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DATE: January 6, 2012 **PAGES: 5**
TO: Directors & Members **FROM: John Kaczor**

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE		
Blocks	*+$.0475*	$1.6100
Barrels	*+$.0100*	$1.5900
Weekly Average, Cheddar Cheese		
Blocks	*+$.0281*	$1.5906
Barrels	*+$.0131*	$1.5831

CHICAGO AA BUTTER		
Weekly Change	*+$.0100*	$1.6050
Weekly Average	*+$.0075*	$1.6025
DRY WHEY		
DAIRY MKT NEWS	w/e 01/06/11	$.6838
NASS	w/e 12/31/11	$.6710

NON-FAT DRY MILK		
Week Ending 12/30 & 12/31		
Calif. Plants	$1.3850	15,211,692
NASS Plants	$1.4006	20,983,212
Prior Week Ending 12/23 & 12/24		
Calif. Plants	*$1.3556*	*27,026,258*
NASS Plants	*$1.3766*	*29,462,123*

CHEESE MARKET COMMENTS: With the holidays behind, a welcome period of quiet trading during which nerves had time to settle afforded the vast network of enterprises downstream from cheese manufacturing plants – brokers, buyers, handlers, cut-and-wrappers, transporters, warehouses, retailers, and food service operations – time to look back, around, and ahead. During the year just ended, many questions were asked and answered but no real issues were resolved. The dairy industry begins 2012 with the same set of problems and opportunities that existed one year ago. Let us hope the orderly start shown so far continues. Total cheese production in November was little changed from a year ago, and down by 11 million lbs from October – in other words not much change. That means the report on the amount of cheese in cold storage at the end of November – 56 million lbs lower than a year ago and 43 million lbs lower than a month ago – reflects a considerable increase in total cheese usage. The first trading this week on the CME happened on Wednesday with blocks and barrels moving up from offers from cheese makers. On Friday 14 carloads of blocks sold with no change in price. The heavy trading is attributed to buyers needing cheese for the next sales event, and sellers telling them the store is open. It is beginning to look like a real market again, although there is a line of reasoning that some of the offers may have carried a message about the reasonableness of the prices. The class III milk futures traders liked what they saw, moving prices up for all months this year, with a $17.87 per cwt high in March and a $17.13 low in November.

BUTTER MARKET COMMENTS: The milk and cream supply is being sorted out as schools re-open and various manufacturing facilities come back on line. It is fair to say the overall supply is in balance with overall demand but the receiving bays of butter plants will nonetheless be the place where whatever is surplus to all other needs winds up. There will be surplus if cheese production does not at least keep up with the rate of monthly milk production increases and if fluid milk usage does not stabilize. Butter production in November was 6.5 million lbs higher than in October and the amount of butterfat products in cold storage fell by 35.5 million lbs during the month. Butter production so far this year has been at record-setting levels, and November's stocks are lower than they were four out of the last five years, are declining at a normal seasonal rate, and would likely be at or below last year's level had not exports dropped off over the last half of the year. That is a pretty good record. Butter prices held where they were last week after two weeks of losses, and gained a penny per lb this week, with light trading. CME futures prices are selling at premiums to the current spot prices, ranging from $.06 per lb in February to $.175 per lb in December.

POWDER MARKET COMMENTS: Production of dairy powders in California have been and are being affected by the same seasonal market circumstances that cheese and butter plants have encountered – more milk production, wide swings in usage of fluid milk products, and holiday schedules affecting other plants' demands. Nonfat powder production, through November, continues to shift from NFDM to skim milk powder. November NFDM production in California was 11 million lbs lower than a year ago, while production of other powders increased by 20.5 million lbs. Very heavy production of NFDM in the U.S. central region just about offset California's lower output for the month. For the U.S. production in November was 19.4 million lbs more than in

October, but stocks on hand at end-of-month rose by only 3 million lbs. California plants have shipped more NFDM in the past two months than was produced during that period. *DMN* says the market tone for NFDM in the west is unsettled to weak, with generally light buying interest this week. The "mostly" price series this week averaged $1.44 per lb in the central region and $1.385 in the West. Interest in buttermilk powder is light throughout the U.S., with prices steady to lower. CME futures prices were about unchanged for the week, averaging $1.40 per lb through June, then moving somewhat lower. The two major price series for last weeks' shipments recovered part of what was lost when an apparent inventory clearance sale occurred.

