

Milk Producers Council

5370 SCHAEFER AVE. SUITE A - CHINO, CA 91710 - (909) 628-6018 - Fax (909) 591-7328

801 S. MOUNT VERNON AVENUE - BAKERSFIELD, CA 93306 - (661) 833-2549

E-mail: mpc@milkproducers.org

Website: www.MilkProducersCouncil.org

DATE: December 11, 2009
TO: DIRECTORS & MEMBERS

PAGES: 5
FROM: John Kaczor

CHICAGO MERCANTILE EXCHANGE

Blocks $-.0175$ \$1.7000
Barrels *N.C.* \$1.4600

Weekly Average

Blocks $+.0025$ \$1.7000
Barrels $-.0185$ \$1.4600

CHICAGO AA BUTTER

Weekly Change *N.C.* \$1.4500
Weekly Average $-.0570$ \$1.4380

DRY WHEY

WEST MSTLY AVG w/e 12/10/09 \$.3850
NASS w/e 12/05/09 \$.3623

NON-FAT DRY MILK

Week Ending 12/04 & 12/05

Calif. Plants \$1.2534 6,949,926
NASS Plants \$1.2617 10,722,258

CHEESE MARKET COMMENTS: The big story on cheese this week continues to be the large price difference on the CME between blocks and barrels – \$.24 per lb. That makes it 21 straight days for the differential to be above \$.10 per lb, with the last 8 above \$.20 per lb. This persistently large difference is not normal; for example, differences of \$.10 per lb or more occurred only 20 times in the previous four years. Market viewers have been saying – again this week – that the **prices** for blocks and barrels do reflect the relative strength of demand for the products, and some manufacturers are taking the expected steps of either cutting back on barrel production or switching to block production. This week, blocks lost \$.0175 per lb and barrels held at \$1.46 per lb. Traders are watching; the market was relatively quiet this week, 19 loads of blocks and 2 of barrels. The *Dairy Market News (DMN)* review of sales this week sees good demand for Mozzarella, not so strong demand for Cheddar for aging, and little export activity. The price differential reported by manufacturers to NASS for sales last week, for fresh Cheddar 4 to 30 days old, on fairly steady volume, climbed to about \$.07 per lb; the average price for blocks was about \$.11 per lb **below** last week's CME weekly average, while the average price for barrels was about \$.04 **above** the CME average. The week-to-week changes in prices charged by manufacturers, so different from weekly changes on the CME, reflect lagged pricing and indexing programs. The strength in the block price could reflect the fact that USDA has been directed to purchase \$60 million worth of cheese for the purpose of supporting or increasing prices, although the time period for that to happen is not clear.

BUTTER MARKET COMMENTS: Butter prices on the CME this week lost \$.02 per lb on Tuesday and gained it back on Friday. Trading continues to be active – 20 carloads this week. The balance between supply and demand for butter appears to be tight. Demand for cream products to meet holiday and related indoor sports viewing activity is affecting butter production, and should continue to do so through the end of January. Butter prices f.o.b. ports in Western Europe and Oceania are very high and few new sales are occurring, according to DMN market watchers. The low end of the price range reported for Europe is \$2.13 per lb, is attracting no buyers, while stocks held in government and private warehouses await disposal. The price range reported for Oceania ports is \$1.72 to \$2.05 per lb, and are reported to be firm.

POWDER MARKET COMMENTS: The two major price averages for sales of nonfat dry milk last week each rose by about \$.05 per lb above the week earlier; both are about \$.15 per lb above where they were three weeks ago, and are nearing the levels reported for f.o.b. docks in Europe and Oceania. The amount of NFDM in manufacturer storage in the U.S. fell to about one month's worth of production (end of October), which makes it a tight market. The amount of NFDM and skim milk powder exported in October was 64.5 million lbs, 13% above a year earlier, the first month this year exports exceeded the same month a year earlier. Credit DEIP sales for the increase. The California weighted average price is keeping pace with prices reported to NASS, on low volume. Even better news is that the average prices for exports for the past five months were about even with the prices reported by California plants. But watch for the pattern to change – sales of fixed priced forward contracted sales without DEIP subsidies in a rising market is expected to leave California producers holding a

bag of something they would not rather have, while Fonterra racks up the profits from exporting California powder.

