



Milk Producers Council

13545 S. Euclid Avenue, Unit B ~ Ontario, CA 91762 ~ (909) 628-6018
801 S. Mount Vernon Avenue ~ Bakersfield, CA 93307 ~ (661) 833-2549
Fax (909) 591-7328 ~ office@milkproducers.org ~ www.MilkProducers.org



DATE: September 30, 2011
TO: Directors & Members

PAGES: 5
FROM: John Kaczor

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks - \$.0075 \$1.7200
Barrels - \$.0675 \$1.6400

CHICAGO AA BUTTER

Weekly Change - \$.0100 \$1.7600
Weekly Average - \$.0550 \$1.7600

NON-FAT DRY MILK

Week Ending 9/23 & 9/24

Calif. Plants \$1.5574 12,864,152
NASS Plants \$1.5413 17,890,133

Weekly Average

Blocks - \$.0040 \$1.7210
Barrels - \$.0200 \$1.6580

DRY WHEY

DAIRY MKT NEWS w/e 09/30/11 \$.6225
NASS w/e 09/24/11 \$.6004

CHEESE MARKET COMMENTS: For this time of year, after the last two weekly losses, cheese prices on the CME can now beat only 2009's prices. That is so ridiculous, it's nutty. The market still seems a little bit unsettled. This week was almost the mirror image of last week for block and barrel prices (meaning opposite changes); last week blocks lost \$.05 per lb and barrels lost \$.0125; this week blocks lost the least, \$.0075 per lb, while barrels gave up \$.0675. Twenty-eight carloads sold this week. Too much barrel stock on hand, it seems. Edginess describes the trading, more than anything else while the cash market (hopefully said) tries its best to sort out short-term supply and demand imbalances. For futures traders, concerns about the economy, feed costs, consumer sentiment, a potential currency crisis in Europe – all seem to combine to cause instant over-reactions. This week, with relatively little change to cash prices, all Class III futures months from November through next July lost ground and now range from lows of \$16.20 per cwt in February and April, to a high of \$16.89 in July. The November price fell \$1.36 after losing \$.70 the previous week. The December price fell \$.07 per cwt after losing \$.99 the week before. With decent and growing volume, cheese futures prices are selling at a small discount to current cash prices, but fall to \$1.62 per lb for November and December.

BUTTER MARKET COMMENTS: The remarkable run of high butter prices that began in January gave a shot in the arm to the industry, helping to raise milk prices to levels close to or even above those in 2007. California's statewide milk blend price in July was only \$.28 per cwt below the record high reached in 2007; the federal order Class III price was \$.01 higher than the 2007 record for the month. This week's average price, after falling for six weeks, is \$.3315 per lb below its recent high and is \$.475 per lb below where it was a year ago. At \$1.76 per lb, the butter price still looks good compared to almost any other month in the last seven years – excluding last year, of course. The lower price is also causing retailers to build stocks, offer deals, and stimulate sales. Despite that, DMN says many plants are holding back somewhat on production (that is fine as far as I am concerned) even though cream is readily available. Retail sales held up surprisingly well through the eight months of uncharacteristic contra-seasonal high prices, and should do even better at current levels. Butter futures prices stabilized this week: today's closing price for October is at a slight premium to the cash price, and the lowest prices on the board are for December and January at \$.0625 below cash, and then rise from that point.

POWDER MARKET COMMENTS: The weak undertone for the nonfat dry milk market that DMN sees is being reflected in the weekly prices reported by manufacturers, as they ease ever so little downward. Once again, the California average price is above the national price. The national series is supposed to include only shipments whose price was set no earlier than 30 days before shipment. The California series is supposed to include all qualifying shipments whose price is set no earlier than 150 days before shipment. The west's "mostly" series also edged downward, with a price range of \$1.42 per lb to \$1.55 per lb. In August, California plants, with about 8% more pool milk than a year before, produced about 13 million fewer lbs of NFDN and about 23 million more lbs of other dry products, included in which is believed to be about 20 million lbs of skim milk powder. The SMP is for Dairy America to export, either directly to Fonterra or through Fonterra's auction

platform, globalDairyTrade, beginning next Tuesday. DA, initially at least, is using only a single shipment month for the products it offers in the auction.

