Milk Producers Council

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DATE: December 14, 2018 **PAGES: 7**
TO: Directors & Members **FROM: Kevin Abernathy, General Manager**

MPC Friday Market Update

CHICAGO CHEDDAR CHEESE

Blocks	+ $.0575	$1.4075
Barrels	+ $.0875	$1.3100

Weekly Average, Cheddar Cheese

Blocks	+ $.0080	$1.3620
Barrels	+ $.0070	$1.2685

CHICAGO AA BUTTER

Weekly Change	- $.0175	$2.1900
Weekly Average	- $.0425	$2.1895

DRY WHEY

Dairy Market News	w/e 12/14/18	$.4450
National Plants	w/e 12/08/18	$.4641

NON-FAT DRY MILK
Week Ending 12/08

Nat'l Plants	$0.8945	17,269,665

Prior Week Ending 12/01

Nat'l Plants	*$0.8838*	*14,724,461*

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California Federal Milk Marketing Order Price Projections

CA FMMO Price Projections	Class I Actual *(Range based on location)*	Class II Projected	Class III Projected	Class IV Projected
This Week	**$16.65 - $17.15**	**$15.54**	**$13.80**	**$15.02**
Last Week	**$16.65 - $17.15**	**$15.51** *(revised)*	**$13.76**	**$14.84**

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November 2018 CA FMMO Statistical Uniform Price Announcement

Nov '18 Final	Class I	Class II	Class III	Class IV	Statistical Uniform Price *(Blended Price)*	Net Price After Quota Assessment
Minimum Class Price	**$17.12** ***(Tulare)*** **$17.62** ***(L.A.)***	**$15.63**	**$14.44**	**$15.06**	**$14.94** ***(Tulare)*** **$15.44** ***(L.A.)***	**$14.56** ***(Tulare)*** **$15.06** ***(L.A.)***
Percent of Pooled Milk	**22.5%**	**4.9%**	**63.7%**	**8.9%**	**100% 2.08 billion lbs.**	

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USDA releases first-ever final price announcement for month

By Geoff Vanden Heuvel, Director of Regulatory and Economic Affairs

The table above summarizes USDA's final price announcement for November 2018 milk, which was released earlier this week. You can see the full price announcement here.

Since this is the first time we have seen a final pricing announcement under the new Federal Milk Marketing Order (FMMO), we want to highlight what these figures mean relative to the numbers we were accustomed to seeing under the California Department of Food and Agriculture's (CDFA) State Order.

The far righthand column is comparable to the CDFA overbase price that we reported in previous versions of the MPC Friday Report. As you can see, the "overbase" FMMO price for November 2018 ranges from $14.56 to $15.06, depending on where you are located. The price range is due to the Class I differential zones established by the FMMO. Interestingly, we estimate that the overbase price for last month's milk under CDFA's State Order would have been $14.20. A switch to the FMMO means producers are seeing $0.36 to $0.86 per cwt. more for their November milk.

Another interesting observation in last month's pricing announcement has to do with the amount of milk pooled under the FMMO. As you may recall, only Class I milk is required to be pooled under the FMMO, unlike the State Order that required all milk be pooled.

Last month, 2.08 billion lbs. of milk were pooled in the FMMO compared to 3.18 billion lbs. under the State Order in November 2017, about 35% percent less milk overall. A significant volume of Class IV milk was not pooled last month, accounting for only 8.9% of the pool, thereby increasing other Classes' share of the pool compared to historical figures. By contrast, State Order 4a milk (Class IV in the FMMO) accounted for 32.5% of pooled milk in 2017. Keep in mind, this is just one month of data and processors have the option to pool or de-pool monthly.

We'll continue to analyze and report information about the Federal Milk Marketing Order to you with the hope that you find it interesting and valuable.

