



Milk Producers Council

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MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks - \$.0050 \$2.0150
Barrels - \$.0150 \$1.9650

CHICAGO AA BUTTER

Weekly Change +\$.0025 \$2.1200
Weekly Average +\$.0420 \$2.1200

NON-FAT DRY MILK

Week Ending 3/4 & 3/5
Calif. Plants \$1.4150 13,557,078
NASS Plants \$1.4730 20,169,358

Weekly Average

Blocks +\$.0115 \$2.0145
Barrels +\$.0085 \$1.9740

DRY WHEY

WEST MSTLY AVG w/e 03/11/11 \$.4850
NASS w/e 03/05/11 \$.4599

CHEESE MARKET COMMENTS: The market is on edge this week. Class III milk futures traders appear to over-react to each movement in spot cheese prices. Trading this week on the spot market was light. Blocks lost \$.005 per lb; barrels lost \$.015. Class III futures lost \$.85 per cwt for the April-June period, selling at a discount equivalent to about \$.30 per lb of cheese. April's price is \$2.24 below March. That looks like equal parts of pessimism and speculation. *Dairy Market News* says current sales from plants are below February levels and some manufacturers are uneasy about carrying high value stocks into what could be a declining market. Cheese was offered this week, and more could come. DMN says production is holding steady. That happens because plants have an interest in maintaining the level of output that results in the plant's lowest unit cost per lb. [Plants also have reason to increase output so long as the price they receive for the additional product is higher than marginal cost to produce it. That's their version of pricing "magic" – the "make" allowance – similar to what producers have with pooling.] We're also told this week that most buyers are buying just what is needed for current sales; they have no concern about future shortages and apparently little concern about higher prices later on. Prices reported to NASS still have not quite risen to CME's spot levels but are \$.30 per lb higher than where they were four weeks ago. "Few buyers are interested in adding to aging programs at current prices," and "new export interest is quiet due to current prices," says DMN this week. The market is on edge.

BUTTER MARKET COMMENTS: CME activity continues to reflect what seems to be unanimous understanding that the butterfat market is tight, and will continue to be so at least through most of this year. The butter price rose ¼ cent this week, with heavy trading which began with offers to sell. It almost looks like someone's pre-emptive strategy. Solid gains occurred in butter futures prices this week, with the largest increases coming in the summer months. Churns are having to compete for cream as ice cream and cream cheese production continues to crank up. DMN is hearing that butter manufacturers are becoming somewhat wary but are continuing to produce what is needed to supply customers' current needs. Export volume could be affected by current price levels, but new orders are still being received, says DMN. Retail sales and food service orders are holding up well. An ad this week in the Sacramento area by a major chain store offered butter quarters for \$2.99 per lb (a very good price, by the way).

POWDER MARKET COMMENTS: Prices for nonfat dry milk shipments last week continued to increase. The CWAP and NASS prices rose to levels not seen since very early in 2008, when prices were on their way down from all time highs reached a few months earlier. Market prices reported by DMN, however, reflect "softness" at the upper end of the price ranges for all areas, and CME futures traders also showed some unease this week, as prices moved lower for all months through July. The April-July price average fell to \$1.58 per lb. The CME spot price for extra grade powder continues to rest at \$1.80 per lb, but grade A was offered lower this week. Continuing use of condensed skim, instead of powder, by cheese plants is keeping NFDM production volumes steady at best. Exports of nonfat powders in January represented 54.9% of production during the month. Buttermilk powder prices are being supported by a tight market and rising NFDM prices. Production of BMP is on pace with butter production. Prices for whole milk powder are reported to be higher on a firm market, with the few spot loads that were offered quickly snapped up.

WHEY PRODUCTS MARKET COMMENTS: That wee dip in the NASS price reported last week, which apparently panicked futures traders, was more than made up this week; the price this week, for shipments made last week, rose by \$.031 per lb, to a level not seen since late summer, 2007. The West's "mostly" price average rose \$.0075 per lb. Exports in January represented 50.0% of dry whey production during the month. The markets for dry whey and whey protein concentrate (34% protein) are reported to be firm (possibly more so for WPC), with prices continuing to edge upward. Virtually all sales continue to be under existing contracts, and some oversold inventory problems continue to affect some Midwest buyers.