WHEY PRODUCTS MARKET COMMENTS: Dry whey prices continue to increase. The NASS price rose by a bit more than one cent per lb, to $.671 per lb. *DMN* says the market undertone is very firm in the northeast, in balance in the central region, and is being supported by re-sales in the west. The west's "mostly" price this week edged up by $.0068 per lb. Contracts for 2012 appear to be close to finalization and, according to *DMN*, in balance with expected production. That means, of course, that buyers without contracts may be facing stiff premiums provided the overall market remains like it has been. CME futures prices for the first four months of this year are selling at a premium to the NASS price, but begin to fall rather sharply in May, all the way down to $.515 per lb in November. [**Note:** A reader last week made some good points and asked some good questions about the balance between the domestic and export markets, and how they should be pursued. "*Sounds like the markets at work*," "*is it wrong to pursue the highest value for our dairy products*," and "*is it wrong to develop dairy policy*"**…**[with a goal to develop the export market] …"*even if we lose some domestic buyers in the process*." Well, most people in the industry at least profess to want an even playing field ("free trade if fair trade" was the chant). Forging policies that nudge the market in one direction or another may not be the best thing to do, but certainly we should pursue the highest value for our dairy products, provided producers get their fair share of the results. So far, there does not seem to be a way to get to there from here in the grand plan being sold by the Innovation Center for Dairy. If they cannot do it, who can?]

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FRED DOUMA'S PRICE PROJECTIONS…

Jan 06 Est:	**Quota cwt. $17.45**	**Overbase cwt. $15.76**	**Cls. 4a cwt. $16.39**	**Cls. 4b cwt. $14.55**
Last Week:	**Quota cwt. $17.31**	**Overbase cwt. $15.62**	**Cls. 4a cwt. $16.45**	**Cls. 4b cwt. $14.20**

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ESTABLISHING THE VALUE OF MILK ON A CALIFORNIA DAIRY: *(By Rob Vandenheuvel)* There's been a lot of talk in the past year about the California milk pricing structure. That's to be expected when we have a structure that cheats the State's dairy farmers out of hundreds of millions of dollars. But this week, I'd like to take it back to basics. I'd like to address the question of why CDFA even has control over our prices and what responsibilities come with that control.

Many years ago, the California Legislature decided that the price of milk should be regulated by the State of California. They passed laws, instructing the California Department of Food and Agriculture (CDFA) to establish and implement a "Stabilization and Marketing Plan" that "includes, among other things, the establishing of prices to be paid by handlers for any or all of the various classes of market milk." These laws are published in the California Food and Agricultural Code ("The Code"). **That simple fact is the *only* reason CDFA even has the authority to establish minimum prices for the milk being produced and sold in California.**

In delegating that important authority to CDFA, the Legislature didn't just give them a blank slate. They outlined a set of parameters that CDFA is required – by law – to follow as they establish a minimum value of milk. Those parameters are outlined in Chapter 2 of The Code. There are 18 "Articles" in Chapter 2 dealing with a host of legal requirements CDFA must follow. But the area I will be focusing on today is Article 9, which outlines the "Establishment of Minimum Prices and Provisions of Stabilization and Marketing Plans."

Chapter 9 of The Code gives the Secretary of Agriculture (currently, that's Secretary Karen Ross) broad discretion in establishing the minimum prices for each class of milk. The Secretary can determine the minimum price for each class of milk by either simply announcing a price or "by adopting methods or formulas…whereby the prices can be determined," or any combination of those two things. In adopting those "methods or formulas," the Secretary also has broad discretion. The Secretary can base the price on the cost of producing the milk. For that matter, the Secretary can even set up a formula that looks at the price of bread, automobiles and orange juice. The Secretary has full discretion. What CDFA has done in the past and continues to do today is utilize "end-product pricing," that is setting the minimum price for each class of milk based on the value of the "end products" that can be manufactured from that milk (i.e., butter, nonfat dry milk, cheese and dry whey).

However, no matter how the Secretary decides to determine the minimum price of milk, the price that results from that determination must meet a specific standard. Section 62062 of The Code states that the prices that are announced **"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."**

So let's look at how the current formulas are performing. In determining the "national value of manufactured milk products," we have to look at what comparable milk is worth in other parts of the country. While California operates our own state system when it comes to valuing milk, more than 80 percent of the milk produced outside of California is produced in Federal Milk Marketing Order (FMMO) areas. FMMOs also divide their milk prices into "classes," based on how that milk is ultimately used (i.e., bottled as fluid milk, turned into cheese, etc.). The FMMO Class III minimum price is a well-known price around the country – it's the price that a plant regulated under a FMMO and producing cheese must pay for the milk they purchase. The comparable price here in California is the Class 4b price.