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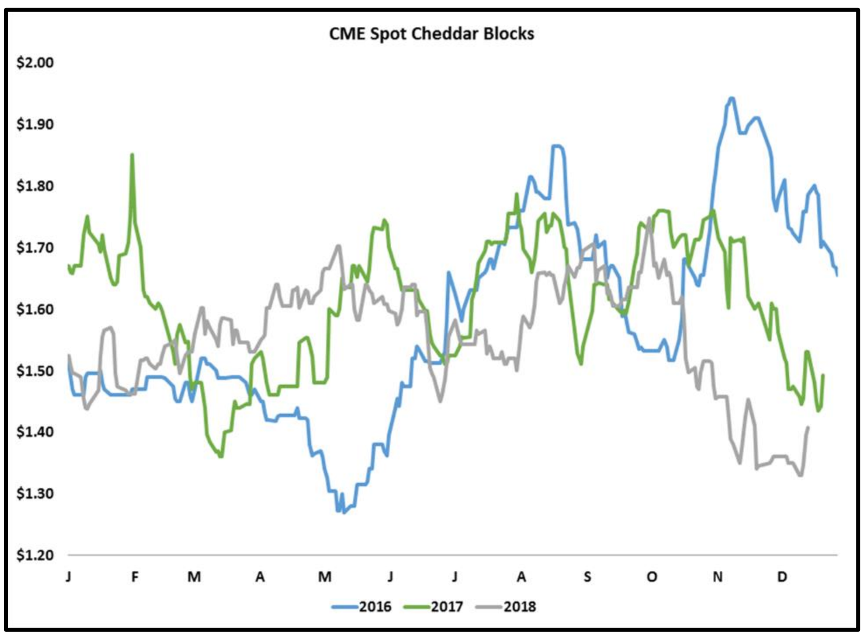
Market commentary

By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com

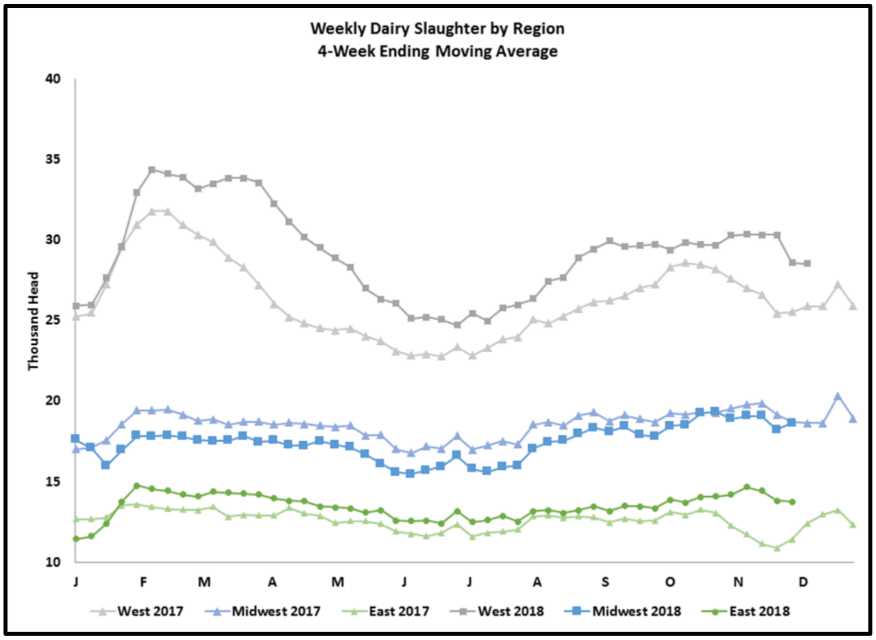
Milk & Dairy Markets

The dairy markets slumped on Monday. December through April Class III futures dropped to new life-of-contract lows. The same is likely true for dairy producer morale. CME spot Cheddar blocks fell to the lowest level in 18 months. But that was low enough; the markets moved convincingly higher for the rest of the week. Blocks closed at $1.4075 per pound, up 5.75¢ from last Friday. Barrels jumped 8.75¢ to $1.31. Spot whey improved as well, climbing 1.25¢ to 45¢. That helped Class III futures to a much better finish. Most contracts gained 20¢ to 30¢. Still, December Class III is $13.80 per cwt. and first-quarter futures average $14.64. While the improvement is welcomed, there is no promise of prosperity in the next few months.



