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DATE: February 11, 2011 **PAGES: 3**
TO: Directors & Members **FROM: John Kaczor**

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks	+*$.1050*	$1.9150
Barrels	+*$.1250*	$1.9000

Weekly Average

Blocks	+*$.1085*	$1.8870
Barrels	+*$.1075*	$1.8485

CHICAGO AA BUTTER

Weekly Change	- *$.0100*	$2.0900
Weekly Average	-*$.0020*	$2.0980

DRY WHEY

WEST MSTLY AVG	w/e 02/04/11	$.4325
NASS	w/e 02/05/11	$.4085

NON-FAT DRY MILK
Week Ending 2/4 & 2/5

Calif. Plants	$1.2946	9,828,242
NASS Plants	$1.3319	17,175,551

CHEESE MARKET COMMENTS: Today's report that exports of cheese in December were among the highest for the year could explain some of the enthusiasm about cheese prices. 44 million lbs were shipped out, 8.5 million of which was cheddar. A CWT release indicates a good portion of the approved bids for export assistance are still to be shipped. Let's hope those deals are still in play. Prices for both styles of cheese gained more than $.10 per lb this week from a combination of sales and bids. *Dairy Market News* says some buyers are "baffled" by the continuing price increases and are holding off until prices settle down; others are readily placing orders and even coming to the Exchange to bid higher for fresh product. The biggest move for the week came on a Thursday bid for barrel cheese, which moved the price by $.0675 per lb. Class III milk futures traders regained confidence; substantial price increases occurred for the March-June period. The March price, at $18.78 per cwt is the highest for the year, but April gained the most for the week, +$1.14 per cwt, to end at $18.24 per cwt. Those prices, with current levels for dry whey and butter futures prices, are solidly supported by current cheese prices, with room to spare.

BUTTER MARKET COMMENTS: The $2.10 per lb for butter price on the CME held for 24 trading days until a single offer at a penny per lb lower brought the price down by that amount. No sales occurred this week. DMN reports butter production to be seasonally strong and inventories are growing. That's normal for this time of year, and there is really no sign that the global shortage of butterfat products could abruptly change. Nonetheless, wholesale prices are being passed through to the retail level and consumers will find that the lowest advertised price will be well above $2.00 per lb. Exports of butterfat products in December were about where they were for the past three months, at about 10 million lbs, but lower than earlier in the year. The reaction next week to today's offer of butter at a lower price could be important.

POWDER MARKET COMMENTS: Average prices reported for nonfat dry milk sales last week by NASS and California plants increased by about $.045 per lb – solid increases considering the number of indexes they have to bounce through. The west "mostly" price range increased to $1.33-$1.65 per lb; sales in the central region were a bit higher. It appears the sales at the upper end of the ranges may be re-sales of product acquired earlier at lower prices. Powder prices on the CME were again bid higher: 4 sales of grade A moved the price by 5.5 cents per lb and a number of bids moved the extra grade product up by 7.5 cents per lb. DMN reports increased usage of condensed skim is limiting production of nonfat powders – which, in turn, helps keep powder inventories lower than they might be. Exports of nonfat powders in December totaled about 75 million lbs; the average price apparently still is below $1.20 per lb. Total exports of nonfat powders in 2010 were the 2nd highest ever, within about 15 million lbs of the record set in 2008. Demand and prices for buttermilk powder and whole milk powder is reported to be very good, with limited product available. Buyers in the eastern part of the country are being squeezed, but not intentionally.

WHEY PRODUCTS MARKET COMMENTS: Export interest continues to drive the market for dry whey and commodity grade whey protein concentrate. Production is about steady, and most sales being made are those under existing contracts. With only limited supplies available for spot sales, those prices are moving higher. DMN reports prices for exports are better than domestic prices; yes, the average price for exported dry whey in December was about $.42 per lb. Exports of dry whey in 2010 beat the previous record set in 2007, by about 10%.