WHEY PRODUCTS MARKET COMMENTS: Prices for dry whey continue to look strong, domestically and internationally. Prices reported to NASS for shipments made last week edged above \$.60 per lb, for the first time since January 2009 when they were on their way downward from 2007’s record highs. Internationally, DMN reports Europe’s price f.o.b. docks increased over the past two weeks, to \$.55 per lb. The west’s “mostly” price also rose this week, by \$.0062 per lb. The outlook for whey protein products, short term and long term, continues to look very good. Despite indications of a tight supply situation for WPC-34, DMN reports a slight downward price movement and buyer resistance for the product. WPC-34 prices this year have been closely tracking 2007’s record high prices but are reported to be somewhat affected by a perceived weakness in NFDM prices.

FRED DOUMA’S PRICE PROJECTIONS...

Oct ‘11 Est: Quota cwt. \$18.88 Overbase cwt. \$17.18 Cls. 4a cwt. \$18.02 Cls. 4b cwt. \$15.80
Sept ‘11 Final: Quota cwt. \$19.93 Overbase cwt. \$18.24 Cls. 4a cwt. \$19.29 Cls. 4b cwt. \$16.33

DELVING INTO THE DETAILS OF THE “DAIRY SECURITY ACT OF 2011” *(By Rob Vandenhoevel)*

Last week, we announced that H.R. 3062, the *Dairy Security Act of 2011*, had been introduced by a bipartisan group of Congressmen from around the country. This legislation is the latest step in a long process of developing much-needed reforms to our safety net policies that are fairer to all dairies and more market-oriented.

The two main pieces of the *Dairy Security Act* are the Dairy Producer Margin Protection Program (DPMPP) and the Dairy Market Stabilization Program (DMSP). In short, the DPMPP is a “margin insurance” program that provides direct cash payments to individual dairy farmers when on-the-farm margins shrink below pre-determined levels. The DMSP is a stand-by market management program that creates a temporary incentive for dairies to modestly cut back milk production (2-4%) during months when on-the-farm margins shrink below pre-determined levels.

As we noted last week, H.R. 3062 allows for dairies to choose whether or not to participate in these two programs; if you want to participate in the government-subsidized “margin insurance” program, you’ll have to enroll in the DMSP. **While no one is ever excited about cutting back milk production (even if only modestly and only for a temporary period like it’s outlined in H.R. 3062), it’s important to remind our readers that under H.R. 3062, the DMSP would have triggered in only during the 2002/03 industry wreck and the now-infamous 2009 industry wreck. This is a program structured to stand on the sidelines and allow for continued industry growth, triggering in only during the [hopefully] rare instances when we are facing a serious need for temporary production cut-backs.** If you’re not familiar with how these two pieces of the bill work, please take a look at last week’s article (http://www.milkproducerscouncil.org/092311_DSA.htm).

As you can see, both of these programs rely on a “margin” calculation to determine: (1) when payments are made under the DPMPP and how much those payments will be; and (2) when the DMSP will trigger in and create a temporary financial incentive for dairies to cut back milk production by 2-4 percent. Much has been written and said about this margin calculation, but one question many folks have asked is, “What would the margin be right now?” **As H.R. 3062 is debated and discussed throughout the industry and in the halls of Congress, MPC will be reporting on what the margin would be if this bill were implemented right now.**

H.R. 3062 utilizes four variables announced by USDA each month to calculate the monthly margin. (1) The U.S. all-milk price, which is the average price received by dairymen throughout the country; (2) The average price received by farmers for corn; (3) The average price received by farmers for soybean meal; and (4) The average price received by farmers for alfalfa hay. For the feed cost calculation, the formula in H.R. 3062 takes a “whole operation” approach by estimating what a

