



Milk Producers Council

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DATE: February 9, 2018
TO: Directors & Members

PAGES: 6
FROM: Kevin Abernathy, General Manager

CHICAGO CHEDDAR CHEESE			MPC Friday Market Update			NON-FAT DRY MILK		
			CHICAGO AA BUTTER			Week Ending 2/2 & 2/3		
Blocks	+	\$.0475	Weekly Change	-	\$.0875	Calif. Plants	\$0.7195	9,665,520
Barrels	+	\$.0350	Weekly Average	-	\$.0630	Nat'l Plants	\$0.6980	22,229,490
Weekly Average, Cheddar Cheese			DRY WHEY			Prior Week Ending 1/26 & 1/27		
Blocks	+	\$.0535	Dairy Market News	w/e 2/9/18	\$2.400	Calif. Plants	\$0.7193	10,094,866
Barrels	+	\$.0375	National Plants	w/e 2/3/18	\$2.524	Nat'l Plants	\$0.7035	20,946,995

Fred Douma's price projections...

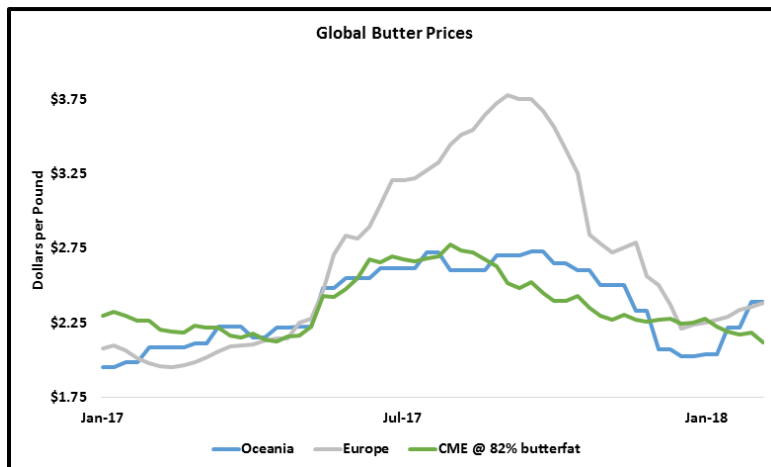
Feb 9 Est:	Quota cwt. \$14.61	Overbase cwt. \$12.91	Cls. 4a cwt. \$12.56	Cls. 4b cwt. \$13.32
Last Week:	Quota cwt. \$14.53	Overbase cwt. \$12.83	Cls. 4a cwt. \$12.80	Cls. 4b cwt. \$12.97

Market commentary

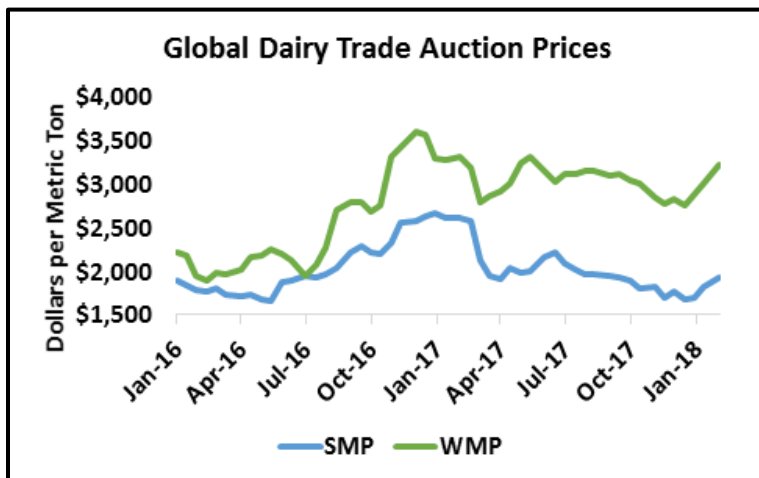
By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com

Milk & Dairy Markets

For more than a year, the butter market has been the Almonds of the dairy complex. It was at times curiously strong, and a breath of fresh air for dairy producers in an otherwise sour market. Today, its fortitude is fading. CME spot butter finished at \$2.0275 per pound, down 8.75¢ for the week and 18¢ below where it began the year. The butter market hasn't been this weak since November 2016. Cream is plentiful and churns are active. The calendar may be partly to blame. Super Bowl demand is past, and March 1 – when the CME will no longer accept “old crop” butter – is fast approaching. Next month only butter produced after December 1, 2017 can be sold at the CME spot market. Traders may be looking to unload older butter while they can. Buyers know they're likely to get older product, and they are adjusting their bids accordingly.