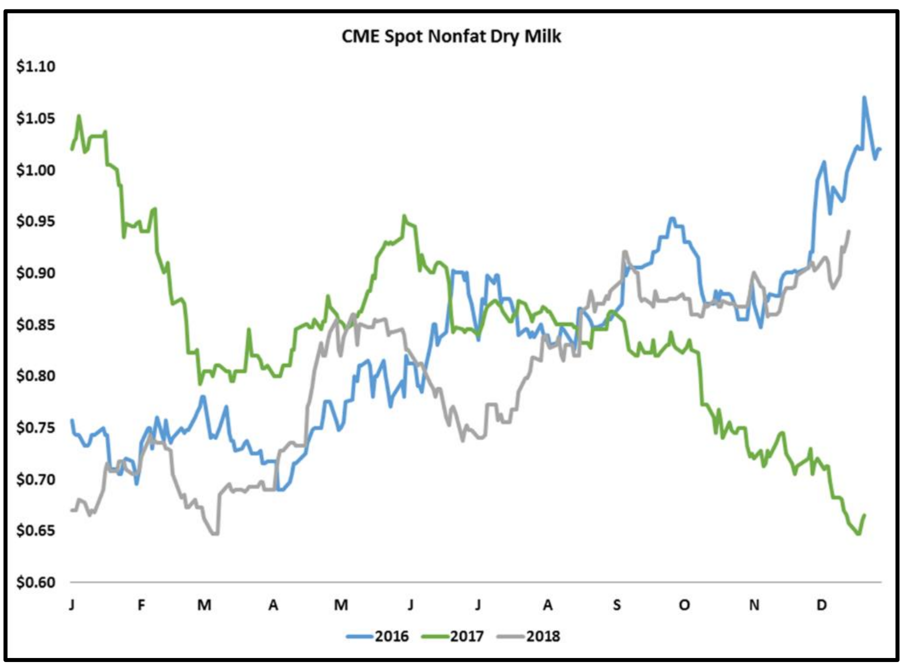
The dairy markets are depressed and the impact is obvious, particularly in the Eastern half of the nation. Dairy cow slaughter is 5% ahead of the 2017 pace, despite the smaller milk cow herd. Some dairy producers are taking a heavy discount on their cull cows to ensure shackle space at overcrowded slaughterhouses. Only the best heifers and milk cows command a price that recognizes their value as a dairy animal and not just a source of ground beef. Many dairy producers are looking to sell a share of their assets, hoping to raise enough cash to survive until prices improve, but there are precious few buyers. Supply vastly outweighs demand for dairy assets. Livestock, feed stock, and rolling stock are offered at firesale prices.

This suggests that contraction in the dairy herd is accelerating, and milk production may follow. In October, lower milk output in the East was more than offset by gains in the West. But heavy rains in Texas in November and a recent wave of sellouts across the nation indicate that year-over-year growth in milk output may soon be lower than the already languid 0.8% increase reported for October. Over the past six weeks, slaughter in the East and the West has outpaced year-ago volumes by wider margins, suggesting that liquidations may have sped from a trot to a canter.



