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

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks	*- $.0675*	$1.3225
Barrels	*+$.0175*	$1.3650

Weekly Average

Blocks	*- $.1190*	$1.3325
Barrels	*- $.0345*	$1.3520

CHICAGO AA BUTTER

Weekly Change	*+$.0325*	$1.6525
Weekly Average	*+$.0350*	$1.6470

DRY WHEY

WEST MSTLY AVG	w/e 12/10/10	$.3925
NASS	w/e 12/11/10	$.3786

NON-FAT DRY MILK
Week Ending 12/10 & 12/11

Calif. Plants	$1.1973	10,923,261
NASS Plants	$1.2133	14,725,683

CHEESE MARKET COMMENTS: One of the more disappointing things about the CME price drops for cheddar cheese over the past two months is that it confirms the wisdom of buyers who sensed that a growing supply of milk and record high cheese inventories wouldn't support prices in the mid $1.70's, $1.60's, $1.50's, or maybe even the $1.40's. On the other hand, it may serve as a lesson costly enough for plants who continue to minimize costs by maximizing output to consider another using another model or strategy. And then again, those plants and buyers who hedged properly don't really care that much about what happens to prices. That could explain why some patterns seem to be repeated over and over. Did the value of cheese in inventory really drop by $140 million in two weeks? Dairy Market News reports cheese sales are running strong, that plants in the west are running full schedules, and more milk will become available over the holidays. Oh boy. Cheese exports in October totaled about 30 million lbs. Last week 33 truckloads of blocks and barrels were sold on the CME; this week 83 truckloads were traded. There does appear to be strong buyer interest at current price levels. Class III milk futures prices are holding fairly steady at about $13.30 per cwt for January and February.

BUTTER MARKET COMMENTS: Butter plants continue to compete against other holiday uses for cream supplies. Production is just about keeping even with sales. Prices on the CME have increased over the past two and a half weeks, gaining $.125 per lb. The price had fallen by $.72 per lb from the high point reached a little more than two months before. Exports of butter and butterfat products totaled about 10 million lbs in October. Cash-settled futures prices have rallied; prices are at $1.70 per lb and higher for all months in 2011. Potential shortfalls in New Zealand's milk supply because of drought conditions could extend this very unusual period of global butterfat shortages.

POWDER MARKET COMMENTS: The market tone for nonfat dry milk is firm, mainly because of very high export demand. Exports of NFDM and skim milk powder in October exceeded 109 million lbs – and is the highest ever recorded. Domestic usage is limited. Production is steady. Inventories are reported to be at comfortable levels. Weekly average prices for the two major sales reporting agencies continue to edge upward – this week on lower volumes. Futures traders apparently believe the current prices will hold or even increase; the CME price has risen sharply, to $1.25 per lb for the February through April period. The California plant average did again slip below the full range of prices reported for the western region for the week. The market for buttermilk powder continues to weaken and prices have moved slightly lower. DMN reports inventories are light, with a good portion of buttermilk moving to market in condensed form. The market of whole milk powder continues to be firm.

WHEY PRODUCTS MARKET COMMENTS: Just over 25 million lbs of whey protein concentrates were exported in October, which keeps the domestic market in a very tight supply position. The average of the price range for the week is at $.995 per lb. DMN reports some buyer resistance at that level, but there do not seem to be many good alternatives other than to try to secure a supply and a contract. Exports of dry whey totaled 47.5 million lbs in October. Production is steady. The domestic market is tight and prices continue to rise, but slowly. Dry whey futures prices on the CME have reached the $.40 per lb level for March.

