Milk Producers Council

13545 S. Euclid Avenue, Unit B ~ Ontario, CA 91762 ~ (909) 628-6018
801 S. Mount Vernon Avenue ~ Bakersfield, CA 93307 ~ (661) 833-2549
222 S. Thor Street, Suite 20 ~ Turlock, CA 95380 ~ (209) 250-1801
Fax (909) 591-7328 ~ office@milkproducers.org ~ www.MilkProducers.org

DATE: February 12, 2016 **PAGES: 6**
TO: Directors & Members **FROM: Rob Vandenheuvel, General Manager**

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE			**CHICAGO AA BUTTER**			**NON-FAT DRY MILK**		
						Week Ending 2/5 & 2/6		
Blocks	+*$.0200*	$1.4900	Weekly Change	- *$.0600*	$2.1100	Calif. Plants	$0.7797	7,954,560
Barrels	+*$.0150*	$1.4800	Weekly Average	- *$.0145*	$2.1310	Nat'l Plants	$0.7735	17,448,361
Weekly Average, Cheddar Cheese			**DRY WHEY**			***Prior Week Ending 1/29 & 1/30***		
Blocks	+*$.0160*	$1.4820	**Dairy Market News**	w/e 02/12/16	$.2500	*Calif. Plants*	*$0.7935*	*6,896,880*
Barrels	+*$.0150*	$1.4710	**National Plants**	w/e 02/06/16	$.2479	*Nat'l Plants*	*$0.7706*	*14,009,565*

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FRED DOUMA'S PRICE PROJECTIONS…

Feb 12 Final:	**Quota cwt. $14.85**	**Overbase cwt. $13.16**	**Cls. 4a cwt. $13.42**	**Cls. 4b cwt. $13.11**
Last Week:	**Quota cwt. $14.85**	**Overbase cwt. $13.16**	**Cls. 4a cwt. $13.57**	**Cls. 4b cwt. $13.01**

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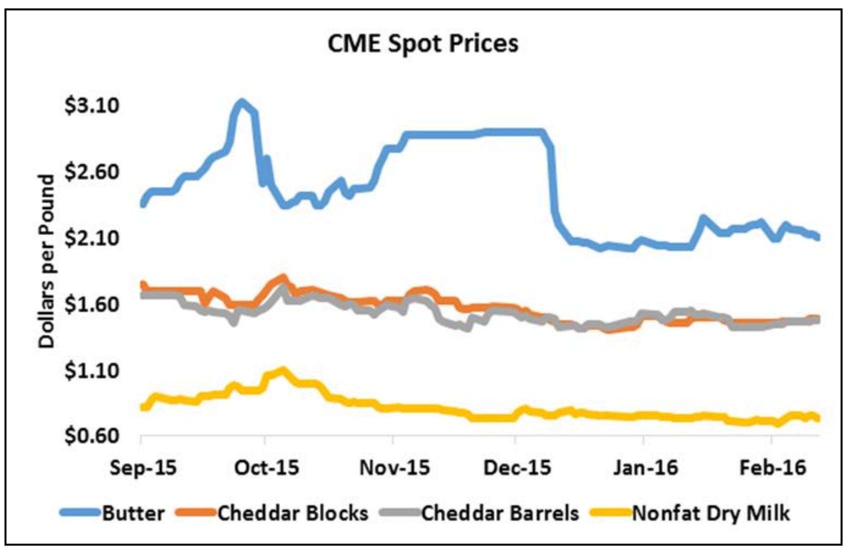
MARKET COMMENTARY: *(By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)*

Milk & Dairy Markets

It was a gut-wrenching week on Wall Street and its counterparts around the globe. Stocks moved higher Friday, but after several days of steep losses, the belated rally was likely a sign that the bears were exhausted, not that the bulls were enthusiastic. On Thursday, crude oil reached a 13-year low. Market recaps on CNBC and Bloomberg could easily be mistaken for an extended "Buy Gold!" commercial. Central bankers are fumbling for answers and investors are worried. Low oil prices, negative interest rates, and mounting sovereign debt all point to an ailing global economy.

