



Milk Producers Council

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MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks - \$.3300 \$1.6850
Barrels - \$.2650 \$1.7000

CHICAGO AA BUTTER

Weekly Change - \$.0500 \$2.0700
Weekly Average - \$.0110 \$2.1090

NON-FAT DRY MILK

Week Ending 3/11 & 3/12

Calif. Plants \$1.4009 15,182,731
NASS Plants \$1.4766 18,223,200

Weekly Average

Blocks - \$.2560 \$1.7585
Barrels - \$.1935 \$1.7805

DRY WHEY

WEST MSTLY AVG w/e 03/18/11 \$.4850
NASS w/e 03/12/11 \$.4628

CHEESE MARKET COMMENTS: Cheese prices whipsawed this week. Just as the NASS weekly average prices finally got to within pennies per lb of the CME spot prices, traders on the Exchange decided to change the course. The spot and market prices had been well above CME's cheddar cheese futures prices as well as the imputed cheese price reflected by CME's class III milk futures prices. The difference in each case was about \$.30 per lb of cheese. Trading by a good number of sellers and buyers was heavy this week; 39 carloads traded hands; blocks lost 34 cents per lb and barrels lost 26.5 cents. The heaviest losses came early in the week; Friday saw barrels unchanged and blocks off by .75 cents per lb, although 5 carloads of blocks offered at .25 cents below the last trade were left uncovered. Friday's prices now are now in line with the two futures contract prices (cheese and milk) but 27 to 29 cents per lb below last week's prices reported to NASS by manufacturers. This appears to be one of those inevitable market corrections resulting from pressure caused by uneasiness coming from all directions. (An analogy to earthquakes is timely and not inappropriate.) Most of the concern this week was focused on where the prices would finally settle, and it appears that they may be settling where there should be solid support – right where a vast amount of money is sitting. *Dairy Market News* points out that price movements like what happened this week (the amount of change and the abrupt inversion of market prices and price indexes) are not only disheartening and destabilizing (think inventory values) – they also present an opportunity for buyers who had been holding back. Each will act to their own interests.

BUTTER MARKET COMMENTS: Even with today's price drop on the CME (4.75 cents per lb, with 11 carloads traded) the butter market continues to reflect relative confidence and balance. The day's trading ended with two sales to a bidder which brought the price 2 cents above the day's low. Unlike cheese market prices, butter futures prices and butter prices reported to NASS by manufacturers have been close to CME's spot prices. Wholesale and retail prices have been reflecting the market's prices for more than a month without affecting retail or foodservice sales. DMN says "seasonally strong churning schedules are generating fresh stocks for current needs and continued international buyers' interests." Some export orders apparently are continuing to be received from Northwestern Europe, where prices are reported to be about 60 cents per lb higher than current CME prices, and a report from New Zealand says that current milk production is almost completely committed to production of milk powders. Butter production is reported to be following its normal seasonal curve – lower, but still higher than current sales levels – so inventories are expected to continue to rise.

POWDER MARKET COMMENTS: The market for milk powders is beginning to show signs of uncertainty. "Unsettled," says DMN, with some buyers indicating a willingness to postpone purchases until a better indication of what the supply picture will be later this year. Current production is boosted because of the "Spring break" effect, with extra milk being diverted to butter and powder plants, and more is expected to come as milk production approaches its highest output period. Interest by domestic buyers appears to be slowing, although exports continue to run at high volume levels, with prices lagging about 25 cents below prices f.o.b. ports in Europe and Oceania, and 50 cents below the latest global auction price for deliveries in May. Weekly average

prices for last week's shipments of NFDM are reported above; the volumes continue to be higher than average; the prices were mixed. Demand for buttermilk powder continues to be rated fair to good; price ranges for contract and spot sales remain closely aligned with those for nonfat dry milk.

WHEY PRODUCTS MARKET COMMENTS: The markets for dry whey and whey protein concentrates continue to reflect strong demand and steady production. Prices for each are steady to a bit higher. DMN reports that re-sale markets for each product line (broker to broker, or broker to end user) at above market prices are serving as sources for buyers who cannot access a supply directly from normal sources. Some WPC users are said to be considering alternative sources of protein in order to avoid telling their customers they cannot fill their products. More than half of all recent WPC production has been going to other countries. Shouldn't sellers support regular customers instead of chasing after the latest hot export lead? Is this what "consistent supplier" mindset for the export market leads to? Spot loads for dry whey protein products are reported to be hard to find, and prices for all are at the top end of the range. The west's "mostly" price this week (reported above) was unchanged.

FRED DOUMA'S PRICE PROJECTIONS...