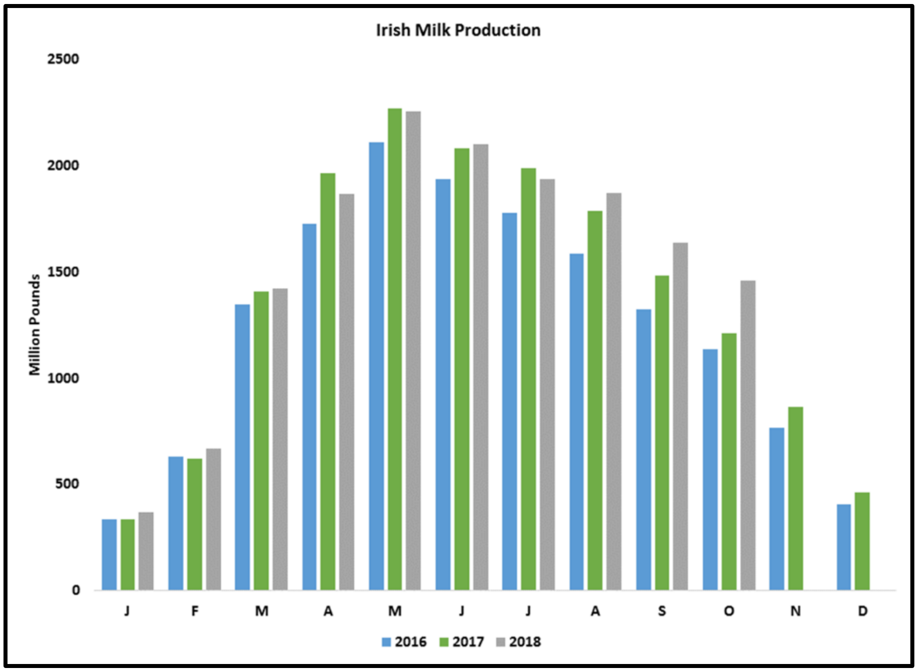
This will buoy milk prices. Indeed, it is already boosting some markets. CME spot nonfat dry milk (NDM) jumped 5.5¢ this week to 94¢, an 18-month high. Spot butter prices slipped 1.75¢ to $2.19, which slowed the advance in the Class IV market. Class IV futures are mostly 15¢ to 35¢ better than they were last Friday. The first-quarter average is none too exciting, at $15.24, but it's still 60¢ higher than Class III.

Lower milk powder output, tightening stocks, and rising prices clearly reflect the decline in milk production in the Eastern U.S. and stagnation in Europe. In October, European milk output was likely close to prior year levels, consistent with steady output in September. While milk production is growing relentlessly in Ireland and Poland, it is slowing in Germany and France. Through September, European skim milk powder (SMP) output lags 2017 by 1.5%.



This week the European Commission sold 133.5 million pounds of SMP from its Intervention stockpile at a minimum price of €1,451 per metric ton, the equivalent of NDM at 80¢ per pound. That's not bad for such stale product. In fact, this week's tender commanded the largest volume and highest minimum price since the Commission began moving powder out of Intervention two years ago. The stockpile has dwindled to 170.4 million pounds, down from a peak of more than 800 million pounds. Exports have helped immensely. European SMP exports are 4.1% higher than 2017, thanks to a 40.9% year-over-year jump in October. In the U.S., January through October NDM shipments are up 25.3% from the record-breaking volumes of 2017.

The uptrend in milk powder prices, and to a lesser extent Class IV futures, is likely to continue. As milk supplies tighten, there will be fewer trucks waiting in line at the drier, aside from the typical holiday swell. Won't less milk translate to less cheese as well? In short, probably not, or at least not enough to matter much. According to