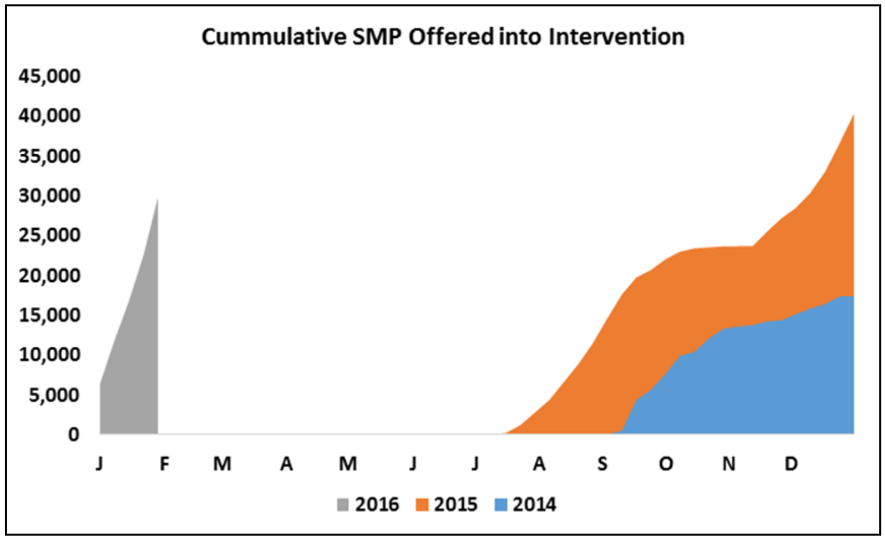


In such a turbulent environment, the dairy markets fared rather well. CME spot Cheddar blocks climbed 2¢ to $1.49/lb., near the high end of their recent, exceedingly narrow trading range. Barrels ended Friday at $1.48, up 1.5¢ on the week. Cheese futures perked up in the latter half of the week, and dry whey futures moved higher nearly every day. This boosted February through May Class III futures a little higher than last week's settlements, but deferred contracts slipped again.

Perhaps the uptick in nearby Class III futures is like the stock market's bounce today, a tepid rebound after a big setback. However, it is worth noting that this is not a particularly auspicious time of year for the dairy market. Class III milk prices hit their annual low in the first quarter in eight of the last 15 years. In a world heavy with dairy products, a rip-roaring rally is likely out of the question. But in the coming months a plateau or even a bounce from low levels is possible.

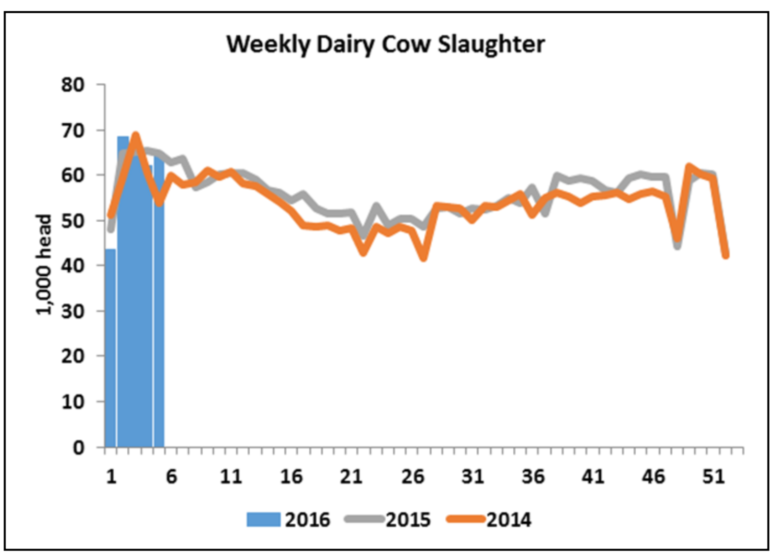
Grade A nonfat dry milk (NDM) reached 76¢ Thursday, its highest level since Christmas. But it was quickly beaten back to 73.25¢ today, down 1.25¢ on the week. Spot butter dropped 6¢ this week to $2.11. According to *Dairy Market News*, "Churns are running close to full capacity" and "cream supplies are readily available." Most Class IV futures contracts lost between 30 and 50¢.

Dairy product prices will not meaningfully recover until European milk production slows, or until demand surges to absorb the surplus. *Dairy Market News* reported last week that "Milk production in the EU… is expected to remain strong this year." Benchmark skim milk powder (SMP) prices are below the intervention purchase price and product is moving into the Intervention storage program at an increasing rate. In just five weeks, European processors have moved 16.1 million pounds of SMP into storage, putting the program at 27% of the allowed capacity for the year.