Mar 18 Est: **Quota cwt. \$18.92 Overbase cwt. \$17.23 Cls. 4a cwt. \$18.74 Cls. 4b cwt. \$16.88**
Last Week: **Quota cwt. \$19.56 Overbase cwt. \$17.86 Cls. 4a cwt. \$18.80 Cls. 4b cwt. \$18.36**

INITIAL REPORT ON FEBRUARY MILK PRODUCTION LESSENS CONCERN ABOUT POSSIBLE SURPLUS: (by J. Kaczor) USDA's initial estimate of milk production in February is somewhat encouraging in terms of concerns about expected herd expansions in response to rising milk prices. The report shows no change in the number of cows from January's level, and less of an increase in production per cow than happened last February. The total production increase above last February is reported to be 297 million lbs of milk, an increase of 2.0%. The increase in production for the 23 largest milk producing states is reported to be 331 million lbs of milk, an increase of 2.42%. The somewhat modest increase in production per cow could be a weather related result or a more deep seated result from what appears to be a greater proportion of heifers in the herd this year than last.

California was reported to have the same number of cows in February as a month earlier, and 8,000 fewer than last February. Production per cow increased by 20 lbs for the month, which was slightly lower than the increase reported for the other 22 largest producing states. California's milk output was 20 million lbs higher than a year ago, an increase of 0.6%.

PRICES ARE BID LOWER IN THE LATEST GLOBAL AUCTION: (by J. Kaczor) Could things have changed so much in just fourteen days to turn a good news, rising, market into a run for cover? This week's global auction results look like that may have happened, but the reasons for the down turn are not clear. The previous report on the auction focused on how much the prices for the products had increased in the five events since the mid December auction, how high they've gotten relative to their all time records, and how seemingly unaffected they were by global events that were not directly connected to dairy industry affairs. On that last point, there usually are exceptions to general rules about global connections – like when bad situations in the middle east become worse, and when the world's third largest economy suffers through a devastating natural catastrophe – and we may be looking at one of those exceptional results right here.

The table to the right updates the price changes from December's averages and from the previous auction held on March 1st for the spot month and for all volume. All three products lost ground this week,

	Spot Month		All Volume	
	Vs. Dec	Vs. Mar 1	Vs. Dec	Vs. Mar 1
Skim Milk Powder	+\$.389	-\$.128	+\$.382	-\$.073
Whole Milk Powder	+\$.353	-\$.282	+\$.234	-\$.233
Anhydrous Milkfat	+\$.376	-\$.126	+\$.342	-\$.142

with whole milk powder taking the biggest hit, although all are still well above December's levels, where each had leveled out. The spot month prices in this auction (for product to be delivered in May) are \$1.705 per lb for skim milk powder, \$1.967 per lb for whole milk powder, and \$2.789 per lb for AMF. Prices for whole milk powder and AMF for delivery in the six months following May are lower than the spot price month; WMP is down to \$1.76 per lb and AMF is down to \$2.71 per lb for the last three month delivery period. On the other hand, the SMP price rose, to \$1.81 per lb, and is \$.04 per lb higher than WMP at that point. The price inversion for the two milk powders is surprising (different bidders, different needs, perhaps, or different perceptions about future demand from a single major buyer for one of the products?). The sharp drop in the WMP price for deliveries in the September-November period also could be explained by bidders' belief that Fonterra's milk supply will have increased sufficiently by that time to forestall product shortages.

Except for the very sharp drop in cheddar cheese prices on the CME, down to a level where the class III milk and cheese futures prices had been waiting, little in the way of hard news affecting dairy industry developments occurred over the past two weeks. The price weakness in the auction could be a reaction to the troubles mentioned above, although prospective sales, and prices, may just as well have strengthened than weakened because of what has been happening. When reviewing this week's results, it's worth considering two important factors which relate to prices. The first is the belief expressed by notable agricultural economists who recently have said current global demand for major dairy commodities is higher than global supply and is expected to remain so for at least the next two years. The other is that globally traded commodities are subject to price volatility and speculation. The sky is not falling, nor is uncertainty.

FONTERRA PLANS TO ADD PRODUCTS TO THE AUCTION, AND INVITES OTHERS TO SIGN ON: *(by J. Kaczor)* On March 9th Fonterra announced they have been discussing with a number of major international sellers their interest in offering products to be included in the twice monthly auctions. The discussions apparently were sufficiently productive to enable Fonterra to draft a detailed set of rules designed to cover various legal and logistical issues relating to multiple sellers offering like products to common buyers under mostly uniform terms and conditions. The companies Fonterra said they have talked with are Arla Foods (Denmark/Sweden), FrieslandCampina (Netherlands), Murray Goulburn (Australia), California Dairies, Inc., and Dairy America (United States). Fonterra says no company has yet committed to offer products in the auction – comments that have been echoed by at least three of the prospective participants.

In order to sell products in the auction a company must first apply for certification, meet the established criteria, and agree to abide by a common set of rules. Sellers must commit to offer a minimum of 11 million lbs per year of each product they bring to the auction, pay an "establishment fee" of \$100,000 U.S., and pay a transaction fee, based on the amount of product sold per year, which is deducted in due course from the establishment fee.