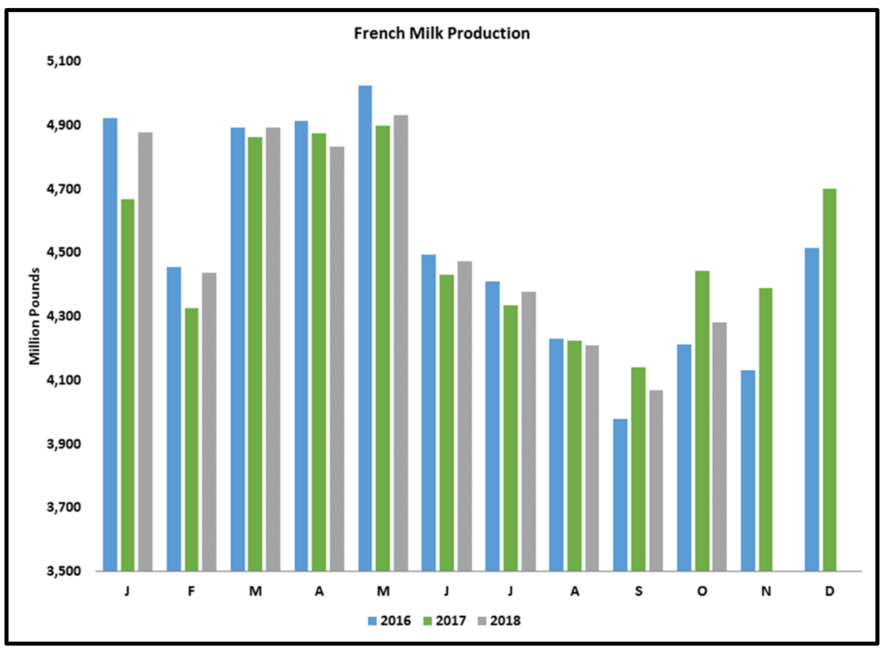


USDA's *Dairy Market News*, while "Midwestern cheese contacts are hopeful for some bullish movements in 2019" due to lower milk output in the region, they have no plans to slow production. "A few producers suggest they plan to go to a full schedule at the onset of 2019, returning to a seven-day workweek." Meanwhile, "Cheese production schedules are very active in the West, following milk output movements. Most cheese processing facilities are running either at full capacity or close to it. Stocks are more than enough to fulfill the needs of buyers. As inventories surpass demand, prices remain low."

While dairy producers would be better off if milk shifted away from Class III and into the "higher of" Class IV products, most processors don't have much flexibility or the incentive to move milk around that way. Most commodity-style cheese plants have contracted the bulk of their raw milk needs. They may take on fewer loads of cheap spot milk than they did last year and run near capacity, rather than beyond it. But any decline in overtime is more than offset by new and expanded cheesemaking facilities. There is room for improvement in cheese prices from these very low levels, but a sustained rally will have to be driven by demand. Supplies remain heavy and output continues to grow.

<u>Grain Markets</u>

China delivered on its promise to import U.S. soybeans. U.S. exporters report at least 35 cargoes of soybeans committed to go to China. More official data from USDA's weekly export report showed 1.1 million metric tons of soybeasn committed to move to China. It's not enough. Even if China were to purchase many times that amount, U.S. soybean stocks would still reach all-time highs. Soybean futures are at least a dollar – and perhaps two – higher than current inventory projections warrant. Despite this week's export headlines, January soybeans slipped 3¢ to $9.1375 per bushel. Corn futures settled 0.75¢ lower, at $3.8475.



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Congress passes a Farm Bill

By Geoff Vanden Heuvel, Director of Regulatory and Economic Affairs

In the end, after months of partisan haggling, the Farm Bill was passed this week with overwhelming majorities in both the House and Senate. Reports in the general media say that dairy farmers got a safety net upgrade in this bill and I would agree with that. Are happy days here again? No, dairy farmers would be much happier if we had profitable milk prices, but the upgrades in the Farm Bill will be meaningful to many producers in the U.S. So, here is what we got.

