

Milk Producers Council

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MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks +\$.0125 \$1.1525
Barrels +\$.0200 \$1.1000

CHICAGO AA BUTTER

Weekly Change N/C \$1.2650
Weekly Average N/C \$1.2650

NON-FAT DRY MILK

Week Ending 5/22 & 5/23

Calif. Plants \$.8134 19,339,009
NASS Plants \$.8313 27,097,939

Weekly Average

Blocks + \$.0123 \$1.1463
Barrels + \$.0131 \$1.0931

DRY WHEY

WEST MSTLY AVG w/e 05/28/09 \$.2750
NASS w/e 05/23/09 \$.2390

CHEESE MARKET COMMENTS: After another week of fairly active trading on the CME, cheese prices moved up again. The largest gain, two cents per lb, went to barrels which finally rose to the support price level. (It had been as low as \$.055 per lb below support.) The CME futures market for cheese milk continues to show steady, but conservative, increases through the year. It looks like they need to be convinced that something is really going to happen to cause cheese production to fall back a bit to align with domestic consumption. Fewer offers of cheap milk would be a start, followed by fewer cows and less milk production, with a little more competition for milk among the market clearing plants. There are signs pointing to that happening. Currently, cheese production is reported to be seasonally strong but should start downward along with the seasonal drop in milk production, and then await the final numbers from CWT's current herd removal program. A positive note showed up this week regarding consumer confidence – it “jumped” in April, showing there is belief the worst is behind them. Let it be so.

BUTTER MARKET COMMENTS: Butter prices were unchanged this week. Production was reported to be heavy last week, but the price weakness that usually follows a major holiday didn't happen. Cream is in strong demand from ice cream operations and retail sales are reported to be holding steady. The CME futures market sees steady price increases through the year – very similar to the outlook for cheese prices. This similarity is not always the case but this year the very big common question facing all dairy product manufacturers is how far will milk production fall. This week, USDA invited offers for the 4.6 million lbs of butter that the CCC had purchased in January and February. The minimum price that can be accepted is \$1.155 per lb, but CCC is not held to selling that low if market conditions are strong. It's possible this offer is part of the DEIP announcement that was made last week, to have USDA subsidize exports through June 30th.

POWDER MARKET COMMENTS: Sales of nonfat dry milk dipped under the two million lb mark last week, and the upper side of the price range for the West “mostly” moved another half-cent per lb. *Dairy Market News (DMN)* reports show there is a lot of confusion about what is and what may happen in the way of sales and prices. In the Midwest, there are reports that some manufacturers seem reluctant to release all of their current production supposedly in anticipation future price increases, while California plants continue to sell to the CCC. USDA's announcement last week that the Dairy Export Incentive Program (DEIP) has been activated for the year ending June 30th, at the time when little international demand is evident, only adds to the confusion. Prices for extra grade and grade A powder on the CME spot market this week again moved up, with extra grade at \$.875 per lb. Demand for dry buttermilk and whole milk are reported to be very good, while domestic demand for nfdm in the West is soft. Prices for dry buttermilk, as measured by the “mostly” range, are higher than those for nfdm. Go figure that.

WHEY MARKET COMMENTS: Demand for the full range of whey-based products continues to be strong, and for the first time in recent memory, **prices for all products in the category moved up this week.** It's beginning to look like a solid seller's market, but just why that is so, is not clear.

FRED DOUMA'S PRICE PROJECTIONS...

