Milk Producers Council

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TO: Directors & Members **FROM: John Kaczor**

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks	*- $.1175*	$1.3900
Barrels	*- $.1125*	$1.3475

Weekly Average

Blocks	*- $.0485*	$1.4515
Barrels	*- $.0785*	$1.3865

CHICAGO AA BUTTER

Weekly Change	*+$.0100*	$1.6200
Weekly Average	*+$.0545*	$1.6120

DRY WHEY

WEST MSTLY AVG	w/e 12/3/10	$.3925
NASS	w/e 12/4/10	$.3767

NON-FAT DRY MILK
Week Ending 12/3 & 12/4

Calif. Plants	$1.1937	12,880,928
NASS Plants	$1.2065	16,492,023

CHEESE MARKET COMMENTS: After hitting what many thought was a bottom three weeks ago, prices advanced for both styles of cheese the next two weeks, until this Monday. Offers brought the barrel price down by $.0575 per lb on Monday and the block price down by $.0075 on Tuesday. That disappointing start turned into a rout; a total of 33 trades occurred over the next three days, taking prices down for the week by more than $.11 per lb for each style, to below where they were three weeks ago. It looks like one or two manufacturers simply, once again, had produced more cheese than could be sold before it became too old to be sold on the exchange. Short-sighted? Maybe. Or it could be a buyer or two may have backed away from what was thought to be a sure thing. It's happened before. Why wasn't that cheese bought two weeks ago, in time for orderly repackaging and use? An encouraging sign, again, is the number of buyers that have stepped in to clear what was offered from the market. Whatever the reason, the near-term futures markets didn't like what was happening; the class III milk futures price this week lost $.66 per cwt for January and $.51 for February. January now has the low price for the next twelve months. Somewhat encouraging is today's class III futures market: unchanged or up for each month from February through November. Exports of cheese in October were 50% higher than a year ago, at 30.5 million lbs.

BUTTER MARKET COMMENTS: The butter market appears to have stabilized after falling from its high that was reached nine weeks ago. Dairy Market News reports that buyers are liking the low prices and are restocking for upcoming sales. Futures prices are supporting the current CME spot prices. With current prices about $.50 per lb below those reported for Western Europe and Oceania, export interest is also reported to on the rise (October's export volume of all butterfat products was 11% higher last October). Retail sales have been very good; expect to see some butter ads at $1.99 per lb or lower. Only one trade occurred this week; the price gained a penny.

POWDER MARKET COMMENTS: The market for nonfat dry milk continues to show improvement. October's exports of NFDM and skim milk powder set another monthly record; the volume hit the 100 million lb mark for the first time. Inventories should continue to shrink. However, with cheese prices so much lower than before, look for less powder to be used for vat fortification. Domestic usage is now definitely lagging behind exports. Prices for buttermilk powder appear to be in a post-season slump; the west's "mostly" prices continued their slide below NFDM prices. Prices reported for sales last week by NASS and CDFA edged upward again, this time with slightly higher volumes.

WHEY PRODUCTS MARKET COMMENTS: The markets for dry whey and whey protein concentrates continue to be tight, with most of the current production going to buyers for export purposes. Prices for both remain firm, with limited supplies available for spot sales.

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FRED DOUMA'S PRICE PROJECTIONS…

Dec 10 Est:	**Quota cwt. $15.78**	**Overbase cwt. $14.09**	**Cls. 4a cwt. $14.88**	**Cls. 4b cwt. $12.50**
Last Week:	**Quota cwt. $16.08**	**Overbase cwt. $14.38**	**Cls. 4a cwt. $16.87**	**Cls. 4b cwt. $13.23**

ETHANOL DISCUSSION HEATING UP IN CONGRESS: *(By Rob Vandenheuvel)* Articles have been written in this newsletter over the past few weeks about the discussion over federal subsidies for ethanol production. The debate is over whether Congress allow a temporary tax credit that was created in 2005 and set to expire at the end of 2010, to expire as originally planned, or to allow it to continue. The tax credit – known as the "Volumentric Ethanol Excise Tax Credit" (VEETC), or in short, the "ethanol blender's credit," is a $.45 per gallon tax credit available to the oil/gas companies that blend ethanol with their fuel.

