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

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks	*+$.0250*	$1.3100
Barrels	*+$.0300*	$1.2900

Weekly Average

Blocks	*+$.0550*	$1.2850
Barrels	*+$.0700*	$1.2680

CHICAGO AA BUTTER

Weekly Change	*-$.0150*	$1.2300
Weekly Average	*-$.0110*	$1.2380

DRY WHEY

WEST MSTLY AVG	w/e 08/06/09	$.3200
NASS	w/e 08/01/09	$.2961

NON-FAT DRY MILK
Week Ending 7/31 & 8/01

Calif. Plants	$.8260	15,026,398
NASS Plants	$.8413	42,709,528

CHEESE MARKET COMMENTS: Last week it was mentioned that cheese sales in the past three months have been good to the extent that they just about equaled the higher level of production and the lower amount of exports during the period. The higher production could be explained by manufacturers sensing that there will be less milk available in a few months and they wouldn't mind having on hand a relatively large amount of cheese at a relatively low cost when the heavy sales season arrives. Credit them for good planning, whether it's true or not. But this week, *Dairy Market News* (DMN) says the surprise of higher support prices which cover a short period of time has got both sides to a trade wondering what things will be looking like by Fall. In light trading, prices for blocks and barrels moved all the way up to the new support levels this week (barrels to $.01 above support). Production of all cheese increased by 2.0% in June; production of Cheddar increased by 4.4%. DMN analysts find a lot of doubt in the industry this week about USDA's statement that CCC expects to be buying 75 million lbs of cheese in the next several months and this week's market activity at least supports that doubt.

BUTTER MARKET COMMENTS: After four straight months of lower production June's butter output jumped by 7.5% over last June; the amount in cold storage at the end of the month was about 3% higher. Trading activity on the CME continues to be fairly active. Prices have been losing ground on a weekly basis since they last peaked at $.27 per lb in mid-July. DMN reports that sales are steady, with retail leading the way and food service lagging. A recent report said restaurant sales this summer are about 25% lower than last summer. DEIP sales have been helping; the average "bonus" to the exporters has been about $.40 per lb.

POWDER MARKET COMMENTS: A very nice price increase occurred almost immediately when the support price increase announcement of $.12 per lb. for nfdm was released last Friday. This week the West's "mostly" price increased by $.07, to $.895 per lb, and grade A powder on the CME moved up to $.98 per lb, $.08 higher than extra grade. The NASS and CWAP prices shown above reflect shipments of products made through the end of last week, so we'll have to wait a bit to see what will happen in the real world this week. DMN is finding so far that buyers are holding back, reluctant to commit to prices that may not mean much – meaning a higher price for a surplus commodity coming from a non-commercial source (CCC) for a short period of time does not automatically translate into a higher value-product. In other words, they are not buying it until more information becomes available. DMN notes that Secretary Vilsack expects to have the CCC buy virtually all of the uncommitted inventory (or maybe only current production, it's not clear) totaling 150 million lbs of nfdm in the next three months. And then what happens? Remember that CCC recently sold its small inventory of butter at close to the minimum markup that was allowed – which at the time was well under current market prices. Considering that CCC presently has about 76 million lbs of nfdm in storage, with a minimum sell price of $.88 per lb, and is expecting to buy 150 million lbs at $.92 per lb, subject to a minimum sell price of $1.012 per lb, the confusion in the marketplace is easily understood. DMN reports that buyers and sellers see the market as "long on product and short on demand," and are very confused. Adding to the confusion, NASS reported today that

42.7 million lbs of nfdm was sold last week, up from 16.7 million lbs the previous week. That could have resulted from buyers insisting on taking shipment before the higher prices became effective, or sellers believing the higher support prices will apply only to product produced after the price announcement was made. No word yet on whether the sales figures include some of the subsidized DEIP volumes.

WHEY PRODUCTS MARKET COMMENTS: The market for dry whey in the West is reported to be weakening, although the "mostly" price remained where it has been for several weeks. In the Central region the "mostly" price edged up, and the market is considered to be steady. The fundamentals for dry whey continue to look good: U.S. production in June was 3.2% lower than a year earlier and stocks at the end of the month were 23% lower, 0nd lactose continues to be good. End of month inventories were down for each by 26%, and prices have recovered to the point where they are approaching last year's levels.

