

Milk Producers Council

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TO: DIRECTORS & MEMBERS

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MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks +\$.0125 \$1.5050
Barrels -\$.0275 \$1.4450

CHICAGO AA BUTTER

Weekly Change +\$.0125 \$1.3400
Weekly Average +\$.0110 \$1.3420

NON-FAT DRY MILK

Week Ending 2/05 & 2/06

Calif. Plants \$1.1088 5,006,607
NASS Plants \$1.1448 10,759,162

Weekly Average

Blocks N. C. \$1.4990
Barrels -\$.0090 \$1.4650

DRY WHEY

WEST MSTLY AVG w/e 2/05/10 \$1.4050
NASS w/e 2/06/10 \$1.3900

CHEESE MARKET COMMENTS: Dairy Market News (DMN) reports that cheese plants are beginning to attract milk away from drying plants and cheese sales continue to look good although not keeping pace with the amount produced. Activity on the CME this week was again on the light side. Prices for barrels lost ground on Thursday and Friday while blocks held steady. Sales are expected to pick up as the Easter season approaches. The market appears to be satisfied with prices ranging from the low \$1.40's to the low \$1.50's per lb – until something happens to change the minds of the traders. One thing to consider is that end of month inventories held by manufacturers of natural cheese have been at twenty-five year highs since April.

BUTTER MARKET COMMENTS: This week was notable in that there were two days with no butter sales. DMN reports that they see a shift to production of anhydrous milkfat and less butter – understood to be a response to or anticipation of orders for the export market. The Fonterra internet auction is providing a “heads up” on AMF prices seven months in advance, which could be helping sellers and buyers to make intelligent guesses on future market interest. Sales are said to be holding up nicely.

POWDER MARKET COMMENTS: Because of recent stunning sales surprises, the market for NFDMM is unsettled. Production continues to be fairly strong, but buyers are reluctant to commit themselves until the spot market prices, which in the West are now at about \$1.05 per lb, stabilize. Both major price series for sales made last week increased, but DMN explains that the increases resulted from indexing old prices and volumes with current prices and volumes. The full price range for the West this week bottomed out at \$1.00 per lb. Some inquiries are reported to be coming in from export interests, and why not, at these prices? Prices for dry buttermilk have been pulled down by what's happening with nonfat powders, but prices for whole milk powder, according to DMN, remain in the \$1.30 to \$1.50 per lb range. See corrected comments from last week's recap on NFDMM inventories, printed below.

WHEY PRODUCTS MARKET COMMENTS: The “mostly” price in the West for dry whey remained unchanged this week and the NASS average for sales made last week again advanced. Production is increasing in pace with cheese production, and sales are said to be continuing strong. Some buyers express concern about prices, but DMN reports that product is clearing readily. Correction to last week's comment on dry whey futures prices: futures prices on the CME for April and May settlement are more than 25% lower than the current market; as of yesterday, the May price was \$.2825 per lb. Uncertainty? Future volumes?

FRED DOUMA'S PRICE PROJECTIONS...

Feb 12 Est:	Quota cwt. \$ 14.95	Overbase cwt. \$13.25	Cls. 4a cwt. \$12.69	Cls. 4b cwt. \$13.27
Last week:	Quota cwt. \$ 14.89	Overbase cwt. \$13.20	Cls. 4a cwt. \$12.61	Cls. 4b cwt. \$13.21

CORRECTION TO LAST WEEK'S COMMENTS ON POWDER INVENTORIES: (By J. Kaczor) In last week's article discussing the balance between December's milk production and usage, some good data was badly used in recapping the status for nonfat powder, resulting in a confusing and incorrect assessment of the situation. Following is a corrected, and fuller, discussion of the subject.

Short term, sales of NFDM are not keeping up with production. Longer term, and looking back, with help from heavy sales to the CCC from January through May and the 35 million lb boost in exports (from DEIP subsidies) in September and October, the amount of NFDM in storage at the end of October was 111 million lbs lower than it was ten months earlier. Since then, despite substantial decreases in production in November and December (compared to the same months a year earlier), the amount in storage at the end of December rose 41 million lbs, but was still the sixth lowest end-of-month inventory in the past twenty-six months. Considering that fact, the optimistic forecasts for lower milk production and increased exports of NFDM this year, and the average price for sales made the prior four weeks (above \$1.29 per lb), it is puzzling why California plants sold the equivalent of 760 truck loads of powder for \$1.054 per lb in a single week in mid-January, and almost 400 truck loads for a penny more per lb the week following?

One market analyst called the single week sale "a shocker," looking like "a dumping of excess inventories." How much did that dumping cost? For the plants, not even a thin dime, because in California the change in price received by powder manufacturers becomes the change in price they pay for the milk that was used to make the powder – and they shift the cost for storage to the buyer. Someone once said a good system pays those who play the system. This is one of those.