FRED DOUMA'S PRICE PROJECTIONS...

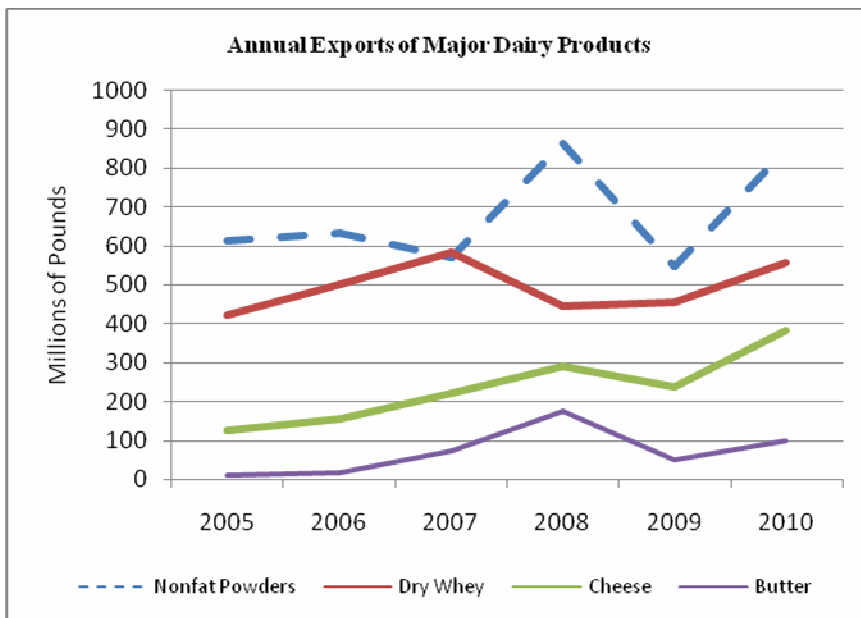
Mar 11 Est: Quota cwt. \$19.56 Overbase cwt. \$17.86 Cls. 4a cwt. \$18.80 Cls. 4b cwt. \$18.36
Last Week: Quota cwt. \$19.45 Overbase cwt. \$17.75 Cls. 4a cwt. \$18.42 Cls. 4b cwt. \$18.40

2010 EXPORTS OF MAJOR DAIRY PRODUCTS NEAR ALL TIME HIGHS; MORE EXPECTED TO COME: (By J. Kaczor) One issue about future national dairy industry policy that seems to be nearing a consensus is the need for the U.S. to become a consistent supplier to international customers. The main reason given to support that position is that it would help to stabilize milk prices by avoiding sharp changes in increases or decreases in demand, which cause short term shortages or surpluses of milk and milk products. That seems to make sense, although arguments made to support an apparent foregone conclusion of stability and prosperity gloss over a number of inconvenient possibilities for milk producers who would be relied upon to be consistent suppliers of the raw product used to fill the anticipated consistent demand.

Up to now, most would agree the U.S. dairy industry, in terms of international trade for most products, has been a supplier of last resort. Two clear exceptions are dry whey and whey protein concentrates, whose export volumes are high and growing. Another product with high but inconsistent export volume is nonfat powder. Trend lines for export of butter and cheese are ascending, but the volumes for both have been relatively low and definitely not consistent.

The graph to the right shows the annual exported volumes for four major U.S. dairy products over the past six years. Exports of cheese in 2010 reached a record high. Butter, nonfat powders, and dry whey each had the second highest export years.

It's not completely clear what a graph showing consistent export volume for all products would look like, but most people would likely agree it would have trend lines less like those for butter and powder and more like that for dry whey. Regardless of consistency or lack thereof, the increases shown for 2010 for all four products are certainly gratifying, and most analysts are forecasting this year's volumes to be close to last year's. January's exports of these products support those forecasts.



