



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
Fax (909) 591-7328 ~ office@milproducers.org ~ www.MilkProducers.org



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FROM: John Kaczor

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks +\$.1075 \$1.8800
Barrels +\$.1525 \$1.9200

CHICAGO AA BUTTER

Weekly Change - \$.0475 \$1.8325
Weekly Average - \$.0060 \$1.8660

NON-FAT DRY MILK

Week Ending 10/28 & 10/29
Calif. Plants \$1.4937 11,923,717
NASS Plants \$1.4872 21,539,909

Weekly Average

Blocks +\$.0855 \$1.8125
Barrels +\$.0895 \$1.8295

DRY WHEY

DAIRY MKT NEWS w/e 11/04/11 \$.6350
NASS w/e 10/29/11 \$.6238

CHEESE MARKET COMMENTS: This week's report on the amount of cheese produced in September, along with the earlier report that the amount of cheese in cold storage at month end was lower than the previous month, may explain what seems to be continuing assertive activity on the CME. The conclusion from the reports was positive. Commercial disappearance of American cheese and all cheeses in September was greater than the volume produced and imported during the month. Bidders/buyers are saying either they want more cheese now to fill current or pending orders, or higher prices, or both. Why would buyers want higher prices? Inventory valuations, perhaps, or possibly to influence futures prices. *Dairy Market News* reports recent cheese production continues to lag behind last year's levels, particularly cheddar production, which is about 70 million lbs lower so far this year than last year. Within the category, either barrel demand has strengthened greatly or supply has fallen off because recent trading activity finds barrel prices again above blocks, as it has been on what seems to be an increasing frequency. Class III futures prices again moved higher early this week for near-by months, but still do not fully support current spot prices, and fall off sharply thereafter. February's price is \$2.33 per cwt below November's, which is \$.70 per cwt below current spot prices. Clearly, there seems to be little agreement and more questions than answers about future cheese price levels.

BUTTER MARKET COMMENTS: USDA recently reported butter disappearance over the first 8 months this year was 10.9% higher than for the same period last year. September's data on butter production and end of month cold storage indicates that trend continued, as about 15 million more lbs of butter was used than was produced and imported. Still, spot prices for butter lost \$.0475 per lb this week. Apparently, concern about international prices is over-riding domestic interests. The international concern seems to center on Fonterra's winning prices for anhydrous milkfat, which are so much lower than they should be after falling again in this week's global auction. The current huge increases in milk production in Argentina and New Zealand also raise questions about how that milk will be used. There also may be concern about what will happen if U.S. cheese producers continue to take less milk to make less cheese than the year before, while more milk is being produced and less of it is being used for fluid milk consumption. CME futures traders do not believe current butter prices are sustainable. Prices for December are now \$.14 per lb below today's closing spot price for butter, and drop \$.05 more per lb by February.

POWDER MARKET COMMENTS: Nothing significant in the way of news regarding nonfat dry milk was offered by DMN this week. The market is described as weak. It may be the slow season for sales. There are some negotiations going on regarding next year's contracts, but nothing to indicate a significant change from the present assortment of unknowns. Exports of skim milk powder and NFDm continue to be the second best outlet for powders. The volumes reported to NASS for the past two weeks have been higher than normal, as prices continue to edge downward. Last week, the California plant average price, with lower volumes, flipped places with the NASS reports: the CWAP was \$.016 per lb higher than the NASS average. Dairy America's price for

skim milk powder to be shipped this month averaged \$1.373 per lb. The first bids for shipments in December came in \$.07 per lb higher. Volumes offered and location of the buyers is not known.

WHEY PRODUCTS MARKET COMMENTS: Prices for whey protein concentrate (34% protein) continue to set record highs, but not through further increases; the 2007 price levels have begun their long decline. Prices for dry whey are also at record levels for this time of year, and are steady to firm throughout the country. DMN says domestic DW prices are higher than those currently being charged for the export market. If true, that might be a first. Prices reported for shipments of dry whey last week edged higher, to \$.6238 per lb. Whey protein products continue to be in great demand throughout the world. Yes, price is a continuing concern. DMN says buyers of WPC-34 continue to look for the best combination of value and function among many alternatives.

FRED DOUMA’S PRICE PROJECTIONS...

Nov 4 Est: Quota cwt. \$19.42 Overbase cwt. \$17.72 Cls. 4a cwt. \$18.22 Cls. 4b cwt. \$17.08
Oct ’11 Final: Quota cwt. \$18.95 Overbase cwt. \$17.25 Cls. 4a cwt. \$18.29 Cls. 4b cwt. \$15.78

WHAT’S THE DEFINITION OF “REASONABLE”? **DEPENDS ON WHO YOU ASK:** *(By Rob Vandenheuvel)* Starting on September 1st, a new minimum price formula was established for milk sold to our state’s cheese plants (otherwise known as the Class 4b minimum price). This new formula included a variable “dry whey factor,” that moves up and down (within a range of \$0.25 - \$0.65 per hundredweight), depending on what the dry whey markets are doing. So how are dairy farmers faring under this new formula?

Let’s start with the September and October Class 4b minimum prices. September was announced at \$16.33 per hundredweight; October was announced at \$15.78 per hundredweight. That information alone doesn’t tell us much (other than the obvious fact that dairy farmers can’t afford to be selling our milk to any of the state’s processors at these low prices for very long).

So now let’s look at comparable values for similar milk around the country. Last month, the Federal Milk Marketing Orders (FMMOs) announced that the September Class III (cheese milk) minimum price was \$19.07 per hundredweight. And this past week, the FMMOs announced the October 2011 Class III minimum price was \$18.03 per hundredweight. Yes, these are substantially higher than our California minimum prices, but even these facts alone don’t tell us what we need to know.