The revised program is now called the Dairy Margin Coverage program, DMC for short. It is still focused on the margin between the monthly "all milk" price and a national representative feed cost calculation based on corn, soybean meal and alfalfa prices. Every month this national margin is calculated and producers who participate in the program can obtain heavily subsidized coverage that will make direct cash payments when the actual margin is smaller than the margin the producer chose to buy coverage for. The catch is that the really smoking good deal is for coverage on the first 5 million pounds of annual production. (5,000,000/365 days is 13,700# per day, about 200 cows)

On this first 5 million pounds of annual production, you can buy coverage for a margin as high as $9.50 per cwt. Analysis of historical prices shows that coverage at the $9.50 level will trigger payments over half of the time. You can obtain this coverage for a premium of $0.15 per cwt. But there is more. If you commit up front to buy this elevated level of coverage for all five years of the Farm Bill, there is a 25% discount in the premium, taking the cost down to $0.1125 per cwt. But there is still more, if you bought MPP coverage in the years 2014-2017, and you paid more in premium than you received in indemnity payments, you can get a refund of part of your premium. You can choose to apply 75% of that refund to premiums that will be due if you decide to participate in the DMC, or you can get a 50% refund in cash, even if you are no longer in operation.

So what is the deal for producers who ship more than 5 million pounds per year? The rules have been changed so that large dairies can buy the 5 million pounds of tier 1 coverage for the very low price and if they buy the higher coverage levels ($8.50, $9.00 or $9.50) for the first 5 million pounds of annual production, then they can access tier 2 coverage for the rest of their production up to a total of 95% of the volume. The $5 margin coverage cost in tier 2 has been reduced to $0.005 which also qualifies for the 25% discount ($0.00375 per cwt.) if committed to for the full 5 years of the farm bill up front. In addition, all restrictions on participating in the two government-subsidized dairy crop insurance programs, LGM Dairy and the new Dairy Revenue Protection program, while simultaneously participating in the DMC program have been lifted. And by the way, the refund of any net premiums paid for MPP coverage for the years 2014-2017 can also be applied to premiums that might be due for participation in the new DMC program.

The DMC rate chart looks like this:

Coverage Level	**Tier 1 (first 5 million pounds)**		**Tier 2 (over 5 million pounds)**	
	Premium	*w/ Discount*	*Premium*	*w/ Discount*
$9.50	$0.1500	$0.1125	n/a	n/a
$9.00	$0.1100	$0.0825	n/a	n/a
$8.50	$0.1050	$0.0787	n/a	n/a
$8.00	$0.1000	$0.0750	$1.8130	$1.3600
$7.50	$0.0900	$0.0680	$1.4130	$1.0600
$7.00	$0.0800	$0.0600	$1.1070	$0.8300
$6.50	$0.0700	$0.0525	$0.6500	$0.4880
$6.00	$0.0500	$0.0375	$0.3100	$0.2330
$5.50	$0.0300	$0.0225	$0.1000	$0.0750
$5.00	$0.0050	$0.0038	$0.0050	$0.0038
$4.50	$0.0025	$0.0019	$0.0025	$0.0019
$4.00	$0.0000	$-	$-	

Additionally, Congress instructed USDA to review the data used in the calculation of the feed cost in the DMC to see if it actually represents the average dairy feed costs dairy farmers pay. They also instructed USDA to do a study that evaluates the difference in the cost between the use of corn silage and the cost of corn. And they ordered

USDA to revise monthly price survey reports to include prices for high-quality alfalfa hay in the top five milk producing states as measured by volume of milk produced during the previous month. So further tweaks in the DMC calculations may be coming.

Another DMC program detail you will have to live with is the production base that was established for the original MPP program. That was based on the highest production from your facility for calendar year 2011, 2012 or 2013 adjusted every year by the annual increase in national milk production. There will be no further upward adjustments during the life of this Farm Bill.

One other change in the Farm Bill worth noting is a change to the Class I formula. Since Federal Order reform in 2000, Class I prices have been set to be a differential (which varies by region) over the **higher of** either the class III (cheese) value of milk or the class IV (butter/powder) value of milk. Because in any month, one or the other might be higher, it makes hedging those costs for the Class I bottlers difficult.