Over the past two years, the Class 4b minimum price has averaged $14.77 per hundredweight. Over that same period, the FMMO Class III minimum price has averaged $16.39 per hundredweight. **That's a staggering difference of $1.62 per hundredweight over the entire 24-month period!** Just this past month alone – December 2011 – the California Class 4b minimum price was $15.14 per hundredweight vs. the FMMO Class III minimum price of $18.77 per hundredweight – a $3.63 per hundredweight difference! What do these numbers mean in real dollars? Over the past two years, an average of more than 1.25 billion lbs of milk per month have been sold to our State's cheese manufacturers. A $1.62 per hundredweight difference between the California Class 4b and FMMO Class III prices represents a "California discount" of more than **$20 million per month**, or **$240 million per year**!

So looking at these numbers, what evidence is there that our Class 4b minimum price is reasonably calculated to result in a price that is in a "reasonable and sound economic relationship with the national value of manufactured milk products"? **That's an outstanding question, and one that MPC and the rest of the dairy producer side of our industry must continue to demand an answer for.**

TWO OF THE THREE MAJOR FEDERAL ETHANOL SUBSIDIES ARE NOW HISTORY: *(By Rob Vandenheuvel)* More than a year ago, I had a conversation with a dairy industry lobbyist about the possibility of getting rid of the tax and trade subsidies enjoyed by the corn-based ethanol industry. I was told quite clearly that the chances were slim-to-none, and that we'd be better off focusing our efforts on preventing the subsidies from getting worse. Fortunately, that's no the end of the story. MPC was able to join forces with a strong coalition of organizations working to eliminate the tax/trade subsidies, and as of December 31, 2011, those subsidies are now history.

As a bit of background, the corn-based ethanol industry enjoys three main Federal support programs:

- ***Ethanol Blender's Tax Credit*** – A tax credit worth $.45 per gallon available to the oil/gas companies that blend ethanol with their fuel. This tax credit cut taxes paid by oil/gas companies by an estimated $6 billion per year.
- ***Ethanol Tariff*** – This tariff of $.54 per gallon applied to ethanol products that are imported into the U.S.

- ***Renewable Fuel Standard (RFS)*** – This is the "ethanol mandate" that requires oil/gas companies to blend a minimum volume of renewable fuel with their gasoline. In 2012, the total mandate is 15.2 billion gallons of renewable fuels, of which 13.2 billion gallons can come from corn-based ethanol. *As a note, it was estimated last year that in order to full the 2011 mandate of 12.6 billion gallons of corn-based ethanol, about 40% of our national corn supply was needed.*

As we enter into 2012, the first two subsidies listed above are **now gone**. This is a huge victory for common sense in Washington, DC. An enormous amount of credit for this victory goes to a broad coalition made up of livestock agriculture groups, environmental advocates, hunger groups and taxpayer advocates. This coalition has fought hard over the past year-plus to eliminate these subsidies. MPC has had the privilege of being a part of this coalition, which also included the following regional dairy organizations:

- Alliance of Western Milk Producers
- California Dairies, Inc.
- California Dairy Campaign
- Dairy Producers of New Mexico
- Dairy Producers of Utah
- Idaho Dairymen's Association
- Milk Producers Council
- Nevada Dairy Commission
- Northeast Organic Dairy Producers Alliance
- Northwest Dairy Association (Darigold)
- Oregon Dairy Farmers Association
- Southeast Milk, Inc.
- Washington State Dairy Federation

In addition, the International Dairy Foods Association (IDFA) – a group that dairy farmers have been battling on a regular basis on other issues, joined the efforts to stop this unwise use of government funding. On behalf of the board and membership of MPC, I would like to extend a wholehearted thank you to the groups listed above. Few may have thought this day was possible, but this issue proved the value of Advocating good policy with a strong coalition of the willing.

While it is nice to enjoy a victory, the work is not yet done. The third major support listed above is still alive and well. The coalition has been able to work with Rep. Bob Goodlatte (R-Virginia) to introduce H.R. 3097, the Renewable Fuel Standard Flexibility Act. This bill, if approved by Congress and signed into law, would force the Federal Government to reduce the ethanol mandate when our domestic corn supplies are tight and reach certain thresholds. The bill has bipartisan support with 30 co-sponsors already on board. It's our hope that with the start of the new Congressional Session, we can see continued momentum on this important issue.