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FRED DOUMA'S PRICE PROJECTIONS…

August 7 Est:	**Quota cwt. $ 12.18**	**Overbase cwt. $10.49**	**Cls. 4a cwt. $10.70**	**Cls. 4b cwt. $11.00**
Last Week:	**Quota cwt. $ 12.25**	**Overbase cwt. $10.55**	**Cls. 4a cwt. $10.81**	**Cls. 4b cwt. $11.05**

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PRICES ON FONTERRA'S AUCTION UP SHARPLY: *(By J. Kaczor)* Tuesday's internet auction for whole milk powder lasted more than three hours as buyers stayed in until they were guaranteed to be awarded the amount of product they wanted. That resulted in an astounding increase in prices across the board – all products for all seven months covered by the auction increased in price: from 17% to 38% above their winning prices in July's auction. Prices for regular WMP, the largest volume product offered in each of the fourteen monthly auctions so far, increased by $.184 per lb for deliveries in October, $.179 per lb for deliveries in the November-January period, and $.150 per lb for deliveries in the February-April period. Fonterra's press release stated "We are seeing signs of strengthening demand and prices…but the market remains…difficult to project." Fonterra continues to see supply and demand "rebalancing" world-wide. As a small first step in their plans to expand the range of products to be sold on their auction, about 2 million lbs of WMP from Australia was offered in this auction, and some of it sold at a higher price than New Zealand product.

While one month does not mean much in itself, the very strong interest in acquiring product shown by the bidders' determination to pay ever higher prices in this go around is not likely to go unnoticed by buyers and sellers of other major dry dairy commodities.

A FURTHER LOOK AT WHAT IS BEING PROPOSED TO STRENGTHEN MILK PRICES: *(By J. Kaczor)* Last week's article on this subject closed with the comment that the announcement of higher than expected increases in support prices for Cheddar cheese and nonfat dry milk on August 1st should be taken as the first of a number of immediate and substantial steps needed to bring about significant improvement in milk prices. Today a review will be made of some specific recommendations that were made to members of Congress and to the administration – principally in the House Subcommittee meetings that concluded on July 28th – as well as some of the not so helpful positions that were expressed. I'll close the discussion with a short list of what I believe to be essential measures necessary to get the industry moving in the right direction.

Before getting to the review of ideas and proposals, let's go back to **the scorecard**. At the end of June USDA counted about 9,200,000 milk cows in the U.S. herd. Numerous stories over the past several months have cited various levels of losses ($3 or more per cow per day, etc.) being incurred by dairy farmers, and cost auditors for the California Department of Food and Agriculture recently reported that the average loss per cow per month for producers in California's central valley was $96.00. A fair and representative number of the average loss for the industry could be $100 per cow per month. **That means that U.S. milk producers have been losing about $920,000,000 per month since January.** The total loss through July amounts to 6.4 billion dollars. [Those who question these calculations are invited to do their own, and then we'll talk.] On the credit side of the ledger is Secretary Vilsack's estimate that the three month support price increase should add 81 million dollars per month to milk prices for those months. Helpful, yes, but that still leaves the industry about 839 million dollars per month in the red, and then what, back to the higher figure?

Among the more helpful presentations made in the hearing on July 14th was the statement by Ray Souza, representing Western United Dairymen and California Dairies, Inc., and Joaquin Contente's presentation on the 28th on behalf of California Farmers Union. Both were factual, clear descriptions of the situation facing California's milk producers, including the losses and growing debt, a review of current pricing systems and support programs (which are well-intended but inadequate), a listing of activities already taken to provide the way towards reasonable recovery, and some proposals. Other notable statements came from National Milk Producers Federation, Select Milk Producers and Continental Dairy Products, Inc, and Blimling and Associates, Inc.

Taken together, these presentations covered some industry and individual achievements and many things to be worked on. They include the need to review and reform price hearings and pricing formulas, the need to increase the use of available risk-management tools (notable among which is the LGM-Dairy insurance program [which by the way is not available for California producers at the present time]), development of value-added products, the need to maximize operational efficiencies on the farm and beyond, and the need to develop a robust dairy export program.

It's very clear that these hearings, along with others that preceded and followed them on related subjects (including the extensive "unorganized" grass-roots lobbying that began early this year) have given our legislators and the administration a fair and complete picture of the current condition of the dairy industry. Throughout, there was no disagreement about the need for substantial relief – none whatsoever.

