Milk Producers Council

5370 SCHAEFER AVE. SUITE A - CHINO, CA 91710 - (909) 628-6018 - Fax (909) 591-7328
E-mail: mpc@milkproducers.org   Website: www.MilkProducersCouncil.org

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

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks	+ *$.0825*	$1.2400
Barrels	+ *$.0825*	$1.2300

Weekly Average

Blocks	+ *$.0530*	$1.2065
Barrels	+ *$.0660*	$1.1990

CHICAGO AA BUTTER

Weekly Change	*N.C.*	$1.1025
Weekly Average	+*$.0040*	$1.1025

DRY WHEY

WEST MSTLY AVG	w/e 02/13/09	$.1525
NASS	w/e 02/07/09	$.1533

NON-FAT DRY MILK
Week Ending 2/06 & 2/07

Calif. Plants	$.8098	19,016,524
NASS Plants	$.8207	25,449,046

CHEESE MARKET COMMENTS: Prices for blocks and barrels on the CME once again this week showed very nice increases despite the growing amount of cheese production in the U.S. NASS reports that each of the last three months (through December) represented all-time records on a per-day basis for production of all cheeses – and near record production for cheddar cheese. *Dairy Market News* analysts didn't provide much to explain what is happening, and the experts who wrestle in the futures market appear to be skeptical; Class III milk futures have been slightly higher than the spot cheese prices, and haven't responded to the current heavy trading activity on the floor of the Exchange. Could they possibly be waiting for evidence that the increase in milk production will continue to decrease? We could find out on the 19th when NASS releases its estimates for January.

BUTTER MARKET COMMENTS: Very little positive news this week about the butter market, and very little activity on the CME. Butter prices were stuck at $1.1025 per lb even as more California butter went into CCC's warehouses. DMN passes along comments from the trade that retail sales appear to be steady and more, but restaurant business is slow. According to a report released Wednesday, export volume tanked in December, and last week we learned that December's butter production was the 2nd highest ever. Nonetheless, cash-settled futures prices for butter continue to show steady monthly increases.

POWDER MARKET COMMENTS: The **average** of the western region's "mostly" price this week for nfdm dipped below the U.S. support price of $.80 per lb, with some product selling for as low as $.77 per lb. Many more offerings are being made to the CCC by California plants. It appears that, despite the sale of close to 170 million lbs of nonfat dry milk to the CCC by California plants since the first week in October, their unsold inventory has actually grown somewhat. It makes one wonder what has Fonterra done for us lately, and what are they doing to us now. (The average price for nfdm exports in December fell by more than $.48 per lb, to $1.08 per lb, which begs the question how could it have been so high for so long while the California average price was $.40 to $.50 per lb lower.)

WHEY MARKET COMMENTS: The western "mostly" average price again edged upward, but DMN does not offer much in the way of market analysis to explain that relative strength. After all, the price is still below what most understand to be the cost of producing the product. DMN does report that buyers of commodity quality whey protein concentrate are beginning to push back at what has been a gradually strengthening price trend. Many believe its only a matter of time before prices for dry whey, dry buttermilk, and nonfat dry milk adjust up to levels where their protein content is roughly equivalent to the protein content of WPC – or the opposite could happen.

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FRED DOUMA'S PRICE PROJECTIONS…

Feb 13 Est:	**Quota cwt. $ 11.45**	**Overbase cwt. $ 9.75**	**Cls. 4a cwt. $ 9.40**	**Cls. 4b cwt. $10.00**
Last Week:	**Quota cwt. $ 11.26**	**Overbase cwt. $ 9.56**	**Cls. 4a cwt. $ 9.51**	**Cls. 4b cwt. $ 9.61**

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2008'S EXPORTS HELPED SUPPORT MILK PRICES; WHAT'S UP WITH 2009? *(By J. Kaczor)* A little more than a year ago, almost all forecasters included heavy exports of major dairy products to be among several things considered necessary to generate the high milk prices that were being projected for the year 2008. The products watched most closely were those used in the formulas for calculating minimum milk prices for federal order areas and California. The products are nonfat dry milk, butter, cheddar cheese, and dry whey. And yes, exports for the first three of these were substantially higher in 2008 than in 2007. Dry whey was the exception, although that volume did increase quite a bit in the 4th quarter of the year. The following table compares the volumes exported for 2007 and 2008, and the percentage of U.S. production those volumes represent. The numbers for volumes represent millions of lbs of product. The volumes for nonfat dry milk include skim milk powder which is considered equivalent to nfdm.