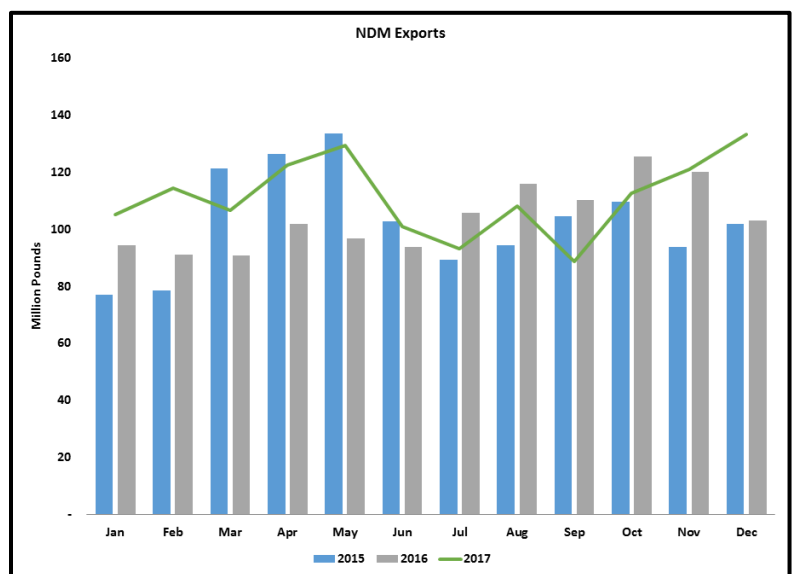
Meanwhile, prices are climbing in Europe and Oceania. Butter jumped 7.9% at the Global Dairy Trade (GDT) auction on Tuesday, reaching the equivalent of \$2.45 per pound at 80% butterfat. With U.S. butter at a discount, there may be more opportunity for exports. In December, the U.S. was a net exporter, sending 5 million pounds of butter abroad and taking in just 3.5 million pounds, the lowest monthly volume since April 2016. However, butterfat in other forms continued to make its way to our shores. In December the U.S. imported 8 million pounds of anhydrous milkfat, the largest monthly volume in nine years.



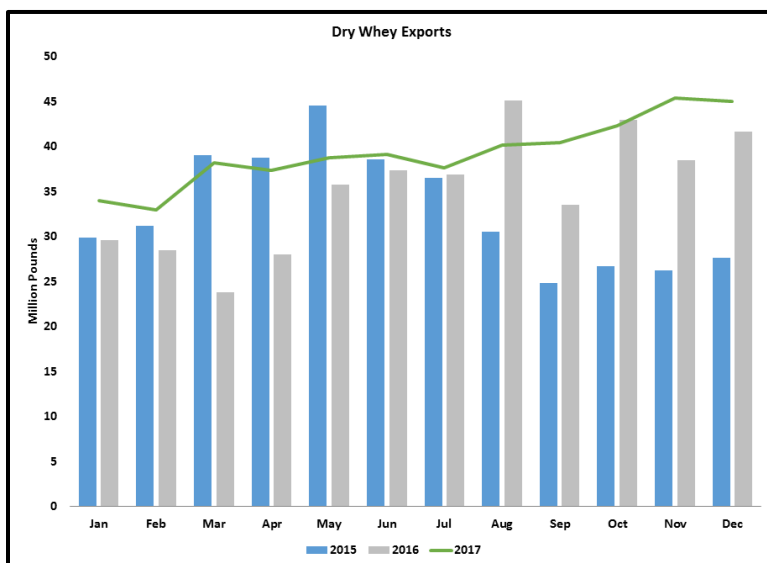
Overseas pricing gave a boost to the milk powder markets this week. CME spot nonfat dry milk (NDM) climbed 1.25¢ to 73.5¢ per pound. Relative to product from Oceania, U.S. NDM looks downright cheap. Skim milk powder (SMP) jumped 7.2% at the GDT to the equivalent of 94¢ NDM after adjusting for protein. Whole milk powder (WMP) prices surged 7.6%, pushing the GDT index up 5.9% to its highest level since December 2016. Fonterra offered less product at the auction due to concerns that dry pastures will curtail milk output in New Zealand in the remaining months of the 2017-18 season.