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FRED DOUMA'S PRICE PROJECTIONS…

Feb 11 Est:	**Quota cwt. $18.26**	**Overbase cwt. $16.56**	**Cls. 4a cwt. $17.66**	**Cls. 4b cwt. $16.75**
Last Week:	**Quota cwt. $17.94**	**Overbase cwt. $16.24**	**Cls. 4a cwt. $17.47**	**Cls. 4b cwt. $16.12**

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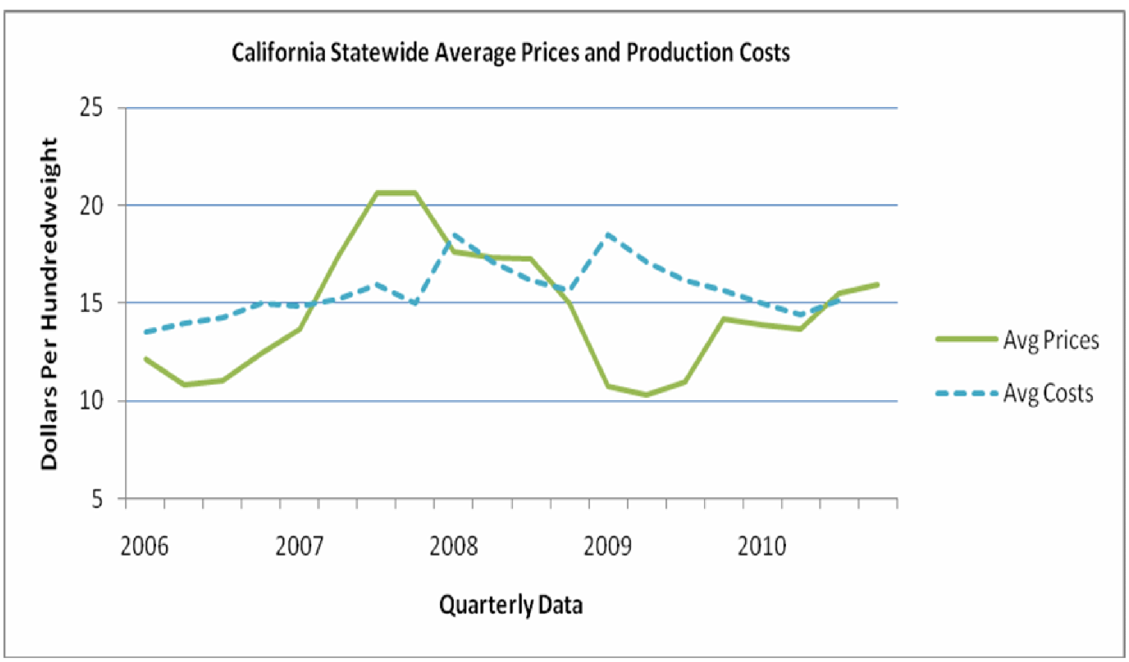
RISING DAIRY COMMODITY PRICES FORETELL HIGHER MILK PRICES, AND RISING COSTS: *(By J. Kaczor)* The comments on major dairy commodities appearing on the first page of these Friday Market Updates are designed to cover the current market situation for each of four product categories in a factual, informative, and sometimes instructive manner. Recently, the news on all prices is very good for milk producers – prices for the full line of commodities are much higher than expected, and it looks like more of the same is being forecast at least through mid year and possibly well beyond. The reasons for these increases include many of the same that caused the unprecedented price increases for the same line of products in 2007 and 2008. They include real and perceived product shortages caused by adverse weather conditions in various places throughout the world, unexpected increase in demand from countries in Africa and Asia, and currency valuations that make U.S.-sourced products extraordinarily competitive. It should be noted that the recent boom in dairy commodity prices is also happening for many other food and nonfood commodities that are traded internationally – which also happened three years ago before they crumbled in the face of the global financial crisis and economic recession.

