



Milk Producers Council

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FROM: John Kaczor

“DISAPPOINTING” IS A HUGE UNDERSTATEMENT IN DESCRIBING THIS WEEK’S ANNOUNCEMENT BY CDFA: *(By Rob Vandenheuvel)* This week, the California Department of Food and Agriculture (CDFA) announced the results from their May 31/June 1 hearing on changes to the Class 4b pricing formula (the minimum price that must be paid for the milk purchased by the State’s cheese manufacturers).

To say the results were “disappointing” doesn’t begin to capture the emotion felt on the producer side of the industry. The table below shows the difference between our current Class 4b formula and the new formula that will be in effect on August 1st. As you can see, the difference ranges from \$0.00 - \$0.10 per hundredweight, depending on the current market value of dry whey.

Dry Whey Price/lb.	CURRENT Dry Whey Factor (per cwt)	NEW Dry Whey Factor, eff. 8/1/12 (per cwt)	Difference
\$0.0000 - \$0.2499	\$0.2500	\$0.2500	\$0.0000
\$0.2500 - \$0.2999	\$0.3000	\$0.3125	\$0.0125
\$0.3000 - \$0.3499	\$0.3500	\$0.3750	\$0.0250
\$0.3500 - \$0.3999	\$0.4000	\$0.4375	\$0.0375
\$0.4000 - \$0.4499	\$0.4500	\$0.5000	\$0.0500
\$0.4500 - \$0.4999	\$0.5000	\$0.5625	\$0.0625
\$0.5000 - \$0.5499	\$0.5500	\$0.6250	\$0.0750
\$0.5500 - \$0.5999	\$0.6000	\$0.6875	\$0.0875
\$0.6000 -	\$0.6500	\$0.7500	\$0.1000

Looking at how this sliding scale would apply today, the current market value for dry whey is approximately \$0.49/lb. Hypothetically, if that were to be the market value of dry whey for the month of August 2012, the new formula would add \$0.0625 per hundredweight to what the Class 4b price would have been under the current formula. What does that mean to your overall pay price? **Class 4b has accounted for approximately 40% of the milk in California’s “pool,” so that \$0.0625 increase in the Class 4b price would equate to an increase of about \$0.025 per hundredweight in your overall pay price.**

To understand why this decision was so frustrating, you have to look at why producers requested the hearing in the first place. California law places the responsibility of establishing minimum prices for each of the five classes of milk on the Secretary of Agriculture. While California law gives the Secretary broad latitude in *how* he or she determines or calculates a price, the law is very specific that whatever price is ultimately determined, it **shall be** in a “reasonable and sound economic relationship” with what comparable milk is worth around the country. (Section 62062 of the Food and Agricultural Code).

So with this clear legal mandate in mind, producers requested that CDFA modify the Class 4b formula so that it more closely followed what comparable milk (milk sold to cheese plants) was worth around the country. Logically, producers pointed to the Federal Order Class III price, which is the minimum price paid by cheese manufacturers regulated under Federal Milk Marketing Orders. In 2010, the California Class 4b price averaged **\$1.24 per hundredweight below** the Federal Order Class III price. In 2011, that gap rose to **\$2.00 per hundredweight**. And in the first six months of 2012, the average difference has been **\$2.08 per hundredweight**. These differences equate to a **discount of hundreds of millions of dollars** for California’s cheese manufacturers. With these staggering numbers in mind, producers requested a change to the Class 4b formula in order to get it

more closely aligned with the Federal Order Class III price.

After two days of testimony and ample evidence presented on the damage being done to California's producers due to this State-sponsored discounting of milk, the end result was an increase of \$0.00-\$0.10 per hundredweight, depending on the market value of dry whey. **If this new "sliding scale" had been in place for the first six months of 2012, it would have shrunk the gap between California's Class 4b price and the Federal Order Class III price by \$0.08 per hundredweight (from \$2.08/cwt to \$2.00/cwt).** So yeah, "disappointing" may be a bit of an understatement.

Milk Producers Council worked closely with a coalition of dairy organizations for this hearing. That coalition, which represents about 80% of the milk produced in California, consists of California Dairies, Inc., Dairy Farmers of America, Land O'Lakes, Security Milk Producers Association, California Dairy Campaign, Alliance of Western Milk Producers, and MPC. In the coming days and weeks, our coalition will be evaluating this hearing decision and determining the best path forward for the dairy families we represent. So stay tuned...