	2007		**2008**	
	Volume	**Pct of Production**	**Volume**	**Pct of Production**
Nonfat Dry Milk	568.6	37.8	862.8	45.6
Butter	72.6	4.7	176.5	10.7
Cheddar Cheese	34.5	1.1	55.5	1.7
Dry Whey	582.7	51.3	443.7	40.8

Clearly, the combination of the **increase in exports,** and the decrease in imports of butter, in the first half of the year helped to clear away products that would have gone into storage: for butter, the additional export of close to one month's worth of production did help to keep prices at fairly high levels for most of the year; for nfdm, the additional export of close to **two month's worth of production** helped to keep the product moving in commercial channels at prices somewhat higher than U.S. support levels through September. Exports of cheddar cheese, and all cheese, never reached a level sufficient to affect domestic prices, and U.S. prices for dry whey weakened early in the year and continued downward over the full twelve months.

The volumes of these products that were exported in the 4th quarter of 2008 may point to what can be expected this year. For nonfat dry milk, 4th quarter volumes represented only 16% of 2008's exports, and *Dairy Market News* reports that current prices f.o.b. docks in competing countries are at or below U.S. support levels; 4th quarter exports of butter represented 12% of the year's total; 4th quarter exports of cheddar cheese represented 14% of the year's total; 4th quarter exports of dry whey represented 41% of the year's total. **The trends for the first three products are now just the opposite of what was foreseen a little more than a year ago.** Changes in currency values, the effect of the global economic crisis, and increasing competition, are contributing factors to the turn-around.

Despite the financial stress of producers throughout the world, DMN reports that Australia's current milk production is running about 2% above the previous year, New Zealand's is running about 8% higher, and Europe's is up about 1 to 2%. **This year's competition for exports presently looks to be fierce**; Fonterra, the world's largest exporter of dairy products, is reported to have "mountains" of **unsold products in storage** (unlike the sizable but much smaller amount of U.S. nonfat dry milk that has been **sold** to the CCC) and has been using its controversial "**globalDairyTrade" program** to determine current prices for whole milk powder (and, indirectly, prices for other major exportable products). And the EU has recently reinstated subsidies for exports of butter, powder, and cheese. Ironically, both of these major exporters are expressing concern that USDA may depress prices by activating its Dairy Export Incentive Program (DEIP) for nonfat dry milk, butter, and cheese. **This is why some people (here) are saying the U.S. dairy industry is at a crossroad** – decide to continue to rely on a fickle and treacherous export market to sell otherwise unsaleable products to customers who prefer to deal with others, or decide to curtail production to a level where the U.S. milk supply will readily be used by U.S. consumers. **The good thing about this question is that every single producer has a vote on the matter.**

Next week: a recap of the disappearance of the profits that were made on 2008's exports of nonfat dry milk and dry whey. Last word from NASS on this subject: nothing "of concern to them."

CONTINUING DISCUSSION OVER THE NEED TO ADDRESS MILK PRICE VOLATILITY: *(By Rob Vandenheuvel)* The current issue of *Hoard's Dairymen* (February 10th edition) includes an article written by Peter Vitaliano, Vice President of Economic Policy and Market Research at the National Milk Producers Federation. The article, which included an excellent analysis of the economics of the dairy industry, and how we got to the point we are today, closed with the following paragraph:

> **"U.S. dairy producers must think seriously about developing a substantial, durable, and dependable mechanism to cope with the increased volatility that they will have to live with in the future. Prices and market forces will always be the principal mechanisms for maintaining supply-demand balance in the U.S. dairy industry. But, by themselves, these forces will reach a new level of boom and bust, and a new level of destructiveness during the bust phases because of how the industry is changing."** *(Reprinted with permission of Hoard's Dairyman magazine – February 10, 2009)*

Peter is absolutely right-on. The boom-bust cycles that this industry has been subjected to in recent times are extremely destructive (and quite frankly, unsustainable). Not only are the bust periods of low prices obviously destructive to producers, but the boom periods of high prices hurt us too, turning some of our customers away from dairy products. We would be much better off as an industry if we had a more steady balance between supply and demand.