They approached producers some time ago and asked for a change that would use the simple **average** of the Class III and Class IV price as the Class I mover. A study was done and it was determined that the **higher of** feature since 2000 had added about $0.74 per cwt. to the Class I price over those years. The processors agreed to support raising the Class I differentials by $0.74 in exchange for producer support for moving to the average instead of the higher of Class III and IV. Congress agreed and instructed USDA to make this change in all the Federal Milk Marketing Orders.

On balance, Congress has done as much as they can for dairy farmers given the constraints of the budget and political realities.

I know there is a lot to digest here. I have scheduled a Farm Bill information webinar for Monday, December 17 at 1 p.m. PST where I will go over the details of the dairy portion of the Farm Bill and do my best to answer questions. If you would like to join me, send me an email or call or text me and I will get you the connection information for the GoTo Meeting webinar. You can email me at Geoff@milkproducers.org or call or text me at 909-730-1240. All are invited.

Farm Bill Webinar

1 PM Pacific Time
Monday, December 17

Join MPC's Geoff Vanden Heuvel for a breakdown of the recently passed U.S. Farm Bill and what it means for California dairy farmers.

All invited
RVSP to Geoff for webinar link
geoff@milkproducers.org
909-730-1240

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Water wars; This week's battles

By Geoff Vanden Heuvel, Director of Regulatory and Economic Affairs

While the elections took place back on November 6, the election results did not become final until this week. Proposition 3 was the water bond and it contained over $1.4 billion of funding for Central Valley water projects. When all the votes were counted, Proposition 3 lost with 6,034,991 No votes to 5,879,836 Yes votes, which means if 77,577 voters who voted no would have voted yes it would have passed. The irony is how poor Proposition 3 did in the Central Valley. It lost in Kern County, passed narrowly in Tulare County, won in Fresno County, lost in Madera County, won narrowly in Merced County, lost in San Joaquin County and lost in Stanislaus County. The biggest project that needs immediate funding is the repair of the Friant Kern Canal, which was slated to receive $350 million from Prop 3. This repair must be done and the leadership of the Friant Water Authority is scrambling to find an alternative funding mechanism. But in addition, the Sustainable Groundwater Management Act will ultimately require major investments in water infrastructure. Prop 3 would have been a good down payment to get started with. Its failure is extremely disappointing.

The second blow of the week was the decision on Wednesday of the California State Water Resources Control Board to adopt flow standards for the tributaries of the San Joaquin River that will require more water to stay in the rivers for the purpose of aiding fish. This decision had been scheduled to be decided in November, but due to a request from Governor Brown and Governor-elect Newsom, the State Board put off a decision until this Wednesday to allow for the development of a Voluntary Settlement Agreement (VSA) between the effected parties.

A partial VSA was reached, and on Wednesday morning at the State Water Board meeting, the California Department of Water Resources and the California Department of Fish and Game outlined a settlement agreement that covered much of the San Joaquin and Sacramento River flows. It included a program that has water districts and the State of California contributing water and/or money to a conservation program aimed at improved health of fish populations at a water cost that was much more reasonable to the communities that depend on these rivers for their water supply. Unfortunately, the State Board while acknowledging the progress represented by the VSA, decided to adopt their flow standard requiring 40% of the flow to stay in the rivers for outflow to the ocean and review the VSA to see if maybe they could adjust these flows in the future. This is a complicated and difficult issue, but the economic costs to the impacted communities, which does involve a significant portion of California, are enormous and it is disheartening to see how unpersuaded the State Board were to these concerns. But as with all things water in California…to be continued.

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What California Dairy Producers should know about SGMA

By California Dairy Magazine

California farmers continue to face disappointment after disappointment with economic and regulatory issues, but now is not the time to bury your head in the sand. The Sustainable Groundwater Management Act (SGMA) is coming into fruition, and farmers need to not only be aware of how this will impact them, but getting involved in their local water agencies will be critical as plans are solidified. Geoff Vanden Heuvel from the Milk Producers Council addressed this at the recent California Dairy Sustainability Summit in Sacramento. Click here to watch a brief video with Geoff and read more about it in California Dairy Magazine.