Bad weather for New Zealand is good news for U.S. export prospects, but the U.S. will still have to compete with growing volumes of SMP from Europe and Canada. In December, U.S. NDM and SMP exports reached 133.5 million pounds, up 29% from a year ago. For the year, U.S. milk powder exports were up just 2% from 2016. Nearly half of the volume went to Mexico.

The cheese markets bounced back this week. CME spot Cheddar barrels rallied to \$1.51, up 4.75¢. Barrels finished 3.5¢ higher, at \$1.36. Milk is still plentiful in the cheese states. *Dairy Market News* reports that Midwestern cheese plants can buy spot milk for as much as \$4 under Class III. Domestic demand is unexciting. In December, U.S. cheese exports totaled 60.2 million pounds, down 4% from the rather large volume reported in December 2016. However, for the year U.S. cheese exports were up 19.2% from 2016.



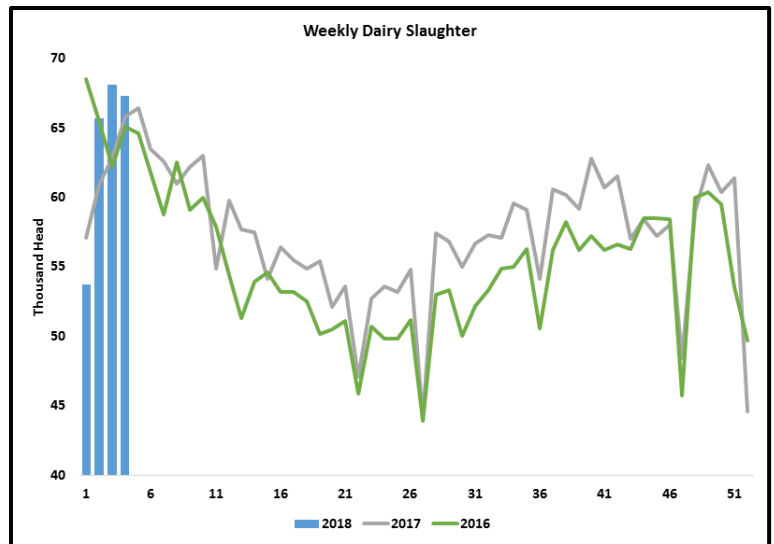
U.S. dry whey exports reached 45 million pounds in December, up 8.1% from a year ago. Exports of whey protein concentrate (WPC) climbed to 33 million pounds, up 26% from a year ago and the second-largest monthly volume on record. For all of 2017, U.S. dry whey exports were nearly 12% greater than 2016 volumes and WPC exports were record large, up 3.5% from 2016. That helped to push total U.S. dairy product exports up 6% in 2017. According to the U.S. Dairy Export Council, U.S. dairy exports were equivalent to 14.7% of U.S. milk production in 2017, the highest share since 2014. Imports were equivalent to 3.4% of U.S. milk production.



Still, cheese and whey stocks are burdensome, as output continues to outpace demand. February through July dry whey futures finished in the red this week. Most Class III contracts finished a little higher, but the February contract dropped 16¢. Class IV futures were decidedly lower. The

February contract is falling uncomfortably close to the \$13 mark.

As one might expect, today's prices are not sitting well with dairy producers or their lenders. *Dairy Market News* reports, "A number of Midwestern dairy farmers are reportedly planning to auction their herds in the immediate future. Conversely, multiple other farm owners have conveyed an interest in herd expansion. Thus, the possibility of an overall change in milk output is up in the air." For the three weeks ending January 27, dairy cow slaughter has averaged 67,033 head, higher than in any three-week period since January 2013. Pent-up culling after the holidays may have pushed this number a bit higher than usual in early January, and there are plenty of heifers to fill those cows' stalls. Still, it's a start.



Grain Markets

USDA surprised the grain markets yesterday, making more aggressive changes to its corn and soybean trade estimates than crop market analysts had anticipated. The agency lowered its outlook for U.S. soybean exports by 60 million bushels, resulting in a nearly 13% jump in end-of-season soybean stocks. The change acknowledges that the U.S. soybean export pace has lagged, as China favors higher protein soybeans from Brazil. U.S. soybeans might also become a casualty of the U.S.-China trade spat. In December, China tightened quality standards on U.S. soybean imports – effectively raising their delivered cost – but did not ask the same of its Brazilian suppliers. This week China's Ministry of Commerce met with industry leaders to discuss the impact of imposing anti-dumping and anti-subsidy measures on U.S. soybean imports. The meeting closed without a consensus, but the event is disconcerting.

