

Milk Producers Council

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

E-mail: mpc@milkproducers.org

Website: www.MilkProducersCouncil.org

DATE: February 6, 2009

PAGES: 4

TO: DIRECTORS & MEMBERS

FROM: John Kaczor

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks + \$.0075 \$1.1575
Barrels + \$.0325 \$1.1475

CHICAGO AA BUTTER

Weekly Change N.C. \$1.1025
Weekly Average $-\$.0040$ \$1.0985

NON-FAT DRY MILK

Week Ending 1/30 & 1/31

Calif. Plants \$.8112 22,626,747
NASS Plants \$.8309 34,431,678

Weekly Average

Blocks + \$.0290 \$1.1535
Barrels + \$.0275 \$1.1330

DRY WHEY

WEST MSTLY AVG w/e 02/06/09 \$.1500
NASS w/e 01/31/09 \$.1586

CHEESE MARKET COMMENTS: Cheese prices on the CME this week advanced a bit, without much trading activity but not without attention from potential buyers and sellers. Both are good signs, and Cheddar blocks closed the week \$.0275 per lb above the CCC support level. Offsetting the good signs, *Dairy Market News* reports that production has been growing, partly in response to the availability of cheap milk, and retail sales still have not shown signs of strengthening. (Mozzarella sales at the wholesale level have turned upward.) Some of that cheap milk may be shifting back to bottling plants, as consumers see lower retail prices beckoning. It appears that the increased production of Cheddar during December went directly into storage for aging, which is o.k. If the news on January milk production, to be released February 19th, shows a clear slowing pattern, a foundation for further price strength may be at hand.

BUTTER MARKET COMMENTS: In the face of heavy production and continuing sales by California plants to the CCC, butter prices did pretty well this week on the CME. The heavy production, like that for cheese, was partially stimulated by the availability of cheap milk. Retail sales are said to be o.k., but food service buying continues to be slow. DMN hears that some plants with heavy production may be betting that butter in storage will turn a profit for them not too far into the future, with little downside price risk. The futures market: above \$1.20 by late May and above \$1.30 by September. Protection is available; the smart ones use it, the others lose it.

POWDER MARKET COMMENTS: More of the same this week for nonfat dry milk. Continuing heavy production, low exports, moderate at best domestic sales, more sales to the CCC at \$.80 per lb, more commercial sales in the West at prices as low as \$.775 per lb, **and growing inventories.** DMN reports they could find no truckload sales this week in the West at more than \$.84 per lb. The average of the West's "mostly" price range is again \$.80 per lb. December's production of **skim milk powder** was 51% lower than in December 2007, an indication of the slow and weak export market for nonfat powders. The Oceania partners, New Zealand and Australia, are showing signs of frustration and confusion, with New Zealand pointing at Europe as the reason for the current low prices. (Example: the latest price f.o.b. dock in New Zealand is averaging \$.795 per lb, \$.16 below the price f.o.b. ports in Europe.) Note to dealers in **whole milk powder**: try to buy it from Fonterra at \$.84 per lb (Fonterra's latest Global Dairy Trade price, February 3rd), and sell it to U.S. customers for \$1.10 per lb, which is what DMN says is the local prevailing price. "Do unto others..."

WHEY MARKET COMMENTS: More of the same this week for the whey market products. Sales are weak; buyers are reluctant to fill more than current needs; production is heavy. However, the average of **the West "mostly" price inched up this week for the first time since last April**, although some product was sold for as low as \$.12 per lb again this week. DMN reports that the market for whey protein concentrates continues to be pretty good, but it's beginning to look like chances for further price increases may be dampened by some buyers' belief that production will continue to outpace demand.

FRED DOUMA'S PRICE PROJECTIONS...

Feb 06 Est: Quota cwt. \$ 11.26 Overbase cwt. \$ 9.56 Cls. 4a cwt. \$ 9.51 Cls. 4b cwt. \$ 9.61
Last Week: Quota cwt. \$ 11.23 Overbase cwt. \$ 9.54 Cls. 4a cwt. \$ 9.37 Cls. 4b cwt. \$ 9.56

DECEMBER RECAP, AND MORE LOOKING AHEAD: (By J. Kaczor) A recent review of December's milk production reported there were 75,000 more cows being milked during the month than the previous December, generating 1.4% more milk. That relatively small percentage increase amounted to an additional 222 million lbs of milk for the month. Because of holiday school closings and cut backs in production of other holiday-related dairy products, normal usage of milk took an expected dip and the surplus was taken up by the country's butter, powder, and cheese plants. Cheese production increased by 9.7 million lbs (1.1%), so the "heavy lifting" occurred in the traditional market clearing sector, butter and powder. Butter production increased by 14.2 million lbs (10.1%), and powder production increased by 27.2 million lbs (18.6%).