In terms of U.S. milk prices, the only year covered by the graph that could be considered "normal" is 2005; the others were characterized by valleys and peaks, or by approaching or leaving valley and peak periods. The milk price increases in 2007 and 2008 resulted from increases in exports which resulted principally from shortages elsewhere and rising international demand. In addition to abnormal milk prices, this period also went through substantial changes in U.S. milk supply. Was it wrong for producers to expand at the time? The loss of export volume that was gained in 2007-2008 and the price crash in 2009, we are told, resulted not from a decrease in international demand but simply from a loss of international customers – because we were not seen as a

consistent source for those important products. The implication taken from that reasoning is that had we attained proper status we would not have lost those sales, others would have. Could it really be that simple or easy?

The forecasts for continuing strong exports this year are based mainly on extraordinary events, similar to what happened in 2007-2008: shortages of supplies in Australia and New Zealand, a huge increase in demand from China, and a weak U.S. currency. The onus is on U.S. manufacturers and brokers. The hope is that they will use the opportunity presented to develop and strengthen their relationships throughout the world to the point where milk producers can rely on having a ready market at reasonable prices for all their production – because that is the plan they are being presented with.

BUSY WEEK IN THE U.S. SENATE ON THE ISSUE OF ETHANOL SUBSIDIES: *(By Rob Vandenheuvel)* Two bills were introduced in the U.S. Senate this week, sending a clear message that Congress is interested in reviewing the billions of dollars in taxpayer-funded subsidies aimed at the U.S. corn-based ethanol industry. Before discussing those bills, let's first review the "tripod" of support provided by the Federal Government for the ethanol industry:

1. The "Renewable Fuels Standard," also known as the RFS (and sometimes short-handed as the "ethanol mandate"), is a provision in the law that mandates that 12.6 billion gallons of ethanol be blended with our gasoline in 2011. Corn-based ethanol is fulfilling virtually all of this "need." This mandated demand for ethanol dates back a number of years and has been increasing each year until it reaches 15 billion gallons per year by 2015. To put this figure in perspective, in order to produce 12.6 billion gallons of ethanol in 2011, nearly 40% of our nation's corn will be diverted away from feed and food usage and be sent to our nation's ethanol plants.
2. The "Volumetric Ethanol Excise Tax Credit," also known as the VEETC or the ethanol blender's credit, is a tax credit available to the oil/gas companies that purchase ethanol to blend into their gasoline. The available tax credit is \$0.45 per gallon. In other words, even though there is a government mandate that these oil/gas companies must blend 12.6 billion gallons of ethanol with their gasoline this year, they also get a tax credit for that activity (An "incentive" to do something they already have to do?). This credit available to oil/gas companies is expected to cost taxpayers as much as ***\$6 billion this year alone.***
3. An import tariff of \$0.54 per gallon is levied on ethanol imported into the U.S. This tariff is designed to slow down or prevent foreign-produced ethanol from fulfilling the mandate above.

Any one of these government protections would represent significant support for the corn-based ethanol industry, but taken together, they provide a seemingly impenetrable fortress for the industry (*Note to R&D Departments: If we can figure out a way to power our cars with milk, maybe our industry could get this kind of protection too...*).

Now back to this week's action in the U.S. Senate. On Wednesday, two bills were introduced that would begin to scale back some of the government protection outlined above. One of those bills (S. 530) was introduced by California Senator Dianne Feinstein. This bill would repeal the ethanol blender's credit (item #2 above) for ethanol that does not qualify as an "advanced biofuel." In other words, the blending of corn-based ethanol, which is not an advanced biofuel, would no longer qualify for the \$0.45 per gallon tax credit. Further, the bill would reduce the import tariff (item #3) to \$0.45 per gallon. This bill is also co-sponsored by Democrat Senator Jim Webb (Virginia).

A second bill was introduced the same day by Democrat Senator Ben Cardin (Maryland) and Republican Senator Tom Coburn (Oklahoma). This bi-partisan bill (S. 520) is a total repeal of the ethanol blender's credit (item #2), regardless of whether the ethanol is considered an "advanced biofuel" or not.