WHEY PRODUCTS MARKET COMMENTS: DMN reports the market for dry whey to be firm and prices continue to trend higher. The weekly average price for dry whey reported to NASS has been steadily edging upward for the past two months. Exports of dry whey in October were 13% above a year earlier – 69 million lbs. Stocks are tight. Prices for whey protein concentrate (34% protein) also continued to increase, nearing the \$.80 per lb benchmark, and stocks are reported to be tight. Exports of WPC in October were strong, continuing the pattern since the beginning of the year. The West’s “mostly” average price is now at a very profitable \$.385 per lb, \$.24 per lb above where it was in January.

FRED DOUMA’S PRICE PROJECTIONS...

Dec 11 EST:	Quota cwt. \$ 16.16	Overbase cwt. \$14.46	Cls. 4a cwt. \$14.47	Cls. 4b cwt. \$15.17
Last Week:	Quota cwt. \$ 16.14	Overbase cwt. \$14.44	Cls. 4a cwt. \$14.24	Cls. 4b cwt. \$15.30

A READER’S RESPONSE: (By J. Kaczor) Two articles in last week’s *Update* got a response from a reader which seemed to reflect a position often expressed by many processors and manufacturers, and some producers – let the market decide milk prices rather than some regulatory agency. The articles the writer referred to were the one about Fonterra’s latest internet auction, and Rob Vandenheuvel’s notice about the December 15th “Webinar” on the Dairy Price Stabilization Program.

The first point made by the writer was to scold us for applauding rising prices and disliking falling prices. Well, Milk Producers Council pleads guilty to that. However, the writer’s comment was made in reference to the “salutary” discussion of Fonterra’s auction and therefore was not in proper context. Articles explaining, and defending, that auction were printed in this *Update* at various times since March, when prices for whole milk powder were at or near their bottom, and when others were calling the auction a seriously flawed “joke” which should be investigated for causing prices to fall. The MPC *Update* articles praised Fonterra for providing an extremely valuable tool for determining prices in an open and transparent way, something that the writer himself said is needed for U.S. markets.

A second mistake made was to accept milk price “volatility” as something desirable – a force itself to be corrected by “the market.” That definition does not recognize very large, destabilizing, price movements as something to be avoided. Future discussions on volatility could contribute to mutual understanding if the word “relative” was included. Milk producers need **relatively** stable milk prices that change by **relatively** foreseeable amounts with **relatively** foreseeable frequency. All participants in the dairy industry should recognize that relative price stability provides an excellent platform for all segments of the industry to plan, to compete, even to prosper. On the other hand, extreme price movements, particularly downward, are destabilizing to the point where significant and irreversible damage to the supply side results. That is what began a year ago. Extreme price increases are also destabilizing for an entirely different set of reasons and, too, should be avoided, but not when they arrive on the heels of a historically destructive period of historically low prices. That is the reason why producers, processors, dairy product users, lenders, and consumers should be interested in tuning into the December 15th Webinar on the Dairy Price Stabilization Program. “Free marketers” and speculators would not be interested. The DPSP is designed to provide incentives for individual producers to manage their milk production within clearly defined reasonable limits. Check it out.

REMINDER: “WEBINAR” ON THE DAIRY PRICE STABILIZATION PROGRAM NEXT TUESDAY:

(By Rob Vandenheuvel) As I noted in last week’s newsletter (and as John Kaczor mentioned in the above article) a “webinar” is being hosted next Tuesday (December 15th) at 8:00 a.m. This webinar is designed to bring producers throughout the country up-to-speed on the Dairy Price Stabilization Program.

It has become painfully clear that our national “leadership” that is supposed to represent producers has already given up hope for doing anything about milk price volatility until 2012 (and has even refused to provided any

legitimate detail on what it is they want to accomplish in 2012). That leaves us with no option but to continue the work we've already started: building grassroots support for a program to fundamentally address the extreme milk price volatility that has devastated producers over the past year, and will continue as long as no change is made (*i.e., the Dairy Price Stabilization Program*).

For those of you willing and able to listen in, please visit <https://www1.gotomeeting.com/register/709795880> and register. And then mark your calendar for December 15th at 8:00 am to listen in and participate in the webinar.

A LOOK BACK...A LOOK FORWARD: (*By Rob Vandenheuvel*) As we wind down the most devastating financial year in the modern U.S. dairy industry, it's always interesting to look back and see where we were a year ago, where we are now, and what we want to accomplish going forward.