With the shrinking of the export market, in terms of volumes and prices, **the industry's practical hope** is for a continuing slowdown in milk production – to where **inventories of unsold products** are reduced to the point where buyers begin to wonder about available supplies. At this point, it doesn't look like we are close, but there are a number of signs that suggest it's not an unreasonable goal. First, current low prices for virtually all dairy products should result in an eventual increase in per capita consumption. Example: the lowest retail price for whole milk this month in northern California is \$2.00 per gallon. Second, producers are likely to continue to aggressively cull marginal cows and reduce feed supplements, resulting in less milk being produced per herd. Third, the current CWT herd retirement is well on its way to removing 184 entire herds, and financial stress is expected to lead an additional substantial number of producers to close down, either voluntarily or involuntarily. Stories about additional partial or full herd reduction actions over the next few months are, at this point, only wishful thinking. Fourth, in response to urgings by a number of industry organizations, there are indications that USDA will begin to use more dairy products in domestic and international hunger-relief programs.

Standing in the way of getting there from here is, first and foremost, the horrid state of the U.S. economy. No one is predicting a quick end to the current deep recession with a recovery in the number of decent jobs that pay decent wages, a turn-around in the housing market, and a re-opening of the credit markets. Second, the amount of nonfat dry milk and butterfat products in storage is very high, and is growing. At the end of January, there is an estimated 80 days worth of production of nonfat dry milk in storage (or on the way to storage once CCC purchases are completed), and close to 25 days worth of butter. With USDA's help, along with consumer participation, there seems to be a reasonable chance that butter and cheese usage, and prices, can strengthen by the end of summer. Less reasonable is the chance for nonfat dry milk prices to recover, unless the "uncommitted" tag is removed from the 160 million lbs presently owned by the CCC that carries a sell-back price \$.88 per lb.

There is a lot to be said for the U.S. dairy industry to get itself back to the point of self-sufficiency, period.

A NOTE FROM ONE OF OUR READERS: The following was sent to MPC by **Gary B. Genske, CPA**. Gary is a Partner in Genske, Mulder Co. as well as a dairy producer/owner.

DO YOU THINK YOU ARE ALL ALONE IN THIS SITUATION? The most frequently asked question by our clients is "How long is this price decline going to last?" Everyone is concerned over the 20% excess supply of heifers and that the C.W.T. program will not be able to retire enough cattle to keep our national dairy herd at the 9 million head level. Today, the total is around 9.3 million head which has resulted in our deteriorating milk situation.

Without a major move by our industry leadership, we have projected an average loss for 2009 for our clients in the 28 largest dairy states, to be around \$1.69 per hundredweight of milk, or about a \$358 loss per milk cow. All dairy farms are projected to lose a substantial amount of money in 2009.

The most troubling factor facing all dairymen in this country is the oversupply of milk that is quickly turned into cheese, butter and powder products that the world markets do not want, but the government will buy at \$9.90 per

hundredweight. The answer to all of this – make the products that will sell in the world markets, or do not produce the excess milk and produce only what can be marketed domestically. Therefore producers can ask themselves this question: “Do you like the current milk production levels that will result in annual losses of \$2.00 to \$4.00 per hundredweight, or should all producers cut back production 3% - 4% from time to time and realize profits of \$2.00 to \$4.00 per hundredweight?”

MANAGERS NOTE: *(By Rob Vandenheuvel) Much of the recent discussion in our industry has been focused on short-term fixes for the oversupply problem at hand (a large-scale herd retirement program by CWT, more products being exported through the Dairy Export Incentives Program, etc.). And while these discussions are certainly important, we can't let this opportunity pass without a serious discussion about fundamental adjustments to our industry that will address the boom/bust cycles we have found ourselves in. **This massive volatility, with times of record profitability followed by record levels of equity loss, is simply unsustainable.** If we only focus on short-term fixes that will get us out of the immediate crisis, we have truly failed as an industry and **history is destined to repeat itself.** (If you have any doubts about history repeating itself, take a look at the article from our January 16th issue - <http://www.milkproducerscouncil.org/predictable.htm>. This current wreck was entirely predictable.)*

MPC really appreciates Gary's comments above. While the American dairy farmer is very independent, we need to be strategic as an industry in how we manage our growth going forward. What's that old quote from Ben Franklin? “*We must all hang together, or most assuredly we shall all hang separately.*” We simply cannot afford, as an industry, to continue growing faster than the market can absorb, constantly subjecting ourselves to massive economic wrecks like we are currently experiencing. As it stands in our current regulated system, **there is simply no incentive for American producers to ever manage their milk supply** (*with the recent exception of California dairies operating in a cooperative with a base plan*). If we are going to continue operating in a regulated pooling system – as I believe most producers want – we need to create real financial incentives for producers to manage their growth, keeping supply and demand in balance.