FRED DOUMA'S PRICE PROJECTIONS…

Dec 17 Est:	**Quota cwt. $15.67**	**Overbase cwt. $13.98**	**Cls. 4a cwt. $14.94**	**Cls. 4b cwt. $12.18**
Last Week:	**Quota cwt. $15.78**	**Overbase cwt. $14.09**	**Cls. 4a cwt. $14.88**	**Cls. 4b cwt. $12.50**

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CONGRESS EXTENDS ETHANOL TAX CREDIT AND TARIFF: *(By Rob Vandenheuvel)* This week, Congress passed a tax bill that will extend the "ethanol blender's tax credit" at its current value ($.45 per gallon) for one year. Much has been written in this newsletter over the past month about the proposed extension of this $6 billion-per-year tax credit, and our efforts to end this fiscally irresponsible policy. Unfortunately, the ethanol lobby was successful in finding the right friends in the legislature, and attaching the measure to a bill that many in Washington, DC, saw as must-pass legislation.

The tax bill that was approved by Congress and signed by the President this week included a two-year extension of the "Bush-era" tax rates. This legislation has become a top priority for President Obama and many in Congress. That bill, known as the *"Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010,"* (should we call it the TRUIRJC Act for short?) is estimated to have an $857 billion impact on revenues to the U.S. Treasury over the next ten years *(Congress measures a bill's impact over ten years, even though the majority of the provisions expire in two years).* By attaching the roughly $6 billion extension of the ethanol subsidies to a much larger tax bill that has support on both sides of the aisle, the issue of ethanol was largely in the background during debate. In fact, of the 17 Senators that recently signed a letter specifically opposing the extension of the ethanol subsidies, only **ONE** – Republican Senator Tom Coburn from Oklahoma – voted against the final bill.

However, with the ethanol provisions only extended for one year, it sets up 2011 for a more drawn out debate over these subsidies. The coalition opposing the extension of the blender's tax credit is a widely-diverse group of organizations, representing conservatives, liberals, livestock agricultural and environmental groups. Congress certainly noticed the rational arguments coming from this coalition, even though it was unable to stop the extension of the subsidies at this point in time. The next twelve months will undoubtedly be a time of education for our legislators and the general public on this important issue. This fight is not over.

NOVEMBER'S MILK PRODUCTION SHOWS SIGNS OF SLOWING GROWTH: *(By J. Kaczor)* USDA's report on November milk production was released today. Compared to a year ago, there were 30,000 more cows, 38 more lbs of milk per cow, and 400 million more lbs of milk. The increase amounted to 2.65%. Compared to October, there was no change in number of cows, production per cow per day increased by 0.4 lbs, and total milk production per day increased by 3.8 million lbs. That's an increase of 0.7%. November marks the second month in a row where the monthly increase over the previous year was lower than the month before.

The overall result looks better than it has been, but November marks the fifth month out of the past six where the amount of milk produced was 400 million lbs or more greater than the year before. Because class 1 usage continues to be about 1.5% below a year earlier, it's virtually certain the additional milk produced, plus the amount not being consumed as beverage milk, will have to be converted into butter, powder, and cheese. Using standard conversion rates, U.S. plants will be producing some combination of 40 million more lbs of cheese or 17 million lbs of butter and 33 million lbs of powders. It could have been worse.

California's milk production increased by 4.5% over last November, with 15,000 fewer cows, and a whopping increase in production per cow of 95 lbs for the month. The total milk output was up by 140 million lbs. USDA says California producers added 2,000 cows in October and another 1,000 in November. The six western states closest to California were reported to be milking a total of 62,000 more cows than a year ago. California continues to be the only state in the western block still with fewer cows than at the same time last year.

THE "HIGHER-OF" CALCULATION IN THE CLASS I PRICING FORMULA – VALUABLE FOR PRODUCERS: *(By Rob Vandenheuvel)* Over the past six months, much has been written in this newsletter and other publications about the various aspects of the "Foundation for the Future" (FFTF) proposal, unveiled by the National Milk Producers Federation (NMPF) in June 2010. This package is a collection of numerous proposals including: (1) replacing the MILC and Dairy Price Support Program with a new "Margin Protection Program," and (2) the addition of a Dairy Market Stabilization Program that will help our industry maintain better balance in the supply and demand for our milk. A third piece of FFTF addresses reforms to our nation's Federal Milk Marketing Orders (FMMOs). Today, I will begin delving into one of the details of that proposal that has gotten very little attention thus far by not only media outlets, but also producer groups.