H.R. 3062, “Dairy Security Act of 2011”			
Estimated Margin Calculation			
	Sept. 2011	Aug. 2011	Sept. 2010
U.S. All-Milk Price	\$20.90	\$22.00	\$17.20
Feed Cost Calculation*	\$13.81	\$13.72	\$9.41
Margin	\$7.09	\$8.28	\$7.79

hypothetical dairy would feed not only their milk cows and dry cows, but also the heifers and calves they raise. **Plugging all that information into the formula outlined in H.R. 3062, the calculated “feed cost” used in the margin calculation for September 2011 would be \$13.81 per hundredweight.** In addition to the current month’s calculated margin, MPC will also report on what that margin calculation would have been in the prior month, as well as in the same month the prior year.

** One note on the chart above: H.R. 3062 uses a monthly figure for soybean meal that doesn’t actually exist yet. USDA conducts a survey at various points around the country (Chino Valley, Kansas City, Portland, ect.), but no national figure is reported. If H.R. 3062 is approved by Congress and signed into law, USDA will have to begin reporting a national average price for soybean meal to be used in this calculation. In the meantime, for our purposes, MPC will be using the average daily values of the nearest soybean meal contract traded on the Chicago Board of Trade (CBOT). The actual figures reported by USDA may vary somewhat from these CBOT values, but this is a reasonable estimate for our purposes. The monthly corn and alfalfa prices are already reported by USDA, so this use of the CBOT only applies to soybean meal.*

To put these numbers in perspective, the DMSP (market management program) would trigger in when we have two consecutive months where the margin calculation is less than \$6.00 per hundredweight. It’s helpful to use this information to work backwards; **in other words, with feed costs at their current levels (generating a \$13.81 per hundredweight feed cost calculation), the U.S. all-milk price would have to be calculated at \$19.81 per hundredweight or higher to avoid hitting that \$6.00 trigger.** As you can see from the chart above, the U.S. all-milk price did come in above that level – at \$20.90 per hundredweight.

The same exercise can be done for the DPMPP (margin insurance program). Under this program, a payment would be made to all dairies enrolled in the program whenever the margin calculation is less than \$4.00 per hundredweight. With the calculated feed cost at \$13.81 per hundredweight, the U.S. all-milk price would have to be calculated at \$17.81 per hundredweight in order to generate a cash payment to the dairies enrolled in the program. Included in H.R. 3062 is an option for individual dairies to pay a partially-subsidized annual premium and set that “trigger” at a higher level (\$5.00, \$5.50, \$6.00, etc.). If your dairy chose to pay the \$0.155 per hundredweight premium to set that trigger at \$6.00 per hundredweight, a payment would have been generated if the U.S. all-milk price in September 2011 had been calculated at \$19.81 per hundredweight or less (\$13.81 + \$6.00). As noted in the previous paragraph, the U.S. all-milk price in September was actually calculated at \$20.90 per hundredweight, so the September margin of \$7.09 would not have generated a payment.

Obviously, these figures are not specifically tied to any one region. You simply can’t structure a national program like this on a region-by-region basis. Instead, H.R. 3062 creates a national safety net program that would use this nationally-calculated margin to determine when the DMSP would be triggered in or when the DPMPP would generate payments to dairies.

Compare this program to what we currently have: a Price Support Program that doesn’t trigger in until butter, cheddar cheese and/or nonfat dry milk prices reach about \$10.00 per hundredweight-equivalent levels, and an MILC program that triggers in only when the Boston Class I price (which is not necessarily reflective of what milk prices are around the country) falls to levels in the high-teens (depending on where feed costs are). We can see that the DPMPP is much more responsive to real market conditions than our current safety net programs. **And because the “margin insurance” can cover up to 80-90% of your dairy’s production, it is vastly superior to our current MILC program that limits coverage to only the first 2.985 million lbs of milk your dairy produced under the program. This is one of the many reasons that the MPC board is strongly supporting H.R. 3062 as a replacement to our current safety net programs.**

PRICES MOVING MOSTLY LOWER ALL OVER THE GLOBE; WHY AND WHERE AND WHAT’S NEXT?: (by J. Kaczor) The rosy outlook in the first half of this year for U.S. dairy prices has turned into something that presently looks much more sober. The main reason for the change is, I believe, a general reassessment of global supply and demand, and increasing competition.

