we've largely been for the past two years – selling product only when it's not available anywhere else and the weak U.S. dollar makes it cheaper to export? A stable supply/demand balance at home will put our dairy product marketers in a much better position to cultivate long-term business relationships with export partners.

Concern: Lack of milk and milk products will result in increased use of ingredient substitutes, which will further reduce our domestic demand for milk.

This argument couldn't be further from the truth. While the "busts" in our milk price (\$9 milk) hurts dairymen, the "booms" in our milk price (\$20+ milk) kills demand, particularly in the use of dairy products as ingredients. Maintaining a better supply/demand balance will result in a much more stable price, allowing for the industry to maximize our domestic demand opportunities. We have no idea what level of domestic demand we are truly capable of if we have a stable industry where the buyers of our milk products are not subject to 100 percent price increases followed by 50 percent price decreases.

Concern: This program would benefit farmers located in excess production areas and penalize farmers in areas that are growing and need to grow to meet their local market.

This program creates an incentive that will help keep our national supply and demand in better balance. It does not fix the local issues of "overcapacity," "undercapacity," "deficit areas," or "surplus areas." Those are all issues that those various areas need to address locally. But aside from those local issues, all areas of the country are hurt by the massive volatility. We're all connected. Regardless of whether you are dairying in a surplus area or a deficit area right now, every dairy is losing money on every pound of milk they produce. The DPSP is aimed at addressing that volatility that hangs over the entire industry.

Concern: Why do we need the DPSP? Individual dairies can already reduce the risk of volatility with marketing tools and hedging.

The DPSP balances supply and demand – an important aspect of any healthy industry. Risk management tools should always be considered by a business, but what risk management tool is available to farmers right now that could mitigate a \$5+ loss per hundredweight month after month? And even when higher milk prices were available for dairies to "lock in" for risk management purposes, what would that dairy have had to "lock in" on the input side? With the high feed prices you would have had to lock in as well, was there a profit margin to be made?

The fact is that we have a definable problem – the industry's ability to expand milk production exceeds the market's ability to absorb it. And anytime there is a profit margin in the industry, all 60,000 dairies have an incentive to chase that margin, quickly turning any supply/demand balance into a surplus. The DPSP is designed to give dairies a financial incentive on the other side – an incentive to actually manage production. Regardless of what individual risk management options there are, they don't mask the need for our industry to maintain a better supply/demand balance. These massive price swings aren't good for anyone – not the farmers, not the processors, and not the consumers. We have an opportunity to fundamentally address the single largest threat to our industry – extreme milk price volatility – and we would be extremely foolish to let this opportunity pass without a serious debate on our options. **The status quo is simply not an option.**

As I mentioned above, more info can be found at <http://www.holsteinusa.com/association/dairyprice.html> or <http://www.milkproducerscouncil.org/GMP.htm>.