Milk Producers Council

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TO: Directors & Members **FROM: John Kaczor**

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE		
Blocks	*- $.0200*	$1.4675
Barrels	*- $.0100*	$1.4700
Weekly Average, Cheddar Cheese		
Blocks	*- $.0070*	$1.4750
Barrels	*- $.0042*	$1.4738

CHICAGO AA BUTTER		
Weekly Change	*+$.0025*	$1.4175
Weekly Average	*+$.0151*	$1.4156
DRY WHEY		
DAIRY MKT NEWS	w/e 02/24/12	$.5950
NASS	w/e 02/18/12	$.6395

NON-FAT DRY MILK		
Week Ending 2/17 & 2/18		
Calif. Plants	$1.3401	17,024,275
NASS Plants	$1.3637	19,973,007
Prior Week Ending 2/10 & 2/11		
Calif. Plants	*$1.3790*	*10,666,725*
NASS Plants	*$1.4039*	*15,793,617*

CHEESE MARKET COMMENTS: *Dairy Market News* says current cheese production in the U.S. is "steady." That is amazing, considering the attractive offers of milk, cream, and condensed skim, made to manufacturers for the super abundant supplies presently available. USDA's report on the amount of cheese in cold storage at the end of January shows cheese sales and usage of all kinds is more than keeping up with production and imports of all kinds. (See report below on January cold storage.) While block and barrel prices on the CME lost some more ground this week, the "market" appears to believe the current price levels are close to representing current values. With that said, it is important to remember the basis for the current pricing system for all cheese in the U.S. – CME's spot prices for bulk cheddar cheese – may no longer be suitable for anything other than serving as the cheese makers' "playground." The only change of significance since the Government Accountability Office's critical report in 2007 on CME's spot cheese market is there was less cheddar produced in 2011 than in 2008. Otherwise, it is business as usual. Directly or indirectly, prices for sales of cheddar blocks and barrels are the major input used by virtually all price-setting agencies to set milk prices. In California, prices for block sales only are used, which means sales of about only 5% of all cheese produced in the state is used as the major basis for setting milk prices for the state's largest usage category. Percentages far higher than that led to discarding the Minnesota-Wisconsin grade B price series as the basis for establishing the basic market value for milk used in federal orders in the 1990's. Should California wait until sales of block cheddar fall to 4% or lower before a change is made? Cheese plants know the full value of cheese comes from the sum of the cheese price, the value of whey proteins, and the value of lactose. Only part of the value of the whey proteins is presently used – that being the lowest valued product in whey product line, dry whey, and none of the value of lactose. On the other hand, who really believes cheese makers, if left to set the prices they pay for milk in open competition with every other user of milk, would pay anything much different than they now do? Class III futures prices this week lost an average of $.64 per cwt for the April quarter and $.37 per cwt for the July quarter. The low for the next twelve months is now April, at $15.12 per cwt.

BUTTER MARKET COMMENTS: As butter production continues at very high levels and inventories grow by huge amounts, *DMN* is finding little alarm among manufacturers. The memorable comments this week about rising inventories involve "minimal" concern for various reasons, including continuing strong domestic sales (retail and food service), "very good" export demand, and anticipated "future needs." The recent steadying of butter prices on the CME have led to some great private label butter ads ($1.89 per lb for one pound prints and $2.00 per lb for quarters), with more like those expected as Easter/Passover approaches. Low export prices, helped some by CWT's assistance, should help to regain some of the sales that were lost the latter half of last year. Trading on the CME was moderate this week; prices gained $.0025 per lb this week, in today's trading. Futures prices continued to weaken but still reflect significant premiums to the current cash price; the average fell by about $.035 per lb for the April-December months, while this week's average cash price increased by $.015 per lb.