In that spirit, I recalled a series of articles written by MPC President Syp Vander Dussen and Vice-President Geoffrey Vanden Heuvel and published in our newsletter about a year ago. I thought it would be valuable for our readers to get another chance to read segments from those articles, which still very much apply today. This week, I'm including segments from Syp's article and next week I'll be including segments from Geoffrey's. Enjoy.

My View on Milk Production Increases

By Sybrand Vander Dussen

Originally Published in the November 7, 2008 issue of MPC's Weekly Newsletter

These are excerpts – Syp's full original article can be found here:

http://www.milkproducerscouncil.org/syps_article.htm

The typical dairyman is a good cow-man; he knows how to produce milk efficiently, and with high quality. As long as he is not on the wrong side of his banker or the dairy inspector, he is king of his domain. His coop puts wheels under his milk every day, his banker tells him what interest rate he pays on loans, the beef market dictates the price he gets for culls, and the California State regulatory system sets his milk price. He is not a milk or milk product marketer, does not need to innovate new desirable products, and doesn't need to concern himself with milk sales – his coop will do all that.

Sounds like the epitome of socialism! It's all good and works well, right? Not even close.

Our crazy “produce more milk!” entitlement mentality, that we can produce ever more milk, no matter what, causes such huge problems that our industry finds itself in a constant state of confusion and tension. Our coops cannot demand higher prices from Buyers, simply because they must get rid of more milk than the market wants. They are constantly in a position of finding “holes” to put the ever-growing supply of milk, transporting milk over long distances, “selling” milk to calf ranches at cents on the dollar, and disposing of milk in other ways best not to put in print. This places the Buyers in an incredibly strong position. Further, and worse, even when a coop is able to extract a premium of a few cents, another coop comes along and underbids them, and that premium is lost.

But things may be changing. There has occurred, in recent times, several “sea changes” that must alter the face of the industry; 1. Near effective irrelevance of the support program, 2. Less mid-west smaller dairies, 3. Imposition of production bases by all three major coops in California.

Let's explore them.

Support Program. In 1933, the federal government authorized the creation of the Commodity Credit Corporation (CCC), and in 1949 the CCC was given the responsibility to assure an adequate supply of milk for consumers – the Dairy Price Support Program was born. The CCC is required to buy all nonfat dry milk, butter, and cheese the industry offers to it at predetermined prices. The initial purpose was to remove excess product in the spring and release it in the fall, all in an attempt to flatten out supply. This law was intended to benefit consumers, not producers, and initially it worked as planned. Over time, the support price was ratcheted up until

President Reagan, in 1981, finally froze the rising support price at \$13.49 cwt, because we were generating huge volumes of product to government warehouses. (That \$13.49 cwt, by the way, translates into \$29.97 cwt in today's dollars!) With the government willing to buy dairy products at that high price, the industry saw it as an actual market and produced giddily, resulting in the government dumping huge amounts of product in 1983-84, followed by a federal government producer buy-out to reduce production. In the short term, that solved the overproduction problem. Since then, the support price has dropped to \$9.90 per cwt making this outlet definitely the last resort and definitely unattractive, especially when our milk prices were well above that price. With feed costs soaring due to the congressional ethanol mandate, that \$9.90 per cwt "market" should effectively be closed to us.

Mid-west Dairies. In years past, when we out-produced demand, and milk prices declined, many mid-west dairies, those many thousands of producers with 20-80 cows, just quit, and stayed with farming only. That soon dried up the excess production, and milk prices gained strength, making us once again, okay.

In the last decade, our west coast style of dairying has been exported to Idaho, Texas, New Mexico, and even to the mid-west. Now, when prices decrease, those dairies, being larger and much better capitalized, have much more staying power. The drops we see are deeper and more sustained and the recoveries are anemic and certainly less dramatic. It seems like it has become a game of the titans seeing who could hemorrhage the longest and still survive. (The polite word for this pattern is "volatility.")

Coop Bases. Apparently, out of sheer frustration with the oceans of milk presented to our California coops, Land O'Lakes, California Dairies, Inc., and Dairy Farmers of America instituted base programs. This was done with little warning and apparently with little forethought, and certainly was not planned in concert with other coops. The only immediate accomplishment was the targeting of those dairies that just happened during that time frame to be in a growth mode, and after a small across-the-board fee, all costs to dispose of excess milk was charged to those "over-base" producers. One Southern California dairy suffered a charge of over \$600,000 for the period of March-July, 2008. Because at all times, various dairies are undergoing expansion, the institution of bases at another point in time would have simply targeted other dairies, perhaps different than those punished now. Sort of like musical chairs-when the music stopped, for those without a seat, they got whupped. And hard.