Fonterra and CRA International, the trading manager, completed a revision to the trading software to accommodate who knows how many more sellers and products. It couldn't have been an easy thing to do; presumably the new system has already been satisfactorily tested and is ready to go. Fonterra has invited all interested parties to comment on the draft rule by the end of March. While no commitments have been made so far, Fonterra appears confident that at least one of the invitees will sign on. Fonterra says they plan to transfer its *globalDairyTrade* assets and infrastructure into a new wholly owned company before the new rules take effect. After making appropriate changes based on comments received, Fonterra indicated the new rules should be ready by late April or May.

Based upon what's said so far, it appears Fonterra may be willing to accept a wider array of products than those offered to date. Fonterra itself has already said they will be adding Rennet Casein and Milk Protein Concentrate (70% protein) in the auction to be held on May 17th. The rules provide for each seller to establish their own product specifications, volumes offered, starting prices, and bidding limits. It's not unthinkable that a U.S. seller may want to offer butter with 80 percent butterfat, and nonfat dry milk. Before that could happen the seller must "*demonstrate to globalDairyTrade that offering its Product through the Trading Platform has a reasonable chance of commercial success.*" That seems doable. Then, another provision in the General Terms of operation states that "*globalDairyTrade will determine the generic Product types that may be offered at Trading Events.*"

Would they dare prohibit a competitor from offering products that are already racking up many millions of lbs of international sales per year? It would make for an interesting auction, wouldn't it? It would at least test the common belief that some U.S. product standards cost the industry dearly in terms of lost sales or lower prices to international buyers.

Most of the rule changes are designed to not affect bidders, but three of them do. One positively and two negatively. The rule with positive effects is to fit a new contract period into the 30 days immediately following the auction; the second month following the auction will continue to be the "Spot Month" supposedly, but not necessarily, the month for which the greatest volume of products are offered. Because new sellers have their own unique production and sales profiles, they could choose to frontload or backload offered volumes as they see fit.

The first rule change that negatively affects the overall usefulness of the auction, in terms of price discovery, market transparency, and sufficiency of information is to prohibit publishing volume forecasts. Sellers may provide confidential forecasts to bidders but all parties to that information must keep that information to themselves. The second rule with negative consequences, which may be necessary due to restraint of trade considerations or simply because certain sellers may not want that information to be released, is one **which absolutely and positively destroys much of the serviceability of the auction's role as a barometer of supply and demand – the decision to stop the timely reporting of winning prices and volumes by contract periods.** Instead, weighted average winning prices will be immediately reported for each seller, by product specification (a single price received by each seller for all sales in each product category for the full eight month period covered by the auction, but with no volumes related to those sales). The only other price report to immediately follow the auction will be the aggregated weighted average price for all products sold by all sellers in the auction, and the total volume associated with that grand total.

It's as if the key information from the auction is placed into a cocoon and held for three months. Yes, the proposal is for at least **three months to pass before the winning weighted average prices for each product group will be reported by contract period.** Why even bother. Let's see: just how relevant to current bidders (and to the countless others who mine the data from these auctions) are the winning average prices from last October or November? Answers should range from "not very" to "not at all." Bidders, and others, will be left to speculate about what shape the collective decisions in each auction has taken. Surely, the "price cocoon" rule needs to be removed or at least modified. Note: an exception to withholding specific product price information for a specific month will be made for financial markets that use winning prices to settle futures contracts for that product. It will likely be up to the more than 300 registered bidders, and possibly NZX (the securities market in New Zealand that is using the auction's spot month prices for settlement of futures contracts for several of the products offered in the auction) to express their views on whether additional sellers under the new rules for withholding important information is an improvement to what already exists or is a change that diminishes its value to the point where participation will fall to the point where it becomes a failed experiment.

A likely result to Fonterra's grand invitation to offer products to bidders would be to have at least one company apply, to test the water by offering a minimum quantity of a standard product. We should find out before summer which company accepts the invitation.

REMINDER TO REPORT AGRICULTURAL DIESEL TRUCK MILEAGE WITH CALIFORNIA AIR RESOURCES BOARD: *(By Rob Vandenheuvel)* Last year, dairies throughout California filed paperwork with the California Air Resources Board (CARB) on their agricultural diesel trucks. The paperwork allowed these ag trucks to follow a delayed timeline for establishing cleaner emissions. Depending on the mileage and/or type of truck registered, this program allows dairies to postpone any retrofit or replacement of their trucks until as late as 2023. Part of this program is an annual update to the odometer reading for each truck. You should have received paperwork from CARB in the past month. Dairies must review the paperwork, update potential errors with the information, and submit the data to CARB by March 31, 2011. MPC members wanting assistance in this matter can contact the MPC office (909-628-6018) or our Central Valley Representative Betsy Hunter (661-205-6721).