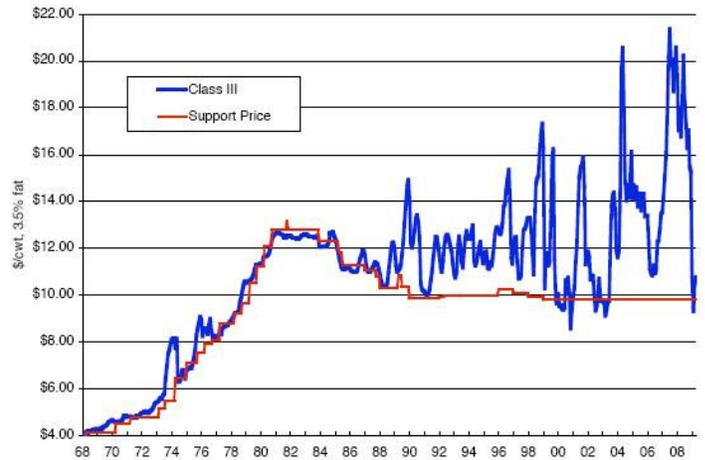
May 29 Final:	Quota cwt. \$ 11.47	Overbase cwt. \$ 9.77	Cls. 4a cwt. \$10.04	Cls. 4b cwt. \$ 9.54
Last week:	Quota cwt. \$ 11.46	Overbase cwt. \$ 9.76	Cls. 4a cwt. \$10.01	Cls. 4b cwt. \$ 9.54

SOME SIGNS OF HOPE FOR PRICE IMPROVEMENT: *(By J. Kaczor)* This comment is intended to be a short counterpoint to the growing number of stories that are showing up each week about the plight of dairy farmers. The situation is severe, but there are a number of signs that price recovery is on the way, and one specific fact that bears mentioning is the recent strong showing for sales of Class 1 fluid milk products in the U.S. That point is often overlooked because attention is usually focused on the amount of surplus milk that is on hand, how the surplus is used, and how it is priced. But Class 1 usage in the U.S. is **the highest priced Class of usage and is averaging about one-third of all milk that is pooled in Federal order areas and in California.** And it's increasing. According to USDA, fluid sales in December, January, and March were higher than the same months a year earlier. March's fluid sales were particularly strong, up 2.6% from March 2008. That trend, along with the reduction in total U.S. milk supply, combine to make a very significant dent in the price-depressing surplus.

Other points worth making include this week's report that consumer confidence "jumped" in April by enough to have the Consumer Research Center conclude that consumers have indicated they believe the worst is behind them. That's important because consumer spending accounts for more than two-thirds of the national economy. An upbeat consumer sector is a necessity for achieving strong sales across the full line of dairy products. And the most important point for dairy producers is the inescapable fact that there is going to be a lot less milk produced in the latter half of this year than was produced last year, and CWT has taken on the job to keep on keeping it lower. Finally, last week's announcement by USDA that U.S. exporters will have the same kind of help in exporting butter, powder, and cheese that their competitors in Europe are receiving shows that the Administration is standing behind its pledge to help the dairy industry, and believes that "fair trade" is not just a motto.

CORNELL UNIVERSITY REPORT HIGHLIGHTS THE CONTINUING THREAT OF MILK PRICE

VOLATILITY: *(By Rob Vandenheuvel)* This week, Cornell University's Program on Dairy Markets and Policy released the full report on their analysis of the Growth Management Plan. Drs. Mark Stephenson and Chuck Nicholson included an expansive discussion of milk price volatility and how it has gotten dramatically worse with each boom/bust cycle. The readers of this newsletter have heard it before, but it bears repeating: **volatility is undoubtedly the single largest threat to this industry.** For those who want to read the full report, it can be found at: <http://dairy.cornell.edu>.

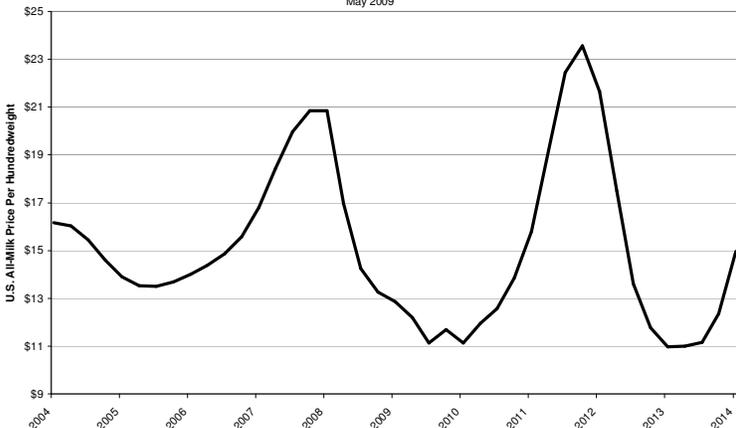


Shown above is a chart taken from Cornell's report, showing how the Federal Order Class III price (cheese) has moved over the past forty years.