In addition to the presentations listed above, another important one was made on behalf of Holstein USA, Inc – a draft presentation of their Dairy Price Stabilization Program (DPSP) – a variation of Milk Producers Council proposed Growth Management Plan. As initially conceived and tested, and in its ultimate form, a DPSP will result in removal of those price peaks and valleys for producers and processors, the price volatility which everyone disparages, no one can avoid, and which repeats itself in evermore harmful fashion every one and a half or two years. You can look it up.

The unfortunate part of the Subcommittee hearings was an apparent intentional misrepresentation of what a DPSP will do. First, it was just a draft. Second, there have been quite a few presentations in various parts of the country of the proposal which demonstrate and explain what it should do and how it would work. It clearly is not designed to limit or suppress milk production. That being the case, the near hysteric discussion of it by the IDFA spokesman was both comical and disappointing. According to IDFA, a DPSP would "penalize many producers all over the country, it would artificially raise domestic milk prices, and make U.S. dairy products less competitive on world markets." **If that's an honest conclusion then either the program has not been explained clearly enough or it needs to be changed to correct whatever shortcomings it has morphed into because the presentations of it by Cornell University economists that I've seen do not result in any of those undesirable outcomes**.

A final misrepresentation that needs to be addressed comes from a source that should know better. A spokesman for the U.S. Dairy Export Council (USDEC) made essentially the same misguided comments that IDFA made. USDEC is an outstanding organization (as is IDFA, for that matter). It has essentially developed a valuable turn-key type program to help manufacturers, brokers, and processors to export a wide variety of dairy products throughout the world. It is noted for its research and market development activities. So why would someone from that organization appear in a public hearing to ridicule and mischaracterize a proposal that is designed to provide more stable milk prices for USDEC's clients? You know the answer.

As a matter of fact the DPSP program that I see will need substantial and continuous input from IDFA, USDEC, and CWT in arriving at recommended levels of milk needed for all purposes. Yes, that does include a regular supply of milk needed to develop, serve, and expand dairy product exports. That's one of the side benefits of the program. One would hope that out of this rancor and probable misunderstanding an honest exchange of views may result on what could honestly be one of the most important and beneficial dairy industry programs, well, ever.

In conclusion, one of the unfortunate lessons learned from all of the testimony, arguments, and comments, is that there is no short term solution to the industry's current financial crisis. Short term, we need to rebalance supply and demand. Short term, U.S. exporters have been pushed away from markets that were handed to them a year or two ago. We can boast, as the USDEC spokesman did, that the sharp growth in exports in 2007 and 2008 was not blind luck, but most forecasters noted at the time the weak U.S. dollar, growing demand world-wide, and product shortages elsewhere as the reasons for forecasting the market for U.S. milk production. Yes, we had the milk then. Was that good planning or simply good luck?

Based upon what I've heard and read, here's the short list of programs that are needed for long-term dairy industry profitability and sustainability.

- Producers need to educate themselves about the risk management tools that are available – and use them;
- The industry needs a program that will help stabilize milk prices and permit intelligent growth;
- Input for intelligent growth must come from the industry's major organizations who have a stake in the outcome and the means to provide reasonable guidance;
- Once a program is operating to help stabilize milk production (and therefore prices), CWT needs to develop a robust export assistance program in order to maximize the export market for a wide range of dairy products;
- Senator Schumer's bill that addresses imports and labeling of Milk Protein Concentrates needs the full support of all segments of the industry; it's only fair;
- The milk price support program and MILC programs should be continued; little, if any, market distortion would result from these programs if the preceding five are adopted.

I've heard your views; **these are mine, offered with the best of intentions**.

JULY CARES COLUMN HAS BEEN POSTED ON OUR WEBSITE: *(By Rob Vandenheuvel)* The latest Dairy Cares Report has been posted on our website at: http://www.milkproducerscouncil.org/cares.htm. This month's column focuses on a recent court decision in the case pitting the extreme environmentalist group "AIR" (Association of Irritated Residents) vs. the San Joaquin Air Pollution Control District over the air regulations imposed on the dairy industry. I'd encourage you all to read this article, as it shows the greed and outrageousness of these extremist groups. Fortunately, the court seems to have seen right through the groups intentions.