Nonetheless, March soybeans settled today at \$9.83 per bushel, up 4.25¢ for the week. March soybean meal climbed \$12.70 per ton to \$343.80. Corn futures also finished higher. The March contract closed at \$3.62, up 1.5¢. USDA took the opposite stance toward the corn market, boosting its estimate of U.S. corn exports by 125 million bushels. At 2.35 billion bushels, end-of-season corn stocks are still massive and projected to build on the previous year's inventories for the fifth consecutive season. But the U.S. trade outlook is improving because grain output is expected to drop for several key exporters, including Argentina, Australia, Brazil, and Ukraine. The trade had grown comfortable with the idea of ever-higher grain output everywhere in the world. That consensus has been shaken.

A very big week for California dairy farmers

By Geoff Vanden Heuvel, Board Member and Economics Consultant.

So far 2018 had been pretty quiet, but all that changed this week. I have five significant things to share with you.

Early this week USDA announced that they are delaying action on the California Federal Milk Marketing Order (FMMO) pending a decision by the U.S. Supreme Court on a case called *Lucia vs. Securities and Exchange Commission*. Dave Natze, editor of the *Progressive Dairyman*, has a very good layman's explanation of the legal issues involved in this case, which you can read [here](#).

We had been picking-up signals that there was something amiss at USDA regarding the release of the California FMMO for a few weeks. The cooperative's legal people have made a thorough evaluation of the legal issue

involved and it seems like there is a strong argument to be made to USDA that the use of the Administrative Law Judge (ALJ) in the California Federal Order hearing, which took place in 2015, was completely different than the use of the ALJ in the disputed Securities and Exchange Commission case. It just so happened that there was a House Agriculture Committee hearing with USDA Secretary Perdue this week, and Congressman Jim Costa asked Secretary Perdue about this issue. You can see that exchange [here](#) (If you watch the video, the next questioner of Secretary after Congressman Costa is Congressman Goodlatte, who as chairman of the House Judiciary Committee, is leading the effort to create an immigration fix for agriculture. His exchange with Secretary Perdue is also worth watching).

Obviously, producers in California cannot sit back and do nothing to try to change USDA's mind. It is clear that the decision is ultimately Secretary Perdue's to make. We need to make our case to him on both legal grounds and economic grounds. To that end, the three trade associations, Western United Dairymen, Milk Producers Council and the California Dairy Campaign are sending a joint letter outlining our concerns with the delay and asking for a quick release of the California FMMO, which you can read [here](#). The cooperatives as well will be doing their best to press USDA. You can read their letter to Secretary Perdue [here](#).

Our political representatives are also being activated to help us out. In addition to that, Secretary Perdue will be in California for a couple of days next week attending the Tulare Farm Show and visiting with farmers. You may have the opportunity to talk to him. Respectfully let him know how important it is to you to have the California FMMO released. Stay tuned.

The next really big deal is the Budget Bill that passed Congress in the early morning hours today. This was not exactly government policy making at its best. But while ugly, it was effective in making what I think will be seen as fundamental changes in the government's dairy safety net.

First, what did NOT change is the feed cost adjuster in the MPP program or the catastrophic coverage at a \$4 margin for all milk. The changes that were made are outlined on pages 646-652 of the Budget Bill, which you can read [here](#).

The first of these changes are designed to bolster the buy-up portion of the MPP program for small producers. The current break point of 4 million pounds per year of production for the lower buy-up coverage premiums gets raised to 5 million pounds. This is about what a 200-cow dairy produces annually. Then the premiums for that coverage are getting drastically reduced. See the table below.

Coverage Level (Margin) per cwt.	Tier 1 Premium for 2016-2018	Tier 2 Premium for 2014-2018	2018 Tier 1: Premium per hundredweight for first 5,000,000 lbs. of production	2018 Tier II: Premium per hundredweight for production in excess of 5,000,000 lbs.
	Covered production history less than four million lbs.	Covered production history greater than four million lbs.		
\$4.00	None	None	None	None
\$4.50	\$0.010	\$0.020	None	\$0.020
\$5.00	\$0.025	\$0.040	None	\$0.040
\$5.50	\$0.040	\$0.100	\$0.009	\$0.100
\$6.00	\$0.055	\$0.155	\$0.016	\$0.155
\$6.50	\$0.090	\$0.290	\$0.040	\$0.290
\$7.00	\$0.217	\$0.830	\$0.063	\$0.830
\$7.50	\$0.300	\$1.060	\$0.087	\$1.060
\$8.00	\$0.475	\$1.360	\$0.142	\$1.360