CALIFORNIA DAIRIES, INC. SUBMITS HEARING PETITION TO LOWER THE CLASS 4A PRICE: *(By Rob Vandenheuvel)* This week, California Dairies, Inc. (CDI) submitted a letter to CDFA requesting that a hearing be scheduled to consider modifying the Class 4a minimum price formula. The changes being requested would increase the "make allowances" in the formula for butter and nonfat dry milk, while slightly lowering the "f.o.b. adjuster" for butter.

The practical effect of these requested changes would be to **reduce** the Class 4a minimum price each month by **$0.3133 per hundredweight**. Using information from the past 12 months, if these changes had been in place in 2011, the California pool would have gotten almost **<u>$43 million less in 2011</u>**. The Secretary of Agriculture has until January 18th to decide if a hearing on this issue is warranted. So stay tuned…

GLOBAL AUCTION: PRICES EDGE LOWER BUT SHOW SIGNS OF STRENGTH IN LATER MONTHS: *(by J. Kaczor)* The number of potential bidders certified to participate in GlobalDairyTrade's twice monthly auctions continues to grow. Nine more were certified since the December 20th auction. This week, 152 entered the bidding, 361 did not. GDT says they do not track the number of potential bidders who clock in before bidding begins, nor the frequency or pattern of their bidding. According to GDT, all qualified bidders have access to all sellers' offer quantities, forecasts, and starting prices, but a bidder is not clocked in as "active" until information is entered for a product's volume. Obviously, many do not. GDT pointed out that the rules permit termination of a bidder's certification after 18 months of inactivity. Beginning with the October 4th auction, GDT rules prohibit communication of each seller's forecasts, starting prices, and offer volumes for ninety days, except for Fonterra's because New Zealand's major market for securities, NZX, considers that data to be material information for the pricing of their futures market contracts which presently includes whole milk powder, skim milk powder, and anhydrous milkfat. [Note: NZX presently only uses Fonterra's results for settling SMP futures prices.]

Winning prices were mixed this week: prices for buttermilk powder, cheddar cheese, and milk protein concentrate rose, while rennet casein, anhydrous milkfat, whole milk powder, and skim milk powder moved lower. The latter three represent about 93% of the total volume of the seven products presently offered in the auctions. The weighted average price for all products was $1.657 per lb, slightly lower for a second straight time, by a total of $.029 per lb for the month. AMF had the biggest percentage drop, 5.1%, while the two major powder products each fell by less than 1.0%. All in all, these results should be considered to be a fairly strong response by the bidders, considering the current major concerns about global financial issues, possible waning international demand, and the sharp increase in milk production in three major exporting nations in the southern hemisphere. Contributing to the positive outlook on these results is the continuing pattern of higher prices for the three major products for delivery periods beyond the "Spot Month," which in this case is March.

Yesterday, *Dairy Market News* commented on the powder markets for western Europe and Oceania. Skim milk powder prices in Europe, f.o.b. ports, ranged from $1.34 to $1.43 per lb, and Oceania prices ranged from $1.42 to $1.68 per lb. The report covered the two week period ending with January 6th. GDT auction prices for SMP delivery in January are $1.40 for Dairy America's Contract 1 (which was bid in December) and $1.50 for Contract 2 (which was bid in November). Whole milk powder prices were reported to average $1.65 in Oceania and $1.71 per lb in Europe. Europe's WMP price, according to *DMN*, was acknowledged as being "too high."

Dairy America's skim milk powder for Contract #1, for delivery in the month immediately following the month in which the auctions are held, corresponds to the delivery period for the auction's Contract #2 which follows the auctions by two months. For example, Contract 2 for September auctions covered the month of November, which was the month covered by Dairy America's October Contract 1 auction. Contract 1 bidders therefore know beforehand the highest price bid the month before for skim milk powder. That may partly explain why the prices Dairy America has been receiving for supposedly identical products are consistently lower than prices for much larger volumes whose prices are already disclosed. Dairy America began offering SMP in Contract #2 in November; once prices and volumes for those auctions are reported, which should be 90 days after the auctions are completed, a direct comparison may be possible.

MONTHLY MPC BOARD MEETING TO BE HELD NEXT TUESDAY: *(By Rob Vandenheuvel)* MPC's monthly board meeting will be held next Tuesday (January 10th). This month's meeting will be held in Bakersfield, CA, in the board room of the Kern County Farm Bureau *(801 S. Mount Vernon Avenue, Bakersfield)*. The meeting will start at 11 am. **All current and prospective MPC members and associate members are welcome to attend.** If you plan to attend, please RSVP by calling (909) 628-6018.