REGIONAL DIFFERENCES LEAD PRODUCERS IN OPPOSITE DIRECTIONS: (By J. Kaczor) USDA's monthly reports on milk production in the U.S. since January 2009 have been tracking the development of two distinct regional patterns: contraction by major dairy states in the West and expansion by major dairy states in the Mid-west. The two are not equal in milk output; Western dairies are larger and their decreases have been greater than the Mid-western increases. Reasons for these differences were discussed by Brian Gould, associate professor, Department of Agricultural and Applied Economics, University of Wisconsin-Madison, in the recently published *Status of Wisconsin Agriculture 2010*. [Wisconsin's profile for dairy facilities is not too different from five states surrounding it so much of the comparison made applies also to them.]

Gould found that milk producers in Wisconsin [and in the other states] had lower costs and better real or perceived opportunities than California and New Mexico [and Arizona, Idaho, and Oklahoma], and higher mailbox prices. In a direct comparison to California, Gould found gross margins for Wisconsin producers to be significantly higher than gross margins for California producers from the second half of 2007 to the present. The cost differences are well known: most dairies in the West have to purchase feed and hire labor; most Mid-western dairies do not. This cost disadvantage is somewhat offset by the benefit from large scale economies for Western dairies whose operations may be more automated and whose fixed costs per cwt of milk may be lower. On the other hand, many operators of all sizes in all regions may have taken on significant debt from purchases of plant and equipment in 2008 and most have incurred a loss of equity through falling values of land and livestock.

Gould's discussion of opportunities focused on the importance of the growth in national cheese consumption, and the differences in cheese production trends in California and Wisconsin. Competitive prices paid by cheese plants in Wisconsin contribute substantially to the higher revenue per cwt of milk received by milk producers. He sums it up this way: *"When the dust settles from the 2009 dairy crisis, Wisconsin will be in an improved position compared to other major cheese-producing states....The implication for Wisconsin is obvious. Our milk is being used to support a segment of the dairy industry that continues to grow. The vitality of the state's cheese industry is evidenced by the continued growth in the face of difficult pricing conditions."* Apparently, many, even most, producers in this six-state area agree, and plan to maintain production or continue to expand through 2010.

Gould's summation is a fair statement, as far as it goes. Milk producers in the Mid-west definitely do have plants

who want more milk to produce products that have a ready market. But in his direct comparison to California, Gould may have overlooked the closure of a major cheese plant in California which accounts for much if not all of the reduction in the state's cheese output over the past eighteen months. The major expansion of Southwest's cheese plant this year, Hilmar's Texas plant last year, Tillamook two years ago, and others announced or in operation in other Western states, creating opportunities for producers in those areas, also were not evaluated with respect to their contributions to producer optimism, which may be similar to Wisconsin's. As to the observation about the continuing growth in cheese demand, it may be worth considering that the cheese market is national, current sales are not keeping up with production, and inventories have been at twenty-five year highs since April.

Much of a second discussion in the *Status* report, on Wisconsin's farm-level financial situation by Paul Dietmann, Director, Bureau of Farm and Rural Services, Wisconsin Department of Agriculture, Trade and Consumer Services, could also apply to California. Referring to the pressure on lenders to build larger loan reserves while rescheduling or restructuring existing loans designed to at least match a producer's net income while the producer may be dealing with debt from "unwilling lenders" such as suppliers and service providers, Dietmann calls the situation "*precarious and unsustainable.*" Risks to the financial system supporting milk producers include possible price weakness or price volatility, further declines in land values, loss of lender confidence, failure of major lenders, and failure of farm suppliers and service providers.

Out of this mixed picture of optimism for the future and fear that prices may not reach levels sufficient to enable continuing debt service comes a key condition for recovery: a substantial turn-around in exports of dairy products from the U.S. Seeds for some improvement in exports are evident, but the apparent unanimous assumption that U.S. plants will certainly regain much of the international sales they were given in 2007 but lost in 2008 is somewhat tenuous. The global recession appears to be nearing its end. Some countries are already on sound footing. China's continuing problems with unsafe production practices means their massive imports of whole milk powder from New Zealand are expected to continue which should tighten the supply side for other importers. Milk production in Australia is 5% below last year's level, and New Zealand's is less than expected. The U.S. currency could strengthen but not likely soon, and Europe's financial situation appears to be as dim as it is in the U.S. Further support for the idea that export demand could improve are the current low prices that are now available which should cause buyers to emerge from their recesses. On the other hand, European stocks of butterfat and skim milk powder are huge, and are considered to be a threat to sustainable price increases for those who want to sell products at prices that are worthwhile, and U.S. milk prices are likely to continue to be volatile and without transparency, which means U.S. exporters do not have the stable foundation needed to aggressively compete.

Gould's reference above to Wisconsin producers supporting a growing segment of the industry while California flounders with growing inventories of nonfat dry milk, is cutting. Our cheese industry appears to be stagnant – not necessarily in trouble, but not really able to grow because of the growth everywhere else. I imagine Wisconsin's advice to California, if it were to be given, might be to eliminate another 80 thousand cows and close or convert two powder plants. Imagine that.