While we are comparing the same quality of milk going into equivalent plants (cheese plants), we need to account for the fact that FMMO minimum price formulas are not identical in structure to the California minimum price formulas. These formulas vary in how they calculate the underlying value of cheese, the amount of the make allowances and generally how the formula captures those factors. What we are trying to dissect today is what portion of that difference is a direct result of differences in how the formulas account for the value of whey products being manufactured and sold by cheese plants in California and throughout the country.

Determining that is actually quite simple. It’s just a matter of reconciling the FMMO minimum price with the California minimum price, and isolating what portion is a direct result of the different whey factors. Rather than bore you with the calculations, let me just provide you with the final results:

	September 2011	October 2011
FMMO Class III Minimum Price	\$19.07	\$18.03
Difference in Commodity Values and Make Allowances	(\$1.08)	(\$0.46)
Difference in Dry Whey Factors	(\$1.66)	(\$1.79)
California Class 4b Minimum Price	\$16.33	\$15.78

So let's break this down. Over the past two months, the difference between the FMMO Class III price and the California Class 4b price has averaged about \$2.50 per hundredweight. Of that difference, about \$0.77 per hundredweight can be attributed to differences in make allowances and a time lag on the value of cheese (FMMOs use USDA's cheddar cheese prices, which lag behind the CME prices that California uses in our Class 4b formulas). While the make allowance differences are steady and predictable (around \$0.20 per hundredweight), we understand that over time, the differences between the NASS and CME cheddar cheese prices will largely even out over the course of the year.

The more troubling fact is that in the past two months, **the dry whey factor has been responsible for about \$1.73 per hundredweight of the difference between the Class III and Class 4b minimum prices!** And unlike the differences in how we "discover" the price of cheese, there is no time-lag that will "even out" this huge difference in the coming months/years.

So why does this matter? Well for starters, our California dairy farmers are paying some of the highest feed prices in the country, making it extremely frustrating to see our State's cheese plants paying significantly less for the same quality milk being purchased by cheese plants in FMMO areas. In fact, some of our State's cheese makers operate plants in other areas of the country (like Leprino, Saputo and Hilmar Cheese). How much more are they paying for their milk in those areas than what they are paying for their milk supply here in California? But secondly – and of equal importance for this discussion – the numbers provided above simply don't jive with what our State legislators have demanded of the California Department of Food and Agriculture.

The following language is taken straight out of the California Food and Agricultural Code (Section 62062):

*"If the [Secretary of Agriculture] adopts methods or formulas...for designation of prices, the methods or formulas **shall be** reasonably calculated to result in prices that are in a **reasonable and sound economic relationship with the national value of manufactured milk products.**" (emphasis added)*

Our elected officials in California have given the Secretary of Agriculture broad discretion in how the formulas are established. But looking at this provision of the Code, it is clear that regardless of how those formulas are set up, the results of those formulas shall be a price that is in a "reasonable and sound economic relationship" with national values of manufactured milk products. Does it say "*we prefer the prices to be*"? Does it say "*it probably should be*"? **No.** The Code clearly says it "**shall be**" in a reasonable and sound economic relation."

Of course, MPC and others made this argument at the hearing this past summer. Representatives from the State's cheese plants countered with arguments about how plants in FMMOs can more easily de-pool, removing their obligation to pay the minimum price. What those folks fail to mention is that simply removing themselves from the pool doesn't remove the need for those plants to compete for an adequate milk supply. Are the plants that have chosen to de-pool able to secure that adequate milk supply by paying \$1.50-\$2.00 per hundredweight below the Class III price like they are doing in California? I highly doubt it.

So what exactly is "a reasonable and sound relationship with the national value of manufactured milk products?" I guess it just depends on who you ask.

PRICES CONTINUE TO FALL; FONTERRA ADJUSTS PRICES TO PRODUCERS: (by J. Kaczor) The answer to the question about how representative the winning prices are in Fonterra's auctions may have arrived in a very practical way. After watching the weighted average prices drop in eight of the last nine auctions, Fonterra notified its members that the forecasted price issued in mid-May for the following twelve months was being lowered, by about 5%. The initial forecast was about 10% lower than the record high payout made by the company, for the year ending May 31st. That was a prudent decision. Current auction price levels are close to 20% lower than they were at the time the forecast was announced, and are about 20% below the high points that were reached early this year.

The point is the volumes offered by Fonterra in the auction are a significant percentage of their total volume, they now include a wider sample of their full product line, the prices are real, and a correction was needed.

The weighted average price in this week's auction was 1.2% lower than in the previous auction. Prices for the three major volume products were mostly lower. Whole milk powder, at \$1.582, lost 0.8% . Skim milk powder, at \$1.493, gained 0.2%. Anhydrous milkfat, at \$1.501, lost 9.3%. Minor adjustments were made by Fonterra in their forecast volumes for the next twelve months. The total volume exceeds 1.5 billion lbs, which is quite a nice way to deal with more than 460 potential customers.

Dairy America took a further step into the auction by offering skim milk powder for delivery in contract 2, in addition to contract 1. Contract 2 is the Spot Month contract, for delivery two months after the auction month. The average winning prices to be paid to Dairy America for deliveries this month is \$1.373 per lb. The price for delivery in December is \$1.442 per lb. The price for delivery in January is \$1.433 per lb. According to auction rules, the volumes offered will be reported three months after the auctions close.