MPC FRIDAY MARKET UPDATE

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CHEESE MARKET COMMENTS: The weather continues to be hot and dry in the Midwestern region of the country while fair amounts of rain has been falling along the eastern seaboard, in Florida, and along the southern most parts of the country. The latest forecasts for crop yields are dismal, and futures prices continue to climb. The Midwestern drought is the most severe in fifty-five years. Cheese manufacturers' and buyers' concerns about possible sharply lower supplies of milk later this year appear to be fueling current pricing on the CME. While trading was light again this week, prices for both styles of cheese rose and got realigned prior to yesterday's report on June milk production, and were unchanged after its release. The weekly average prices for both styles ended the week above \$1.70 per lb and some analysts are predicting much higher prices later this year. However, today's report that American cheese in cold storage at the end of June was 10 million lbs higher than the previous month, and American cheese stocks were 25 million lbs higher, in a month with cheese production was falling, makes one wonder about the direction of future prices. Cheese production is trending lower as milk availability falls and becomes less predictable. Plant efficiencies and production planning are consequently affected by variations in raw product supply. For reasons unknown, *DMN* says they see relatively little interest when the opportunity arises for building inventories for other than aging purposes. Cheese sales have been holding up fairly well but industry participants are concerned about consumer reaction to expected inevitable higher prices. Class III milk futures for September-January rose by an average \$.37 per cwt. Prices for September-November are now above \$19 per cwt. Cheese futures rose by just under \$.04 per lb, with the October's \$1.889 being the current high for the year.

BUTTER MARKET COMMENTS: Butter production continues to trend downward. The milk and cream supply is falling while the need for cream for usages other than butter production is seasonally strong. *DMN* says some plants are having to tap into their stocks to fill current orders. Retail sales have been good, and food service operations, principally those associated with vacation sites, continue to be heavy buyers. Today's report on the amount of butterfat products in cold storage reinforced the recent price increases as stocks at the end of June were 19 million lbs lower than the previous month. Prices rose again this week on the CME, mostly from bidders. The outlook for continuing increases appears to be very good. Butter futures prices rose by an average of \$.04 per lb this week, reaching a high of \$1.67 per lb for most of the months on the board.

POWDER MARKET COMMENTS: Prices for nonfat dry milk continue to move up this week – on the CME and throughout the country, according to *DMN*. CME Grade A NFDM increased 9.5 cents per lb, to \$1.36, and extra grade increased 5.5 cents, to \$1.25 per lb. Full range and “mostly” prices also were sharply higher this week, reflecting higher usage from cheese plants and other dairy usages, and buyer concerns about future market conditions. The “mostly” prices in the central and eastern regions range from \$1.23 to \$1.28 per lb and from \$1.19 to \$1.27 per lb in the western region. Prices reported for shipments made last week were steady to lower with somewhat larger volumes than the very low shipments the week before. The AMS price was about unchanged. The California plant average fell by about 4 cents. They currently are about equal. Production has slowed, reflecting the reduced volumes of milk which, in turn, provides a firm undertone to the market. With the availability of cream much tighter than earlier in the year, buttermilk powder production has slumped just as demand for the product is increasing. *DMN* says buyers from as far away as Central and South America are among those looking for low cost alternatives to nonfat dry milk. They may be too late.

WHEY PRODUCTS MARKET COMMENTS: The overall market for dry whey continues to look very good. Domestic demand is steady to strong and exports continue to pull about one half of all that is produced. Prices, while mostly moving sideways, appear to be firmly seated in part because of concern about future product availability and/or higher prices. Lower production is anticipated because of lower cheese production as well as from a continuing shift to production of more concentrated whey products. Dry whey supplies are considered to be relatively tight. Prices for WPC-34 are mixed, as demand for usage in human food products remains steady to strong, but is weaker for usage in animal feeds. *DMN* says current prices for some concentrated WPC are comparable to dry WPC prices, which helps some manufacturers to control inventories. Dry whey futures again showed little movement this week. Prices for the August-January period were slightly up or down from month to month. The high price for the period is November’s \$.5975 per lb.

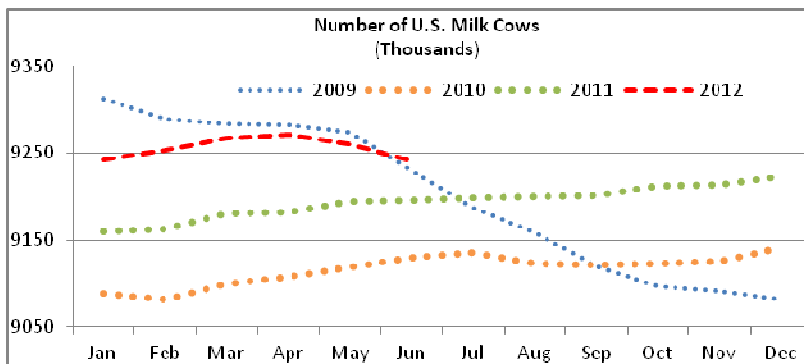
FRED DOUMA’S PRICE PROJECTIONS...

July 20 Est:	Quota cwt. \$16.06	Overbase cwt. \$14.37	Cls. 4a cwt. \$13.43	Cls. 4b cwt. \$15.18
Last Week:	Quota cwt. \$15.97	Overbase cwt. \$14.28	Cls. 4a cwt. \$13.36	Cls. 4b cwt. \$15.04

MILK PRODUCTION IN JUNE CONTINUES TO SLOW: (by *J. Kaczor*) NASS this week published their revised estimates of 2012’s first quarter milk production, along with some revisions for April and May and their initial estimates for June. The number of milk cows averaged 86 thousand more in the first quarter than last year, and produced 2.6 billion lbs more milk, an increase of 5.3%. Preliminary figures for the second quarter show 66 thousand more cows than a year earlier and only 1.0 billion lbs more milk, an increase of 2.0%. For the month of June, NASS now reports the number of milk cows over a year ago has dropped to 45,000 and milk production was only 152 million lbs (+0.9%) more than last year, the lowest increase since last July, which was the low point for that year. Monthly production per cow was 8 lbs higher than a year ago.