You've heard it many times in this newsletter, but **it simply doesn't need to be like this**. Our industry needs a tool built into the system to give dairies a financial incentive to manage their production. The Growth Management Plan (GMP), which will be discussed next week at an industry forum in Modesto hosted by Western United Dairymen, would create this financial incentive. The program would not stop growth, but instead would allow us to grow in a smarter, more managed way. For those of you who may not have heard about the GMP, please visit our website for more details: http://www.milkproducerscouncil.org/GMP.htm.

CWT ANNOUNCES ADJUSTMENT TO THE PROGRAM: *(By Rob Vandenheuvel)* This week, Cooperatives Working Together (CWT) announced that their members had agreed to fund the program for two years (2009 and 2010), provided that the program gets at least 67% national participation at $0.10 per cwt. In addition, CWT noted that they had secured a line of credit tied to the amount of funding their members are committing to invest during these two years.

In the same press release, CWT also announced two major changes to the policies surround their Herd Retirement Program (HRP). The first change is that dairies that participated in past HRPs will be allowed to participate in the next HRP that CWT conducts. The second – and most significant – change is that all dairies whose bids are accepted in future HRPs "will agree and warrant to cease dairy production for one year. This warranty will apply to both the producer and his/her dairy facility."

This one-year prohibition for participating dairies will undoubtedly be praised by some in the industry, while scorned by others. It certainly changes the dynamics of the program, and will be an additional consideration for dairymen interested in participating. Regardless of the criticism/praise CWT will receive for this recent decision, I'm encouraged that they continue to re-evaluate the program as they attempt to improve its effectiveness, and only time will tell if this latest change will produce improved results for the program. **The fact is that absent a program like the Growth Management Plan, CWT is the only real tool we have to bring our milk supply closer to demand**. So while it's perfectly healthy to debate the merits/flaws of the CWT program, in the end, it is still the only real tool we currently have at our disposal to combat these bargain-basement milk prices.

DAIRIES CONTINUE TO EVALUATE MILC OPTIONS: *(By Rob Vandenheuvel)* With the recent bump-up in cheese prices on the CME, the forecasts for monthly MILC payments continues to change. The latest estimates from NMPF, Cornell University and the University of Wisconsin – all of which are updated weekly – indicate that March will be the highest single-month payment, which is important for large dairies that will only receive one month worth of payments (since the program only issues a payment on 2.985 million lbs of milk).

For dairies that wish to select February as their start month, your paperwork must be filed with your local FSA office by the end of February. For those who wish to select March, you have until the end of March to select your payment. The Boston Class I price for March – which drives the MILC payments – will be announced in less than two weeks, so we will have a better estimate of the March MILC payment at that time.

AN UPDATE ON THE EPCRA REPORTING FOR DAIRIES: *(By Rob Vandenheuvel)* As you may recall, last month we passed along a recommendation from the National Milk Producers Federation (NMPF) that dairies with more than 700 mature cows should comply with the Emergency Planning and Community Right-to-Know Act (EPCRA) reporting requirements. These requirements stem from an EPA ruling in December 2008 which exempted smaller dairies from reporting, but continued to require larger facilities to report.

At that time, NMPF was recommending that dairies with more than 700 cows initiate compliance with EPCRA by calling both your state and local emergency response committees, and following up with a written report in February. For those that still need to comply with this EPA regulation, CARES has put together some information, including a script and contact numbers to use for your initial phone call, an ammonia emission estimator, and a template to fill out for the written follow-up report. All this material can be found at http://www.milkproducerscouncil.org/epcra.htm. If you have any questions, please contact the MPC office at (909) 628-6018.

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