But, almost imperceptibly, the tide may be starting to turn. As the *Daily Dairy Report* notes, "Subsidies to European dairy producers have buffered many from the true impact of the region's 4-5% increase in milk output and its influence on world dairy prices. However, the coffers to support European dairy producers may be drying up." France is lobbying the European Commission to do more for dairy producers and other agricultural sectors struggling from the Russian ban on Western imports. But Brussels is not exactly flush with cash these days. Those looking for ways to salve the dairy industry's wounds may have better luck restoring trade with Russia. France's Finance Minister was in Moscow this week, echoing comments from Prime Minister Hollande that France would be open to allowing sanctions to lapse this summer. In the interest of diplomacy and camembert, Russia might respond in kind.

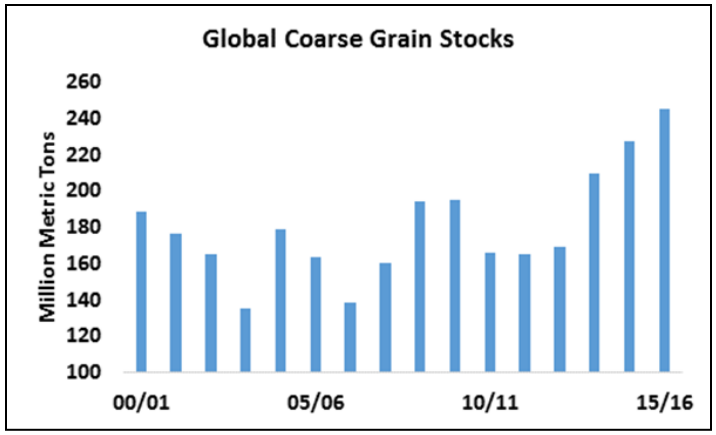
Processing capacity constraints are also coming into play. FrieslandCampina paid its Dutch members €14.1 million to limit milk production over the past six weeks. They responded, reducing production by 77.2 million pounds. FrieslandCampina and other cooperatives may have to consider similar measures again during the spring flush. That is not to say that European dairy producers are stomping on the brakes. A one-off, six-week program to reduce production, political gossip, and speculation of reduced subsidies are rather thin gruel in a market starved for good news. But they may represent the first signs of attrition on the long, slow road to higher prices.



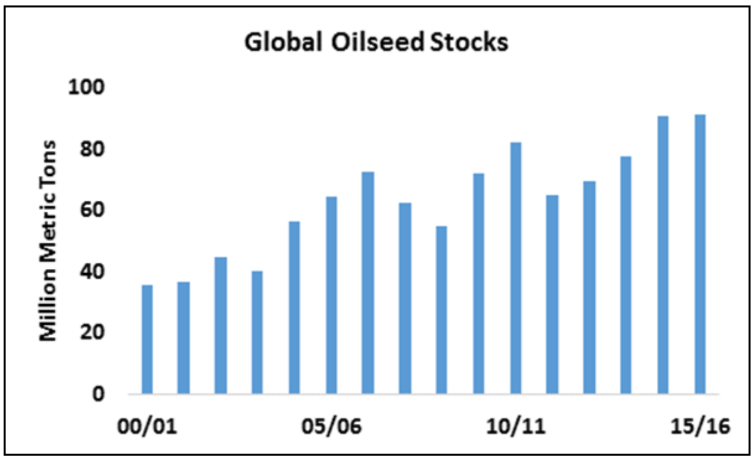
For the week ending January 30, dairy cow slaughter totaled 65,133 head, up 0.6% from the same week a year ago. After one month, the 2016 cull rate is 1.2% behind the 2015 pace.

Grain Markets

March corn settled Friday at $3.5875 per bushel, down 7¢ this week. Soybean futures jumped 5.25¢ to $8.7275. Malaysian palm oil futures are surging, boosting soybean oil prices and, to a lesser extent, soybean futures. The strong El Niño has reduced rainfall in Malaysia and Indonesia, lowering production prospects. However, demand for palm oil has not been impressive, and production typically hits its low in February. Stocks are large after a big crop last year. Soybean market bulls may soon have to look for fodder outside the palm oil market.



USDA's monthly update to its World Agricultural Supply and Demand Estimates didn't offer much for the bulls to chew on. The agency raised its estimate for U.S. corn and soybean stocks due to lower demand. USDA dropped its outlook for corn exports by 50 million bushels and raised its import estimate by 10 million bushels, emphasizing fierce competition in a global market that is flooded with grain. Domestic corn stocks are expected to stand at 10-year highs when the season ends on August 31.



Global supplies of grains and oilseeds have grown in each of the past four crop years. Such consistent supply growth is unusual and reflects the impact of the historically high prices in the preceding years, which encouraged farmers to expand crop acreage and invest in better seed genetics and inputs. Farmers in South America are just beginning to harvest another big crop. They will also reap the benefits of weaker currencies, improved infrastructure, and freer markets. Barring a weather disaster in the United States, feed prices are likely to stay low for some time.