With this change the small producer, for a payment of \$0.142 per cwt. can get \$8.00 margin coverage in the MPP program. The cost to buy \$8 margin coverage for volumes over 5 million pounds has not changed and is \$1.36 per cwt. This has proven to be cost prohibitive and therefore unattractive to producers whose volume coverage needs are larger than the 4/5 million pounds. If the Budget Bill changes ended there, it would seem that this legislation would be very unfair to larger producers, but it does not end there. Accompanying the changes to the MPP is a lifting of the \$20 million program cost cap for the Livestock Crop Insurance products. I have talked a bit about this problem in the past. With the elimination of the \$20 million cost cap in the Budget Bill, a Dairy Revenue Crop Insurance Program becomes a viable and potentially very valuable risk management tool for all dairy farmers.

The American Farm Bureau has developed and advanced such a plan called Dairy Revenue Protection (Dairy-RP). It is in the formal approval process with the Federal Crop Insurance Board and final approval could come yet this Spring. This program would enable producers to purchase Crop Insurance style coverage to protect dairy margins up to 5 quarters out. The Crop Insurance program subsidizes these premiums and there had been until this morning a \$20 million cap on federal expenditures for those premium subsidies for any insurance product that was considered benefiting a livestock operation (the crop side of the Federal Crop Insurance program had no cost caps and the government has spent an average of about \$7 billion per year in premium subsidies for the nearly 80 different crops that are covered by some type of federal Crop Insurance program). The \$20 million cap has been seen as a huge barrier to the successful implementation of a Dairy Revenue program. With the lifting of this cap, the way is clear for a dairy Crop Insurance approach to become a major part of the government's dairy safety net. Thus, this is a very significant development.

Two other water related things happened this week. Governor Brown modified his two-tunnel delta fix by announcing that the project would be built in phases with just one tunnel and two intakes on the Sacramento River being part of the first phase. As you may recall, the Governor had originally proposed a \$16 billion, two-tunnel, three-intake project that would be designed to move up to 9,000 cubic feet (cu. ft.) per second of water flow directly from the Sacramento River north of the Delta to the California Aqueduct and Delta Mendota Canal.

However, over the past few months it became clear that only the mostly urban contractors of the State Water Project were willing to agree to pay for the project. No federal contractors signed up to pay and that necessitated the change in phasing. The one tunnel option is designed to move 6,000 cu. ft. per second under high flow conditions to the California Aqueduct for State Contractor use only. Meanwhile, the State Water Resources Control Board which must issue permits to actually allow a change in the diversion points for the project delayed their on-going hearing to sort out the various legal challenges to their process. So, there is a decision by the Governor, but still lots of challenges.

The other significant water related development this week was the release of a detailed analysis by the California Water Commission of each of the storage projects seeking funding from Prop 1. A number of these projects are important to the California dairy industry and the analysis was very critical of all the projects casting into doubt how much, if any, Bond money would be allocated to them.

The stated reason for this is that the Bond money is designated to pay for the "public benefits" only with others paying for the water supply benefits of these projects. Public Benefits are described as ecosystem improvements, water quality improvements, flood control benefits, emergency response benefits or recreational purposes. As you can imagine, the estimation of the Public Benefits by the proponents of these projects greatly exceeded the Water Commission staff's calculations of these benefits. There is an appeal process and it seems that a pretty big amount of subjectivity is used in making these determinations.

There is \$2.7 billion at stake in Prop 1 funding, and for us in the dairy industry, the Temperance Flat Reservoir Project, the South Sacramento County Ag Program, the Tulare Lake Storage and Floodwater Protection Project are all of value to us. The Water Commission staff estimated Public benefits for the Temperance Flat Reservoir

at 10 cents for every requested Bond dollar. They estimated 75 cents of public benefit for every dollar of bond money requested for the South Sacramento Ag project and 1 cent of public benefit for every dollar of requested bond money for the Tulare Lake project. The Sites Reservoir in the Sacramento Valley was estimated to provide 40 cents of public benefit for every dollar of requested bond funds. Who knows how this all shakes out. But it seems to me that when the public voted for bond money for water storage in California they intended to see water storage actually get built. Stay tuned on this as well.