Milk Producers Council greatly appreciates the hard work of these four Senators and their willingness to stand up to the forces defending this unwise taxpayer-funded subsidy. MPC is part of a broad coalition of organizations working to scale back the massive government protection afforded to the corn-based ethanol industry. That coalition put out the following press release this week: <http://www.gmaonline.org/news-events/newsroom/broad-and-diverse-coalition-applauds-senators-coburn-and-cardin-for-bill-to/>. This same coalition also sent the following letter to members of the House and Senate last week, urging members of Congress to end the ethanol blender's tax credit: <http://www.milkproducerscouncil.org/0211veetcletter.pdf>. **I**

strongly encourage our readers to check out the diverse collection of organizations that have signed this letter and are supporting this effort. This is the kind of broad support we're going to need to scale back or repeal this "sacred" support Washington, DC has for the ethanol industry.

Time will tell whether these bills are able to attract additional bi-partisan support. There appears to be a change in how Congress is viewing these protections for the ethanol industry – particularly in a time when budget concerns are at their greatest. This is \$6,000,000,000 per year in taxpayer-funded subsidies – paid to the oil/gas companies – that should be viewed as “low-hanging fruit” when looking at ways to save the Federal taxpayers some money. So stay tuned...

NMPF CONTINUES TO MAKE PROGRESS ON THEIR “FOUNDATION FOR THE FUTURE” PROPOSAL: *(By Rob Vandenheuvel)* This week, the board of directors for the National Milk Producers Federation (NMPF) voted to support a package of reforms to our Federal Milk Market Orders (FMMO) and include them in their comprehensive “Foundation for the Future” (FFTF) dairy reform proposal. While these proposed reforms would not directly impact our dairies here in California, since we operate in a State order, we are certainly interested observers as market dynamics in other parts of the country inevitably impact our markets here in California.

In short, NMPF describes their reforms in the following five bullets:

- Replaces end product pricing formulas with a competitive milk pricing system;
- Incorporates two classes of milk - fluid (*Class I*) and manufacturing (*formerly Class II, III and IV product uses*);
- Maintains the higher of for establishing the fluid use (*Class I*) minimum base price;
- Maintains current Class I regional differentials;
- Maintains the number and basic structure and provisions of Federal Orders.

These five bullets represent a significant shift in how the FMMOs would operate. In future issues of this newsletter, MPC will be further exploring this part of FFTF and how it would impact our nations farmers and our dairy markets.

Readers should note the third bullet above, which is an extremely positive update to the package of reforms. As you may recall, the issue of using the “higher of” milk sold for cheese and milk sold for butter/powder to drive the Class I formula is an issue recently discussed in this newsletter and other dairy publications (http://www.milkproducerscouncil.org/121710_higherof.htm). The “higher of” feature in the FMMO Class I formula has represented billions of dollars in additional revenue for dairy farmers over the past decade throughout the FMMO areas. Maintaining that feature in the formula – as this proposed package does – is a key to garnering support from dairy farmers for this proposal.

In addition, NMPF has published a 12-minutes video explaining the design of their FFTF proposal. **You can see the video here:** <http://www.youtube.com/watch?v=iVutl6oMFIY>.

The MPC board and staff are encouraged by the work NMPF has done in putting together FFTF. MPC has been very active over the past four years in developing sound dairy policy that would empower dairy farmers to better align our future growth in milk production with our future growth in dairy product demand. Included in FFTF is the Dairy Market Stabilization Program, which would give that power to dairy farmers throughout the country. While the board and staff of MPC continue to examine all pieces of FFTF and will withhold final judgment until a legislative bill is presented to the industry, we have much to be encouraged about. We have a rare opportunity to move legislation through Congress, and an industry proposal being developed that would address major shortfalls in our current dairy policies. As an industry, we need to fight hard to avoid past mistakes – namely our natural inclination to allow regional differences to prevent positive national change.

The past two years has proven that as a nation, our industry sinks or swims together. If producers from coast-to-coast do not unify behind a common proposal, we will be left with the status quo, with any equity you have left in your dairy at great risk the next time we experience the “down” portion of this volatile industry. Opportunities for fundamental change are few-and-far-between. We simply can't afford to miss this one.