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TEMPORARY CLASS 4B CHANGE NETS SOME ADDITIONAL DOLLARS INTO THE CALIFORNIA MILK POOL IN JANUARY: *(By Rob Vandenheuvel)* While we must unfortunately report that a significant California Discount continued in January 2016 *(the California Class 4b price was $0.64/cwt below the FMMO Class III price)*, there was a silver lining to the news. For the second time since the temporary Class 4b price change was implemented by CDFA in August 2015, producers saw a net benefit to the change, compared to the previous *(and future if the current formula is allowed to expire in July 2016)* calculation. At a time when producers are facing monthly operating losses, anything that reduces the painful California Discount – albeit very modestly – is positive news.

CDFA's Temporary Class 4b Adjustment*

	What Jan '16 would have been without CDFA's Adjustment	Actual Jan '16	Net Benefit in Jan '16
California Class 4b Price	*$12.94*	**$13.08**	
FMMO Class III Price	*$13.72*	**$13.72**	
Discount	**($0.78)**	**($0.64)**	**+$0.14**

** CDFA's temporary changes to the Class 4b pricing formula are set for August 2015 – July 2016*

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THE CALIFORNIA DISCOUNT – IT AIN'T A MYTH FOLKS! *(By Rob Vandenheuvel)* While California producers face some of the lowest milk prices in the country and have watched our margins turn from black to bleeding red, we have the continued long-term hope that at least we are moving along the path towards a California Federal Milk Marketing Order (CA-FMMO). While the CA-FMMO will in no way guarantee a profit for dairies in California, it can put us on a level playing field with our competition around the country by eliminating the California Discount, giving us at least a fair shot at a sustainable future.

At the same time, the Dairy Institute of California – on behalf of the California milk processors they represent – have a very different position on the current state of the California Dairy industry. That makes sense, as the regulated milk price formulas provide them with opportunities for profits regardless of whether the price of milk is high or low. In the interest of preserving the status quo, they have taken their rally cry to the media in the form of an "open letter" on the issue of the California Discount. Their message in short: **The Discount is a "myth, a total myth."**

Wow. Your blood boiling yet? It's one thing to argue that the Discount is justified (which we would of course strongly object to). At least that could be an intellectual debate. It takes a whole new level of chutzpah to go beyond that and try and sell the message that the Discount is merely a myth!

Below, I've copied the "open letter" written by Rachel Kaldor, Executive Director of the Dairy Institute of California, as published in the *Cheese Reporter* on February 5th. While I could certainly take Ms. Kaldor's claims and expose them one-by-one, producers have already done during the course of the recent CA-FMMO hearing. Perhaps the Dairy Institute didn't like how their position was portrayed once sworn testimony exposed many of their arguments as mere rhetoric. That could at least explain why they would go to the media at this time with this shameless argument.

Regardless of their motives, the letter is out there, so I've also included a response below that we submitted and was published in this week's *Cheese Reporter*. Our sincere thanks to the *Cheese Reporter* for the opportunity to respond.

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http://www.cheesereporter.com/editorial.htm

A Total Myth: 'The California Discount'

by Rachel Kaldor, Executive Director
Dairy Institute of California

An open letter from the Dairy Institute of California:

California dairy farmers have been sold a bill of goods. They've been told that since they aren't getting the Class III price, they're being cheated. But it's a myth, a total myth.

This fiction has gotten in the way of any reasonable discussion about dairy pricing in California. It has become all or nothing. Unless California farmers get the Class III price, they're completely dissatisfied.

Here are the facts that completely debunk the myth:

- In no existing federal milk marketing order does USDA require all cheese makers to pay the Class III price. So the claim that California dairy farmers should get paid what Wisconsin farmers get paid deserves closer scrutiny.

- Today, Wisconsin spot milk sales are happening at between $4.00 and $8.00 UNDER Class III. That is never part of the "California Discount" story. California processors, however, never pay less than the Class 4b price.

- California's binding minimum price regulations limit competition across manufacturers and that has led to adequate supply, limiting market pressure for increased premiums.

- Wisconsin has many specialty, value-added cheese plants, which generate more revenue than commodity products. California's largely commodity cheese plants were built to accommodate our large milk volume; those commodity products generate lower revenue.

- Wisconsin cheese plants are nearly half a continent closer to our domestic market. California is the most distant dairy region from domestic cheese markets. It costs money to move product to market.

These facts add up to the real story.