As you can see, we have dealt with volatility for a couple of decades, but the recent "peaks" and "valleys" have gotten dramatically worse.

Also included in the report is this sobering chart to the left showing what the Cornell University model forecasts will happen to the U.S. all-milk price over the next five years if we do nothing.

Baseline Projection is we do nothing
Cornell University's Program on Dairy Markets and Policy
May 2009



What does all this mean? This year is shaping up to be the worst year ever experienced by those currently in the dairy business. There's no way to sugarcoat it – this year, dairy farmers will collectively take billions of dollars in equity built up over the decades they've been in business, and convert it into bank loans.

There will be some producers that decide to get out of the industry – either by choice or by force. And while that is extremely unfortunate, the real question I'm asking today is aimed at those who are staying in: **With the massive boom/bust cycles that have become common in this industry, how do you plan to build your equity back up?** And with the banks feeling the pain in this wreck, are they going to be there for you the next time to get you through that wreck?

Sure, there will be profitable times once we come out of this wreck, and Cornell's model predicts that as well. But are the good times going to be long enough to make up for the massive hemorrhaging of equity that is currently taking place? Are your pockets really deep enough to not only survive this wreck, but survive the next one as well?

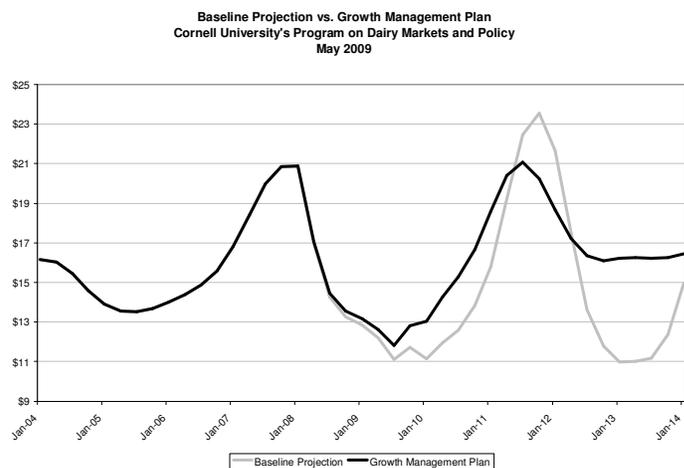
It doesn't take a complex formula to understand why we have this volatility. Our industry is hard-wired to overproduce. Not only do U.S. producers have some of the best genetics, the best technology, and the most efficient operations in the world, but we've also got every incentive to maximize those resources and produce as much milk as we can, particularly when dairy farming has any level of profitability. **Simply put, individual dairies in our industry have every ability – and every incentive – to exceed market demand for dairy products, quickly turning any possible supply/demand balance (and profitable price) into a surplus (with a plummeting price).**

It doesn't have to be like this. As our readers know, MPC has been talking with industry groups for more than two years about the benefits of the Growth Management Plan. Despite what critics may say, this is not a supply management program – at least not the kind of program that we've become familiar with, such as the quota systems in Canada and Europe. **It does absolutely nothing to dictate how many cows you milk, how much milk you produce, what you feed your cows, whether or not you use sexed semen, or any other business decision you make on your farm.** Instead, the Growth Management Plan is a uniquely-American concept that creates a financial incentive for dairies to actually pay attention to the amount of milk you produce.