Included in the proposed FMMO reforms is the elimination of the "higher-of" calculation when determining the Class I minimum price. Currently, the FMMOs use the "higher of" the advanced Class III (cheese) or Class IV (butter/powder) prices to determine the minimum price for Class I (fluid milk). California's Class 1 minimum price formula also utilizes a similar mechanism. What that means is that when the cheese/whey values are higher than the butter/powder values, those cheese/whey prices are utilized to determined the Class I price. On the other hand, when the butter/powder values are higher, those prices are used.

Embedded in FFTF is a proposal that would use only the value of milk sold to cheese plants to calculate the Class I price, regardless of whether the Class IV price is higher or not. This proposed change in policy has gotten very little attention, as much of the focus for FFTF has been on the other aspects of the proposal. However, producers around the country are starting to figure out that a tremendous amount of producer money could be at stake if this specific policy were to become the law of the land.

This past week, a Position Paper written by the Dairy Cooperative Marketing Association, Inc. (DCMA) was published regarding this specific issue. The DCMA is a Marketing-Agency-in-Common that represents the major Class I milk marketers in the Southern U.S. A copy of this Position Paper, which was submitted to USDA Secretary Tom Vilsack's Dairy Industry Advisory Committee, has been posted on our website at: http://www.milkproducerscouncil.org/121010DCMA.pdf.

In their report, DCMA took a look at the last 10 year's worth of data to see what the impact on producer prices would have been if we had not utilized the "higher-of" calculation. In short, their data found that in **44 percent of the months over the past 10 years, the advanced Class IV price was higher than the advanced Class III price**, which meant that the butter/powder prices were utilized to calculate the Class I price. The paper goes on to explain that in **24 of those 44 months, the advanced Class IV price was more than $1.00 per hundredweight higher than the advanced Class III price**.

As for the financial impact on producers, the paper calculated that if the FMMOs did not have the "higher-of" calculation in its formula, the Class I price would have been $0.48 per hundredweight lower on average. As the paper states, **"With annual Federal Order Class I milk production averaging about 44.5 billion lbs., a decline of $0.48 per cwt. means over $213 million less revenue to dairy farmers per year."** Or in other words, **elimination of the "higher-of" calculation would have meant more than $2 Billion less money in producers' pockets over the last 10 years!**

Clearly, this is a significant change in policy being proposed, and producers need to be aware of the impact this proposal will have on our bottom line. The members of DCMA clearly stated in their Position Paper that, **"we support retaining the current method of calculating the Class I Mover which uses the 'higher of'' the Advanced Class III or IV price calculated by product price formulas."** These members include:

- Arkansas Dairy Cooperative Association, Inc.
- Cobblestone Milk Cooperative, Inc.
- Cooperative Milk Producers Association, Inc.
- Dairy Farmers of America, Inc.
- Dairymen's Marketing Cooperative, Inc.
- LANCO-Pennland Quality Milk Producers Cooperative
- Lone Star Milk Producers, Inc.
- Maryland & Virginia Milk Producers Cooperative Association, Inc.
- Premier Milk, Inc.
- Select Milk Producers, Inc.
- Southeast Milk, Inc.
- Zia Milk Producers, Inc.

At our Milk Producers Council board meeting this week, the Board of Directors unanimously voted to echo the statements of the organizations above and **strongly support the continuation of using the "higher-of" formula in determining our Class 1 minimum price**. While this proposal is specifically aimed at reforming FMMOs, it would also negatively impact our State pricing system. CDFA is bound by law to consider the national value of milk when determining our minimum price formulas, and it's hard to imagine the FMMOs removing this valuable provision for producers without California's Class 1 bottler's asking for the same change here at home.