Let's look at a federal order that has large commodity cheese plants, with a normally ample supply of milk, but closer to domestic markets than California: New Mexico. What's the most recent mailbox price paid to farmers in that Federal Order? For October 2015, in New Mexico — a federal order with the same rules as Wisconsin but with a dairy industry structured a lot like California — the price was $15.55. But the price paid to dairy farmers in California was $15.82.

That is the real story. It's not the California discount. It's the California difference — one state's unique industry structure compared to another's.

"The California Discount" makes an easy target of our state's industry. It deliberately distracts from the real work needed to make our industry successful in changing markets; domestic and now global. And it's simply a myth. A total myth.

Rachel Kaldor
Executive Director
Dairy Institute of California

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Letter to the Editor

By Rob Vandenheuvel, General Manager
Milk Producers Council

A response to last week's "open letter" written by Rachel Kaldor, Executive Director of the Dairy Institute of California, entitled, "A Total Myth: 'The California Discount'" (Feb. 5, 2016):

Rachel Kaldor proclaims the "California Discount" is a myth? Let's call a spade a spade; the Dairy Institute of California is in the business of advocating for their processor clients. Ms. Kaldor's job is to preserve the advantage her California processors have received, in the form of a regulated discount in the minimum milk prices they pay. Our job, as California producers, is to call them on it and smoke out the steer manure.

The "California Discount" is a running tally of the devastating financial impact on California dairy farms of having a State Milk Marketing Order that establishes a monthly minimum price for milk sold to cheese plants (Class 4b) significantly below the Federal Order Class III price. That tally is up to $1,951,728,890 since 2010, AND COUNTING!

We've been fighting this battle for years, but last Fall a wonderful thing happened. We had an opportunity – in the context of a USDA hearing on a California Federal Order – to ask pointed questions of Dairy Institute witnesses under oath about some of the rhetoric we've heard over the years. Check out the excerpts below from testimony given by two large cheese manufacturers with operations in both California and Federal Order areas: Saputo Cheese Company and Leprino Foods. (The full transcripts from this hearing can be found at: https://www.ams.usda.gov/rules-regulations/moa/dairy/ca/transcripts.)

October 22, 2015

- **Question by Marvin Beshore, Counsel for the California Dairies, Inc., Dairy Farmers of America and Land O'Lakes:** "Do you know what your average cost of milk in [Saputo Cheese Company's] Wisconsin plants is?"
- **Answer by Greg Dryer, Senior Vice President, Saputo Cheese Company:** "Well, it is higher. Definitely higher than the minimum [Class III] price."

October 29, 2015

- **Question by Mr. Beshore:** "So I just want to talk about [Leprino Food Company's six] non-California plants, briefly. Those are all nonpool plants, correct?
- **Answer by Sue Taylor, Vice President, Leprino Foods:** "Correct."
- **Beshore:** "And while they are nonpool plants, the contracts are based on Federal Order prices, are they not?"
- **Taylor:** "Yes."
- **Beshore:** "Without getting going any further than this, they are at least minimum class prices, federally, correct?"
- **Taylor:** "We are also from time to time offered milk at below Federal Order minimums by that supplying cooperative."
- **Beshore:** "Okay. So the average price paid by your plants on, you know, throughout the year, year-to-year, is at least Federal Order minimum price, is it not?"
- **Taylor:** "Yes, it is."

Let's get this straight: In sworn testimony, two of the nation's largest cheese manufacturers had to admit that whether or not they buy occasional spot loads of milk at distressed prices, the average price they pay for all the milk their plants (outside of California) need is at or above the Federal Order minimum price! Seems like the "myth" that has been "debunked" by the "facts" is Ms. Kaldor's myth that a California Discount doesn't even exist!

The sad reality is that the Dairy Institute has been completely shortsighted in their insatiable thirst for cheap milk. They have completely missed the fact that their demand for a steep California Discount is actually killing the golden goose of milk production in the State. Dairy farming is no longer the prized agricultural activity in California, with milk production dropping year-over-year and modern dairy facilities being plowed over to grow almonds, pistachios or other tree crops. The Dairy Institute has believed that California dairies will produce the milk they need no matter the price; that arrogant position is being proven wrong in front of their own eyes.

So what's the bottom line? Ms. Kaldor and her clients clearly know that their days of the California Discount are numbered, and they are desperately clinging to every opportunity to preserve it however they can and for as long as possible. California producers have united in a way that's unprecedented in supporting a unified proposal for a California Federal Order that will finally establish a level playing field in California. Enough is enough; the California Discount must end once and for all.

Rob Vandenheuvel
General Manager
Milk Producers Council