A flood of news stories and reports in the past two weeks on matters important to the dairy industry was so great it was if a dam had broken. They include activity in the CME spot and futures markets, Fonterra's global internet auction price increases, *Dairy Market News* reports on international supply and demand and product price increases, updated class prices for milk in California and federal orders, export activity, oil prices, feed costs, and political activity and unrest throughout the world. Combined, they present a picture of increasing revenue for milk producers along with increasing costs and increasing uncertainty.



What should producers think? What may they do? What should they do? The current trend in milk prices is definitely bullish. But, if the past is any indicator of what could happen in the future, the current upward trend in prices will eventually end in another resounding crash – and then it will all happen again. That cycle of boom and bust has been reviewed and discussed extensively by MPC over the past three-plus years. It's the natural result from low marginal costs for additional production being covered by pool-wide average prices – "the magic of pooling." But a different picture is seen when **average** costs are paid for by average prices. The graph shown here shows what has happened to California's statewide blend price over the past five years. It also shows what CDFA analysts report has happened to statewide average production costs for the same period of time. The prices and costs are per hundredweight for milk at average test.

The prices reflect the familiar pattern of sharp increases and sharp decreases. They were predicted by some of the best industry models of producer response to changes in price levels. More of the same is expected. The mantra of "money makes milk" is as true today as it was forty and fifty years ago. The graph's average costs of production over this same period show as clearly as can be how out of synch are prices and costs. Major losses in 2006 were followed by significant gains for four quarters. Next came a year of what looks like break even prices which was followed by the disaster of 2009-2010 – seven quarters of losses; some among the greatest in industry history.

Unfortunately, one of the major stories released this week is about feed costs: corn and soybean production and usage, and their prices. Part of the report about corn usage is that the percentage of the growing corn production used to produce ethanol has increased from 27% two years ago to a projected 40% for the crop year ending this winter. Exports of corn are also increasing, thanks in part to the weak U.S. currency which means most international buyers need less of their money to purchase more of U.S. corn. A story reported yesterday by *Bloomberg News* contains the following: "*The price of corn, used to make livestock feed and ethanol, jumped 89 percent in the past year, reaching a 30-month high on February 7. Soybeans are up 54 percent from a year ago, and wheat Wednesday touched the highest since August 2008*." [Corn prices advanced again on Wednesday and Thursday.]

CDFA analysts are completing 2010's fourth quarter production costs; preliminary indications are that they will be higher than third quarter costs, about in line with the known increases in prices. What a shame. What a cruel twist of fate. Dairy product prices seem poised to approach levels reached three years ago, but this time are likely to be substantially offset by higher costs of production.

Comment on feed costs. Within each area of the state and within each size category of producer, CDFA's cost of production studies show a wide range of feed costs per cow and per hundredweight of milk. Those ranges reflect a number of things, including what and how much of grain or forage is produced on site and also the extent to which producers have hedged against future feed price increases. The increases in prices for beans, wheat, and corn were not even on the screen until recently. For example, just three months ago, on November 12, 2010, the February futures price for corn was $5.48 per bushel; today it is $6.99. For those of you who have not yet done so, it's worthwhile checking out with a commodities broker what options are available to you to protect your margins. It appears that at least some of those who do it regularly have saved themselves from substantial cost increases.

MPC HONORED AT THIS WEEK'S WORLD AG EXPO: *(By Rob Vandenheuvel)* At the World Ag Expo held in Tulare, CA this past week, Milk Producers Council President Syp Vander Dussen and I were honored to accept recognition on behalf of MPC from *Western DairyBusiness* magazine as their "2011 Outstanding Dairy Industry Service Award" winner. While Syp and I were the fortunate individuals who received the formal award, this honor is really a recognition of the entire Milk Producers Council team. And the most important part of that team is our membership. It's impossible to overstate the importance of the dairy families that financially support MPC. Your contributions, along with contributions from our allied industry associate members, make our efforts possible. Thank you for your continued support.