The chart to the right shows what Cornell University's model forecasts the U.S. all-milk price would be if we had the Growth Management Plan in place. Granted, we're in a hole that the Growth Management Plan can't get us out of overnight. But look at the next wreck predicted to be in 2012-2013. **Which line would you rather invest your hard-earned equity in?**

The U.S. dairy industry is a highly regulated industry, and anyone who says something like “the markets will fix this problem” is not living in reality. Some people will tell you that this is the “market” getting rid of the “less efficient dairymen.” They will argue that the industry is stronger coming out of these wrecks. To put it bluntly, that logic is just plain wrong. The wreck we are currently going through has almost nothing to do with “efficiency” on the farm. After going through the volatility we've seen in the past couple decades, the “inefficient” dairymen are long gone. This wreck is about who can bleed equity the longest? Who has the massive amounts of family money behind him? And for those that don't, tough luck.

This is not about “market signals” to producers. In fact, the Growth Management Plan would actually send more market-oriented signals back to individual producers than the current industry. How do I make this claim? Let me put it this way – in virtually any other industry, a new entry into an established market would have to compete directly with its competition for a piece of that market. Usually, that new entry will have to compete by having a



lower price or better quality to earn that market share. Once that market share is established, that new business merely needs to stay even with his competitors in order to maintain his customers.

Contrast that with the dairy industry, where anyone can set up shop and as long as they can find a cooperative that will pick up their milk, they are guaranteed an equal share of the market revenues – **on day one**. What if the market is theoretically “full” and that new production is actually surplus milk that is ultimately sold to the government for \$9.90 per hundredweight? That cost is spread out over all producers in the pool while the new producer gets the full blend price, just like his neighbor.

So how does the GMP change that? Under the GMP, the new entry would still be able to set up a dairy just as they can now. But during the first year of production, that dairy would need to pay a “market access fee” – their cost for bringing new production to the market. That fee would be distributed to all the dairies that hold their production in check, which in turn allows the market room to absorb the additional production. And the same concept applies for dairies that expand their production.

For the dairies that hold their production, their benefit is an additional revenue stream (their share of the market access fees) and stability in the market. For new dairies or dairies that wish to expand, they have the benefit of growing in a stable and profitable industry, and once they have established their new production for a year, they no longer have to pay the market access fee. A win-win.

So for those “free-marketers” who oppose the Growth Management Plan on the grounds that it is “more market-distorting government,” I would strongly suggest that, in fact, **the Growth Management Plan gets us closer to real market signals than currently exists in the dairy industry.**

As I’ve reported in this newsletter, the Holstein Association has developed the “Dairy Price Stabilization Program” (DPSP) – a concept identical to the Growth Management Plan. Milk Producers Council is supporting the Holstein Association in promoting their concept around the country. For more information on the DPSP, and a current list of supporters, please see: <http://www.holsteinusa.com/association/dairyprice.html>.

I have come across a few opponents of this plan (although I would point out that a vast majority of those opponents are individuals who own *zero* cows...it’s a lot easier to take that position if your livelihood is not dependant on the stability of this industry). To those opponents, I would extend a challenge to you: **What are you proposing we do?** Cornell has given us their professional opinion that this volatility will continue as long as we have the perverse incentives to grow, grow, grow in our industry regardless of market demand, so **how are you proposing we deal with this?** Is the current “supply management” we have (*a.k.a. enough bankrupt dairy farmers to finally get production in line with demand*) your preferred option? And if you are a dairyman who takes that view, are you that confident that you will be able to hemorrhage equity longer than your neighbors? How many wrecks will it be before your number is called?

It’s easy to be against something. It takes courage to be for something. This is the time for our industry to show courage. Courage to be willing to explore a new direction. We’re not asking for anyone to embrace Canada or Europe’s flawed programs. We’re asking producers to embrace a uniquely-American proposal that would allow us to – in the words of Holstein Association President Doug Maddox – “produce for the market instead of trying to market all we can produce.”

This plan is being considered by a number of groups across the country. As I wrote a few weeks ago, DFA has set up a task force and is exploring long-term solutions for this industry, including this proposal. So is National Milk Producers Federation. If your co-op or trade association has taken no position on the Dairy Price Support Program, call your board members. Call your co-op and trade association managers. Ask them why they’ve taken no position. If they are opposed, ask them why, and what their plan is. **The time for this discussion is now, and dairy producers across the country should be demanding that their leadership be engaged in this debate.**

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