Production per cow this year peaked in April at 61.9 lbs per day, a month earlier than normal, is falling, and should continue to fall to its lowest annual level by October. As very favorable weather changed to hot and dry conditions in May and June, and the outlook for feed costs changed from disappointing to almost intolerable, producers have been trimming herds and cutting rations. Production per cow this June dropped by more than 1.1 lbs per day from May’s level, one of the highest month-to-month changes ever reported.

After the revisions, NASS now shows there were 30 thousand fewer milk cows in the U.S. in June than two months earlier. Before the revisions NASS reported the number of U.S. milk cows (last month, for May) had climbed back to where it was three years ago. After the revisions and the passage of one more month a different picture appears. The chart shown here is updated from the one reported last month. Because of the astounding number of cows



taken from production in 2009, mostly from CWT's herd removal programs that year (168,000 milk cows vanished between May and October in 2009) any comparison to 2009 with respect to number of milk cows from here on is irrelevant. Instead, under the current set of industry conditions, as the chart indicates, the most relevant question is whether producers over the next few months will continue down-sizing, or shutting down completely, to the point where this year's herd will dip below last year's. It would take a further drop of only 29,000 cows over the next four months to get there. This week's Outlook update from USDA's Economic Research Service projects milk cow numbers in 2013 to be below both 2011 and 2012 although because of expected continuing increases in per cow output milk production for 2012 and 2013 is projected to be somewhat higher than 2011. The projection for fewer cows is attributed solely to "the prospect of rising feed prices...for the balance of 2012 and into 2013." Milk prices, however, for 2012 and 2013 are projected to be lower than current levels.

The national pattern for milk production continues to reflect concentration of milk production in a relatively few states. The top ten milk producing states are spread throughout the country; five of them are in the west or southwestern region, three are in the Midwest and two are in the eastern region. Somewhat surprising, California is reported to have 1,000 more milk cows in June than in May, although the monthly comparisons to last year (+14,000) continue to edge lower. California also was one of the four top 23 states showing lower production per cow in June than a year ago; total production was only 10 million lbs higher than last June, an increase of 0.3%.

THE INTERNATIONAL AUCTION: REFLECTING CHANGING SUPPLY AND DEMAND? *(by J. Kaczor)* Even as the total volume of dairy products sold on the twice monthly internet auctions grows larger as additional sellers sign on and the heavy milk production season down under comes into play, it is becoming more difficult to consider the winning prices representative of true product values or as valid indicators of current and future changes in supply and demand for the products offered. That is not to say the transactions are not real or the bidding is not at arm's length. There are other reasons for calling into question at least some of the results.

Volatility of prices is what first comes to mind. U.S. milk producers have been reminded far too many times for them to forget that price stability for extended periods of time is what international buyers not only want, it is what they demand to have in order to even consider a bid by a potential supplier. And yet, we have seen winning prices for major dairy commodities in the auctions bounce around in seemingly erratic fashion apparently to the total satisfaction of the winning bidders. Was the need for stable price offerings fiction or fact? If it was factual, why is it no longer the case for the approximately 40% of Fonterra's products sold on the auction?

Inexplicable differences in prices for the same fungible product offered by internationally known and experienced sellers raises another question about whether the auction determines true product values in a fair and open fashion. That \$.45 per lb difference in winning prices for medium heat skim milk powder in the June 5 auction is the most obvious example of inexplicable differences. Its correction over the following two auctions through inaction by bidders for Fonterra's medium heat SMP only raises more questions about exactly what happened, and how it happened.

Another oddity occurred this week, a repeat of what happened last year. Winning prices from one auction to the next for Fonterra's SMP swung from about \$.06 per lb lower than Fonterra's whole milk powder to about \$.12 per lb higher than Fonterra's WMP. That happened by SMP increasing in price and WMP decreasing in price. Did those values really change so markedly and suddenly? Did bidders believe there is a looming shortage of SMP and a looming surplus of WMP? Probably not. It looks more like some kind of international gamesmanship, something akin to flash mobs but conducted through key strokes on a computer instead of going somewhere or doing something.

Ah well. So long as NZX, New Zealand's major commodity trading house considers the winning prices for Fonterra's three major products in the auctions as a satisfactory basis for cash-settling futures contracts for those products, why should anyone care about the results? For the record, this week's auction reported 692 qualified bidders, 155 of which participated and 114 winning some strangely priced products for later delivery. The weighted average winning price (total prices bid divided by total volume sold) was \$1.2501 per lb, down by \$.0141 from the previous auction. At least it is fun to watch.