In partial response to the unexpected imposition of bases, many cows were sold to out-of-state producers. Between that, and producers so affected reducing their production, a short term positive response has occurred.

So why do so many producers have as their primary goal to just produce more milk? The answer lies in the "magic of pooling," which was instituted at the same time quota was issued. Pooling of milk is a brilliant, efficient method of valuing and distributing milk in California. Imagine two buckets; one, a large "milk" bucket and the other a large "money" bucket. All milk produced in California is "poured" into the milk bucket. At the bottom of that bucket are 5 faucets. One faucet for each milk usage. Class 1, 2, 3, 4a & 4b. As milk enters the bucket, it loses its producer identification and then, various processors, whether it be for their intended use of bottled milk, cheese, powder, etc., tap into the faucet corresponding to that use. As milk is processed for those various uses, that identifies a value based on our pricing formulas, Class 1 price, cheese, etc. The payment for the corresponding usage value is then "placed" into the money bucket.

At the end of the month, it will have been determined how much milk has been produced and what its value is, strictly according to how and where it was used. That amount of money is then reported as a pool total, which then has deducted from it transportation credits and allowances, the quota payout of \$1.70 cwt (less the RQA) according to quota holdings, and what is then left is divided equally according to volume of milk, and milk components to all producers.

This is a wonderful system. It establishes an equitable price to all, allows maximum availability of milk for higher-valued products, and allows a quota producer to ship to a powder plant or a non-quota producer to ship to

a Class 1 bottling plant. All very efficient and equitable.

However, for all the positives this system provides, it has a serious flaw. Because all milk is pooled, the common value established by usage and the equitable payout to producers means when a lower value is created by overproduction that devaluation is shared by all producers simply by an across-the-bucket reduction in total proceeds. Stated differently, and simpler, if I produce one extra load of milk, which of course will go to powder (and possibly to the CCC) it will have a value of less than \$10 to the pool, but I will receive a blend value of approximately \$15.00 cwt for that load. But remember, the income to the pool bucket is about \$10.00! That \$5.00 loss is shared by all!

Stated in again another way, it is in the best interest of every producer to produce as much milk as he can, always, because the lower value for that excess product is borne by everyone. Indeed, the producer who hasn't expanded in recent years is sucking air. So many others have expanded, and that expansion, if it exceeds market demand, by definition has largely gone to lower or lowest value uses.

This flaw in an otherwise brilliant system is described best by the two hikers in the forest being chased by a bear. Those two do not need to outrun the bear, **one just has to outrun the other!** So my and your best business plan is to keep producing more, because the system, as designed, rewards individual growth but punishes producers industry-wide. The negative effect of me producing that "one more load" will be picked up by you.

MANAGER'S COMMENT: *(By Rob Vandenheuvel) As Syp has clearly demonstrated, our industry is hard-wired to overproduce. Every time milking cows is profitable (which signifies a balance in supply and demand, or perhaps demand that slightly exceeds supply), all 60,000 dairies across the U.S. have the individual incentive to go produce more milk. Does everyone build a new barn or add a new corral? Of course not. But in recent years, our industry has perfected the art of building easily-expandable, "western-style" dairies, which can easily facilitate quick production expansions. And that "western-style" of dairying has been exported across the U.S. We can "turn on" production seemingly overnight – the problems lies in our inability to "turn it off" when needed. 2009 was a painful reminder that we have no sufficient tool to bring us back to supply/demand balance once we've outgrown our demand.*

This is why MPC has invested so much time and effort into promoting the Dairy Price Stabilization Program (DPSP), which would fundamentally address the flaw Syp writes about in milk pooling. Under the DPSP, every dairy across the country would have a choice – do you want to expand production and pay a fee for accessing that additional market? Or do you want to maintain your current market share and receive your piece of the "market access fees" that are being paid by the expanding dairies? It's an "agreement" amongst dairy producers that allows any dairy that wants to grow to do so, merely by paying a knowable, budgetable market access fee to his fellow dairymen who are holding their production in line. Growth without overproduction – a simple concept that would help prevent or at least mitigate the massive booms and busts we see in the milk price.

Next week, I will be reprinting part two of this series – an article by MPC Vice President Geoffrey Vanden Heuvel expanding on the "magic of pooling." So stay tuned.