POWDER MARKET COMMENTS: *DMN* reports prices for nonfat dry milk in all regions are mixed this week, but prices for the two major reporting agencies each fell by about $.04 per lb for last week's shipments. The west's "mostly" price this week ranged from $1.28 to $1.375 per lb. Some sales were reported as low as $1.25 per lb. U.S. production is booming; U.S. sales are not booming; U.S. inventories are rising. U.S. prices for nonfat powders appear to be going in the opposite direction of international prices. Skim milk powder prices in last week's global auction for shipments from New Zealand in April averaged about $1.50 per lb, and were higher for months beyond April, apparently buoyed by China's growing demand. According to reports from New Zealand, China imported about 41 million lbs of skim milk powder in January, three-quarters of which was supplied by New Zealand. China's monthly imports of SMP have now been above the same month a year earlier for thirteen straight months, while their imports of whole milk powder have been lower for eight straight months. The net winner and major benefactor is Fonterra. *DMN* says export demand for U.S. nonfat powder is active, but lower, partly because of overseas competition. Production of buttermilk powder has grown in line with butter production; it is a buyer's market for this and other low fat powders in the U.S, and buyers continue to hold back from making major commitments.

WHEY PRODUCTS MARKET COMMENTS: Lower priced dry whey from Western European sources are affecting the U.S. eastern market, although it is not clear if sales volumes are falling or only prices. Elsewhere, everywhere in the U.S., the market tone definitely has changed from as little as six weeks ago when buyers were finding it difficult to get the quantity of dry whey they needed. Something does not seem right about that report; perhaps the report on January's production and end of month inventories will help us understand. Even harder to understand is the wide difference in price per lb of protein between nonfat dry milk and the whey proteins. NFDM's protein is now about $1.00 per lb below that of dry whey, and about $.50 per lb below WPC-34's protein. It is not that difficult for end-users to substitute one dairy protein for another. Maybe that is why the dry whey futures prices are averaging somewhere around $.42 per lb, a level that prices DW protein about equal to that of NFDM. NFDM has less lactose per lb of protein than dry whey (and about the same amount as for WPC-34), which could be a factor in deciding on which ingredient to use.

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FRED DOUMA'S PRICE PROJECTIONS…

Feb 24 Final:	**Quota cwt. $16.41**	**Overbase cwt. $14.72**	**Cls. 4a cwt. $15.49**	**Cls. 4b cwt. $13.42**
Last Week:	**Quota cwt. $16.44**	**Overbase cwt. $14.75**	**Cls. 4a cwt. $15.56**	**Cls. 4b cwt. $13.44**

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JANUARY COLD STORAGE REPORT DID NOT SCARE THE MARKET: *(by J. Kaczor)* Those anecdotal comments over the past several weeks about a veritable flood of milk and cream showing up at the receiving bays of butter plants were not just talk. NASS released its numbers this week for January. The increase over December was large – the amount that was in storage increased by a net 64.3 million lbs during the month. That brought the total to 171.1 million lbs, just over where it was in 2010 and just under where it was in 2009. The low point last year was November, with 93.5 million lbs. Based upon reports so far this month, February's end of month stocks are expected to be even higher, which is the normal pattern for this time of year. The market's reaction after the release of this report, which would seem to be dreadfully negative news, was to tack on a small increase in the cash price for butter but to take a bit more from the premium prices for butter futures. It appears the size of this increase may have been expected and already priced into the market. Apparently, the reason for that is a considerable portion of the butter that went into storage is believed to be destined for export, including all of the butter containing 82% butterfat. If so, that would help to make up for some of the export sales that were lost in the latter half of last year.

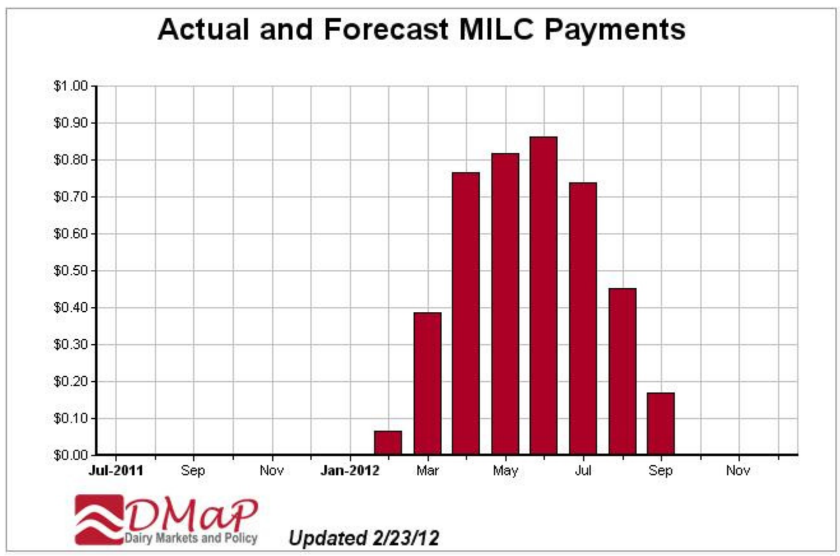
The fact that the level of butterfat in storage in January is above the average of the last five years, a point that was made in a number of places, would seem to relevant only if the years 2007, 2008, and 2009 were considered to be normal. Not many in this industry would think that were the case.