Earlier in the year, the monthly increases in U.S. milk production were easing off and monthly exports of the four major U.S. price-setting dairy products continued to match, or beat, 2010's high levels. The report for August changed the outlook; it now looks like milk production should continue to set monthly records at an increasing monthly rate. Milk production in the European Union was following a pattern similar to the U.S. pattern – some members' production was sharply higher, exceeding their given quotas, and others were, for various reasons, lagging behind. Overall, EU milk production is running about 2% above the year before.

In the southern hemisphere, monthly milk production in major exporting countries in 2011 is increasing by large amounts. Argentina's production was so great they recently stated an intention to consider establishing a global internet auction for their whole milk powder, similar to Fonterra's auction. [It is unlikely to happen, but their concern about surplus product was made.] Milk production in Australia showed signs of something to close to full recovery, and New Zealand's production is booming. Recent reports from these five major exporting countries indicate the earlier projections for milk supply will likely be on target or, in the case of the U.S., too conservative.

On the demand side, it appears that economic issues may again be affecting earlier projections for continuing strong demand. The U.S. economy is struggling with high unemployment, very slow growth, depressed real income for more than half the population, and a record number of people living in poverty. It is a national shame, not being helped at all by unwillingness by some in Congress to set aside partisan politics to aid the recovery. Dairy product demand from the two largest international buyers, China and Russia, appears to be slowing, although north African and some Asian and south Asian countries' demand may be holding steady or even growing. Dairy product demand from Russia and China is critical for the EU and for New Zealand – and, in one way or another, for all major exporting nations, because of the huge volume of product those countries have been importing over the past three years.

A recent recap in NZX's Dairy Trader publication reported the EU, which has a built in massive sales market consisting of their 27 member nations, had a 32% increase in SMP exports this year, through July, and whey exports were up by 14%. (Sales within the EU are not classified as exports.) Their exports of WMP fell by 10% and butter exports fell by 20%. The butter report shouldn't be relevant to U.S. interests because vast amounts of European butter moves into government subsidized storage from March 1 to August 31 each year, and is gradually released over the following months when butter production declines. However, their increase in exports of SMP and whey products may mean the U.S. is losing some north African sales.

WMP is by far the largest volume product in international trade and, although the U.S. is a virtual non-participant in that category, increased export volumes of WMP may indirectly benefit U.S. exporters by creating shortages in supplies of other products, and decreased exports may have the opposite effect. China's imports of SMP and WMP have increased by vast amounts over the past three years. NZX reports Fonterra's share of that increase exceeds 80% of the total, but the year-to-year increase appears to be falling. Total WMP exports from New Zealand for the January through August period rose from about 70 million tons in 2009 to 230 million tons this year. Exports of anhydrous milkfat fell from 110 million tons to 95 million tons over that same period.

DMI's Innovation Center for Dairy a year or two ago adopted a plan to support the U.S. dairy industry's ascent to a more prominent and permanent position in international dairy trade. A key pre-condition for that plan's success was to first stabilize the domestic side of the industry by, among other things, increasing price transparency, reducing price volatility, and protecting producer gross revenue. Unfortunately, nothing has been accomplished on these three important issues (although a lot of ideas are being reviewed and debated). Regardless, producers have been told by ICD's consultants the industry is already beyond the "tipping point" of no return on the road to ICD's lofty goal, and they must continue to produce milk for the export market, regardless of the effect on prices.