I strongly encourage each of you to get in touch with your producer trade association and/or cooperative and make sure they are focusing on this important issue.

PRICES ADVANCE IN FONTERRA'S LATEST AUCTION: *(By J. Kaczor)* With two minor exceptions, prices advanced across the board in Wednesday's internet auction. The exceptions were lower bids for deliveries of buttermilk powder and anhydrous milkfat in February (the 1st contract period), compared to prices bid two weeks ago. For all products to be shipped from February through August Fonterra calculates the weighted average price to be 2.4% above the average from the December 1st auction which covered the same shipment period. Current winning prices per lb are shown in the table below, with comparisons to prices from the two prior auctions. The prices shown are those for regular grade WMP, the average price for low and medium heat SMP, UHT BMP, and premium grade AMF in drums.

Prior to the auction, Fonterra adjusted their estimate of volumes available for the next twelve months. The volume of WMP was unchanged. The volume of SMP was lowered by 32 million lbs. The volume of AMF was increased by 16.5 million lbs. Neither of these changes is believed to be related to the recent report of a drought in the heaviest milk producing region of the country.

Fonterra Auction Prices: December 15th, With Comparisons

Products	1st Contract	2nd Contract	3rd Contract
Whole Milk Powder	**$1.624**	**$1.642**	**$1.617**
> Dec 1st	*+$.048*	*+$.032*	*+$.030*
>Nov 16th	*+$.068*	*+$.095*	*+$.075*
Skim Milk Powder	**$1.357**	**$1.436**	**$1.601**
>Dec 1st	*+$.043*	*+$.019*	*+.038*
>Nov 16th	*+$.019*	*+$.034*	*n/a*
Buttermilk Powder	**$1.275**	**$1.497**	---
>Dec 1st	*-$.063*	*+$.070*	*n/a*
>Nov 16th	*-$.138*	*+$.086*	*n/a*
Anhydrous Milkfat	**$2.436**	**$2.461**	**$2.522**
>Dec 1st	*-$.004*	*+$.026*	*+.041*
>Nov 16th	*+$.002*	*+$.027*	*+$.086*

The winning prices for WMP, the category with the largest volume offered in the auction, are strong and steady over the full seven months covered, and have been strong since September. The average winning price bid in the two December auctions is $.285 per lb higher than the price bid four months ago. SMP prices for the heaviest volume months (the "spot" months) have been on a roller coaster pattern – falling steadily from $1.74 in April to $1.23 in August, then rising rapidly to $1.43 in mid-September before falling to $1.31 early this month, and are again moving upward. The sharp price increases for deliveries in June through August (the 3rd contract period) appears to reflect concerns about product availability next summer. Prices for BMP cannot be considered to be representative; very low volumes are offered, possibly indicating prior commitments made to buyers. Prices for AMF, after reaching a five year high of $2.81 per lb in June, fell to $2.04 in August and have since reflected strong and steady interest which seems to verify reports of a hard to understand global tightness in butterfat availability. Prices bid for the 3rd contract period are at their highs for the past year.

The reason so much space is given to these auctions is because they represent one of the few innovations in how dairy products are sold internationally. Except for BMP, the volumes offered in the auctions every other week are substantial and the bidding process is open and fair. Still, questions do remain about how representative the winning prices really are. It's understood that competitors, local and elsewhere, use the winning prices as reference points for their products and services, and there are some who believe adjustments are made by Fonterra to at least some of the winning prices before shipment occurs, to reflect variations in services or other considerations. Nonetheless, it's notable that New Zealand's commodity exchange, NZX, has decided the auction's Spot Month prices for whole milk powder are suitable for settling futures contracts for that product.

KNOW SOMEONE THAT'S INTERESTED IN RECEIVING THE MPC FRIDAY NEWSLETTER? Send an email to office@milkproducers.org with their name and email address and we'll start sending them the newsletter each Friday.