The surprise in the report on cheese in cold storage, considering how much more milk was available for production of commodities during the month, was about how little change in stocks occurred compared to a month before. A total of 389 million more lbs of milk was produced in January than in December and class I usage in federal order areas used up about 4 million lbs more during the month than in December, leaving 385 million more lbs of milk to be disposed of. Yet stocks of American cheese rose only by about 1.5 million lbs during the month. Stocks of other natural cheeses, mainly Mozzarella, fell by about 14 million lbs. Total cheese in storage was 13.8 million lbs lower than a month before and 74.6 million lbs lower than January 2011.

KEEPING AN EYE ON THE PROJECTED MILC PAYMENTS: *(By Rob Vandenheuvel)* While we all would hope that dairy markets recover to profitable levels as quickly as possible, based on the information we have right now, it appears that things will continue to get worse before they get better. Our two main Federal safety net policies include the Dairy Price Support Program and the Milk Income Loss Contract (MILC) program. The Price Support program "supports" prices by allowing the Federal government to purchase basic commodity dairy products (nonfat dry milk, butter and cheddar cheese) at "support" levels that would provide dairies with a pay price of around $10 per hundredweight (we certainly hope this part of our safety net policies is left dormant in 2012). The MILC program generates direct payments to dairy farmers when milk prices drop below a certain threshold (which adjusts based on national feed values). It appears that payments under this safety net program may be available as soon as this month.

As we all know, the MILC program only makes payments on the first 2.985 million lbs of milk produced per dairy each year (which is only about one month of production for a 1,500 cow dairy, or two months of production for a 750 cow dairy, etc.). Therefore, the month each dairy selects as its "start month" will determine when that dairy will start collecting payments on its 2.985 million lbs.

Since dairies are forced to make decisions about future months in the Milk Income Loss Contract (MILC) ahead of time (changes to your dairy's contract must be submitted by the 14th of the month prior to your "start month"), we're left in the position of trying to guess where milk and feed prices are heading. Various organizations around the country publish projected MILC payouts in future months, which can be helpful for dairies hoping to sign up for optimal months.



The University of Wisconsin publishes their projections on a regular basis (http://dairy.wisc.edu). Their latest projection, which was published on February 23rd, indicates that given where the futures prices are for dairy and feed commodities in the next several months, payments will be generated during the months of February – September 2012. A chart of those projected payments is to the right.

MPC members needing any assistance with their MILC paperwork should contact the MPC office at (909) 628-6018 or office@milkproducers.org.

ADDITIONAL NOTE: It's difficult to write an article about the Dairy Price Support Program and the MILC program without pointing out the obvious observation that as we enter into this extremely challenging time for dairy farmers, our current Federal safety net policies are woefully inadequate in providing any real "safety net." A program that "floors" the milk price at around $10 per hundredweight and another program that provides payments on only a limited volume of production (and forces many dairymen to make educated guesses in selecting their optimal "start month") doesn't give us much of a tool to combat this rapidly deteriorating economic outlook for dairy farmers. MPC continues to work with fellow trade associations and cooperatives around the country to implement much-needed reforms to our safety net policies in Congress. The Dairy Security Act (H.R. 3061, or the "Peterson-Simpson Bill") would give us better tools and provide us with fundamental reform that would empower dairy farmers in times such as these. We've written numerous articles about the Dairy Security Act in prior issues of this newsletter, and as the Farm Bill debate heats up in Washington, DC, those articles will become more frequent. We need action and we need it now. So stay tuned…