Fonterra's global auction continues to attract interest. Last week's results summary reported the number of qualified bidders has risen to 417. There were 155 active bidders; 133 wound up with some product. Winning prices for milk powders in the auction were mixed. The weighted average price for whole milk powder rose by \$.014, to \$1.517 per lb. The weighted average price for skim milk powder fell by \$.097, to \$1.465 per lb. The

weighted average price for anhydrous milkfat fell by \$.229, to \$1.974 per lb. Prices for milk protein concentrate-70 rose by \$.194, to \$3.035 per lb. Prices for cheddar cheese for further processing were about unchanged at \$1.844 per lb.

A month or so ago, Fonterra and others down there said they was believed that auction prices were at or approaching their seasonal lows. Let's hope last week's prices were, in fact, the season's lows. Last week's results saw a net price swing between the WMP and SMP of \$.111 per lb, with SMP now about \$.05 per lb below WMP. How low are these prices? The weighted average winning price for AMF was 41% lower than February's high, and is at its lowest point in a year and a half. The average price for WMP was 32% lower than the year's high, about equal to where it was a year ago. The average price for SMP is 41% lower than the year's high, slightly higher than where it was a year ago. Dairy America will be offering SMP in next week's auction. For legal reasons, they disclose the volume available only to qualified bidders. It is to be seen whether their volumes and prices will be promptly reported, as Fonterra has previously said. DA, at least for the present, will have contract 1 all to themselves. Contract 1 is the delivery month immediately following the bidding month; in this case October's winners will take delivery in November. The original contract 1, 2, and 3, for Fonterra, have been changed to number 2, 3, and 4, and continue to cover seven delivery months; in this case, October's winners will take delivery from December through June.

CME's cash and futures markets have followed a similar recent pattern: in July the Class III milk futures prices for October was \$2.13 per cwt higher than the current price for October; butter futures were \$.32 per lb higher than the current October price; cheese futures were \$.219 per lb higher than current October price. What's next? According to virtually every dairy economist who has weighed in on the matter, manufacturers, processors, exporters, and especially milk producers should expect to see continuing price volatility caused by the same combination of predictable and unforeseen events that affect the supply and demand of fluid milk and basic dairy products.

GUEST COLUMN: ADDITIONAL THOUGHTS ON U.S. FLUID MILK CONSUMPTION: *(By Thomas Gallagher, CEO, Dairy Management, Inc.)* The September 16, 2011, edition of your *MPC Friday Report* on milk sales caught my attention as it contains several important points that all farmers should understand. I'd like to add three thoughts to the conversation:

1. Milk sales analysis usually includes a statement to the effect that other beverages have "stolen our share" of stomach. The reality is, no one stole our share of stomach – we gave it away. Experience shows, again and again, if we give consumers what they want, where and how they want it, milk sales will increase. Nowhere is this more obvious than in schools; just think about how the competitive beverage set looks next to our cardboard containers. Innovation is sorely lacking.
2. Milk at retail, sold in gallons and half gallons – representing 78% of all milk sold – is a commodity, and as such is very responsive to the huge price swings we experience. This dynamic requires a strategy that brings value back to the category with brands developing strong identities and innovation. Generic groups, meanwhile, should support brand marketers by providing pre-competitive information and research that supports new claims and consumer insights, rather than feed the commodity mindset that is unintentionally created by generic advertising.
3. The point about children and the good work of the Dairy Council of California is important. The National Dairy Council's Fuel Up to Play 60 program to educate youth and increase dairy sales is in more than 70,000 schools from coast to coast, reaching 36 million students. Partners in this effort include the National Football League, USDA, every significant health organization in the United States, and processors/manufacturers. In the end, however, product experience for children in school when they are making the choice on what to eat and drink, trumps everything. Schools may represent only 7% of current consumption, but the experiences these children have affects 100% of future consumption.

The milk industry cannot continue to look outside itself to blame others or find solutions to the problems we face. Milk processors, along with generic groups such as Dairy Management Inc. and others, must make fundamental changes before we give up even more ground.