MPC has spent significant time in the past two years talking about the Growth Management Plan (GMP). As many of you know, this plan would keep our national milk supply in line with our demand, directly addressing the **single largest threat to our industry – extreme and unsustainable volatility**. If you haven't already heard about the GMP, I urge you to take a few minutes and browse the material on our website: <http://www.milkproducerscouncil.org/GMP.htm>. **Cornell University's Program on Dairy Markets and Policy is in the process of updating the modeling for the GMP, and in the near future, we will be sharing those results with you in this newsletter. So stay tuned...**

CONGRESSMAN DEVIN NUNES (R-VISALIA) URGES ACTION ON WATER CRISIS IN CALIFORNIA: *(By Rob Vandenheuvel) Today, Rep. Devin Nunes sent the following letter to President Barack Obama and Governor Arnold Schwarzenegger, urging immediate action to address the impending water crisis in California. The letter can also be found at: <http://www.milkproducerscouncil.org/020609nunesletter.pdf>.*

Dear President Obama and Governor Schwarzenegger:

The State of California is experiencing a disaster. The economy of the state is dependent on two major water supply projects that were designed and built in the middle of the Twentieth Century, the Central Valley Project (CVP) and the State Water Project (SWP). Collectively, these projects serve more than 25 million people in the San Francisco Bay Area and Southern California and serve more than three million acres of highly productive farmland. However, we have failed to invest in the infrastructure required to make these Projects capable of serving the current needs of the state. Moreover, our failure to invest in conveyance infrastructure in the Sacramento-San Joaquin Rivers Delta has subjected the CVP and SWP to severe restrictions under the Endangered Species Act. As a consequence, the people who rely on the CVP and SWP are facing unprecedented water supply shortages at the hands of policymakers.

For the first time in the history of the CVP, which is operated by the Bureau of Reclamation, agricultural water service contractors on the westside of the San Joaquin Valley will receive no water for the irrigation of nearly a

million acres of farmland. As a consequence, as much as 500,000 acres will be forced out of production and, according to a recent forecast by economists at the University of California, Davis, more than 40,000 farm workers will lose their jobs. This is a number which exceeds the number of job losses at General Motors. Moreover, these job losses will occur in poor, rural communities, such as the City of Mendota, which already has unemployment rates in excess of 40%, and these communities are the least capable of reacting to this economic devastation.

This year the SWP, which is operated by the California Department of Water Resources, will be able to deliver only 5-10% of normal allocations to cities and farms served by the SWP. The economic losses in places like the Los Angeles basin and Silicon Valley, which rely on water from the SWP, will be exponentially greater than losses in the farming communities of the San Joaquin Valley, and the consequences of this water supply disaster will eviscerate any benefits from a stimulus package passed by the Congress.

I am writing to urge you to act immediately to ameliorate the economic disruption that is already occurring in California. There are actions that can be taken. For instance, New Melones Reservoir, which is owned by the Bureau of Reclamation, currently holds nearly 1.2 million acre-feet of water. Historically, water from this reservoir has been used primarily to enhance fisheries in the Stanislaus River. However, current needs demand that this water be made available to farmers and cities outside of the historic place of use, and it is within the discretion of your agencies to enable this change. In addition, agencies within your respective administrations exercise great discretion in the administration of federal laws, like the Endangered Species Act and the Central Valley Project Improvement Act; or state laws, like the California Water Code. These agencies should be directed to exercise that discretion in a manner that will enable the CVP and the SWP to move water to the farms and cities that depend on these projects. I implore each of you to direct agencies under your control to take all steps necessary to restore water supplies to some sense of normalcy.

Finally, I am asking that you join me in supporting legislation that will prevent environmental laws from impeding progress on stimulus projects and actions required to deal with emergencies like the one currently facing California. Senator David Vitter has proposed an amendment to the stimulus bill that would exempt from the application of the National Environmental Policy Act for a period of three years projects intended to stimulate the economy and exempt from the application of the Endangered Species Act actions taken during periods of a declared emergency to mitigate the impacts of that emergency. I will introduce companion legislation in the House of Representatives at the earliest opportunity. Please support Senator Vitter's proposed amendment and my legislation.

As you know, the San Joaquin Valley is America's breadbasket. Our region supplies food and fiber to the world. Communities in the San Joaquin Valley grew on the foundation of a strong agriculture economy, but today many of those communities are withering because of chronic water supply shortages. I do not believe that I am exaggerating when I state that people in rural areas of the San Joaquin Valley are facing a humanitarian crisis unparalleled in modern history. Moreover, large urban areas of California are about to experience the hardship endured by these rural communities for the last two decades.

While you cannot reverse decades of bad decisions overnight, you do have options before you today. I urge you to exercise leadership and act now to mitigate the suffering of my constituents. Failure to act will simply push the San Joaquin Valley unemployment rate above 20% and result in the collapse of civil society.

With deep concerns, Devin Nunes, Member of Congress

REMINDER FOR SOUTHERN CALIFORNIA DAIRIES – AQMD'S ANNUAL EMISSIONS REPORT DUE MARCH 3RD: *(By Rob Vandenheuvel)* For dairies that have a permit with the South Coast Air Quality Management District (which includes dairies that milk about 700 or more cows), your "Annual Emissions Report" is due by March 3rd. If you need any assistance in filling out this report, please give me a call at (909) 992-9529.

End