For those of you who haven't paid much attention to our nation's ethanol policy, here's a brief history. This generous credit was created in the *American Jobs Creation Act of 2004*. The idea behind the credit was to provide an incentive for ethanol production as an alternative to burning fossil fuels. However, the authors of that legislation decided this should be a temporary measure aimed at stimulating initial production, not a permanent credit to subsidize the industry. As such, the credit was scheduled to expire on December 31, 2010.

The next year, in 2005, Congress created a "Renewable Fuel Standard" (RFS) that mandated a certain volume of ethanol ***must*** be purchased by oil/gas companies and blended with their fuel. At the time, the RFS mandated that 8 billion gallons-per-year of ethanol and biodiesel be sold by 2012. In 2007, those mandates were increased, phasing up to 36 billion gallons-per-year of renewable fuel that must be sold in 2022, of which 15 billion gallons can be corn-based ethanol. Under this law, next year's RFS mandates that 13.95 billion gallons of renewable fuel be sold, of which 12.6 billion gallons can be corn-based ethanol.

Now fast forward to the present: the mandated demand in 2011 for 12.6 billion gallons of corn-based ethanol exists, and there is no talk in Congress of eliminating that mandate. Instead, the debate is over whether or not the Federal Government should continue the outdated and unnecessary $6 billion-per-year ethanol blender's tax credit that was established before the mandate existed.

We need to ask ourselves: what are we (and by "we," I mean the American taxpayers), getting from this $6 billion subsidy? We can get a glimpse of that by looking at a recent economic analysis done by Dr. Bruce Babcock from Iowa State University (http://www.card.iastate.edu/publications/DBS/PDFFiles/10pb3.pdf). In his analysis, Dr. Babcock's economic model indicates that the existence of the "ethanol blender's credit" (combined with a tariff on imported ethanol), will result in an estimated 13.2 billion gallons of ethanol being produced. ***Without*** these Federal subsidies, the estimated U.S. ethanol production would be 12.6 billion gallons – the amount of the mandate under the RFS. So what we're really talking about is spending $6 billion of taxpayer money for a tax credit that may result in about 600 million additional gallons of ethanol being produced. Or in other words, $10 in taxpayer money for every 1 gallon of additional ethanol being produced beyond the mandated demand. Whether you are a supporter of the ethanol industry or not, I'm hard-pressed to see the logic and wisdom of that particular use of taxpayer dollars.

Now for the politics. You may have seen a press release put out by MPC earlier this week. If you missed it, the release is posted on our website at: http://www.milkproducerscouncil.org/120810ethanolrelease.pdf. The debate over ethanol has heated up in recent days, as Congress has attached a 1-year extension of the blender's tax credit to a large tax bill that will address individual tax rates, the estate tax, and numerous other tax provisions. While there has been a strong message sent by a widely-diverse group of organizations *(for more info on this, see last week's MPC newsletter: http://www.milkproducerscouncil.org/updates/120310.pdf)*, the ethanol lobby has been successful in finding the right friends in Congress to get this outdated taxpayer giveaway extended for another year. Until an extension is passed by the House and Senate, MPC and our fellow coalition partners will continue to work on convincing Congress that in this time of huge Federal deficits, there is simply no justification for a $6 billion-per-year tax credit that provides little benefit. Unfortunately, it's going to be an uphill battle.

MORE PERSPECTIVE ON INTERNATIONAL PRICES: *(By J. Kaczor)* One of the reasons for an article touching again on the subject of international price comparisons is a report published by farminguk.com, dated December 10th, published today on the Dairyline.com website. It reports on a proposal by the European Commission to consider minimum standards for contracts between milk suppliers and milk buyers. The standards would be in the form of recommendations to the EU's member states. The proposal for contracts between producers and handlers includes requirements for determining prices based on specified market indicators or a formula, volumes to be supplied, duration of the contract, and provisions for termination of the contract. That sounds reasonable; it sounds at least a little like the way milk prices are determined in the U.S., only with more flexibility. However, unless European producers and handlers are wiser than their U.S. counterparts in deciding on market indicators or price formulas, they may wish they hadn't gotten what they may get.

Federal order and California dairy provisions are "foreign" to U.S. competitors. While producer cooperatives in other countries are common, few contracts **that specify prices** exist because prices are almost always determined by the buyers who often have conflicting interests and uneven competitive positions. California producers should picture the situation before statewide pooling became effective in 1969 – but without state-established minimum prices. It's a jungle out there. Typically, prices in Europe and Oceania are announced by the handlers at the beginning of a year, based upon what they project in the way of volumes of products, operating costs, and prices, and are adjusted from time to time to reflect changes in those projections. The changes can be up or down and are, in some cases, made retroactively to the beginning of the year. Under the present system, protests and riots throughout Europe regarding producers' concerns about prices they are being paid are not uncommon.

The prices U.S. producers are most interested in and concerned about are those that affect their monthly milk prices. Unlike what happens in virtually all other countries that are now heavily engaged in international dairy trade, the U.S. uses price formulas, set by administrative agencies through public hearings, to establish the basic rules for calculating prices for various milk usages. The milk prices themselves are based on weekly and monthly prices for cheddar cheese, nonfat dry milk, butter, and dry whey. Hearings to amend the price formulas are relatively infrequent, usually contentious, and often result in Job-like findings by USDA and CDFA that split differences between two or more reasonably sounding, well supported, positions. So the price formulas don't change very often but the prices generated by the formulas do change every month, sometimes by stomach-wrenching amounts. From the viewpoint of our international competitors, it is the U.S. that is strange, and they may even prefer the differences.

Until recently (before Fonterra created its international auction), the U.S. had to mainly rely on bi-monthly reports by Dairy Market New analysts about price changes in New Zealand, Australia, and Western Europe. Of course, companies and cooperatives who were engaged in international trading and price negotiations had, and still do have, inside knowledge of current and developing conditions supply and demand. USDA, through its Foreign Agricultural Service, did and still does provide certain detailed country-by-country estimates of milk production, usage, product production, imports, and exports, to help guide the U.S. industry to determine appropriate forward-looking strategies. And, two months after the fact, FAS reports on the amounts and values of U.S. imports and exports for a wide variety of dairy commodities, which is interesting but not timely.

The most important of the above international price-indicating reports and summaries should be the Fonterra auctions. They are now conducted twice monthly and include two of the four dairy commodities with the largest volumes of international trade: whole milk powder and skim milk powder. Anhydrous milkfat is included but butter is not. Fonterra says they plan to continue expanding the list of products offered for auction. One striking thing about these auctions is how much prices can change from month to month, and how existing and near-term prices relate to prices bid for delivery of products as far out as nine months in the future. (The December auctions are for delivery of products from February through August.) Another striking thing to note is the wide array of prices that apply for a particular product to be delivered in a particular month. For example, the succession of prices per lb bid in past auctions payable **for delivery of skim milk powder in December** are \$1.56, \$1.53, \$1.53, \$1.38, \$1.25, \$1.45, \$1.45, \$1.42, and \$1.32. Price information like this should help to reduce the "information gap" on supply/demand questions that some of the industry's giants have had. The first price in that list was bid in April (reflecting bidders' views of future supplies); the last price was bid in October, reflecting near term supply prospects. Prices bid since then, range from \$1.31 per lb for deliveries in February to \$1.56 per lb for deliveries in June, July, and August. Similar wide price swings occurred for whole milk powder, buttermilk powder, and anhydrous milkfat. Through it all, including a continuing rise in the value of New Zealand's currency relative to the U.S. dollar, which puts downward pressure on their prices, Fonterra basically maintained its forecasted price for it milk suppliers. Isn't that interesting? Also, through it all, the price indexes for U.S. milk prices (butter, powder, cheese) rose and fell by large and unpredictable amounts and, as of today cannot be considered to be stable. That's also interesting, isn't it?