Milk Producers Council

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TO: DIRECTORS & MEMBERS **FROM: John Kaczor**

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks	*- $.0325*	$1.1175
Barrels	*-$.0225*	$1.0700

Weekly Average

Blocks	*- $.0175*	$1.1320
Barrels	*- $.0210*	$1.0760

CHICAGO AA BUTTER

Weekly Change	*-$.0225*	$1.2050
Weekly Average	*-$.0215*	$1.2080

DRY WHEY

WEST MSTLY AVG	w/e 06/18/09	$.3050
NASS	w/e 06/13/09	$.2668

NON-FAT DRY MILK
Week Ending 6/12 & 6/13

Calif. Plants	$.8182	12,720,039
NASS Plants	$.8516	20,742,008

CHEESE MARKET COMMENTS: The buyers market for cheese is still here. Prices for blocks and barrels lost ground this week on the CME and both ended the week below price support levels. USDA's Foreign Agricultural Service (FAS) says they received numerous requests for DEIP subsidies to export cheese but none were accepted because the fixed allowances didn't support the proposed sales. FAS may be considering increases to the allowances. *Dairy Market News* (DMN) reports the market as fair but prices are weak. No one seems willing to look beyond the immediate time period in placing orders. There is some concern that the customer traffic in resort areas this summer may be less than expected, which should keep pressure on barrel prices for a time. Holidays are upon us. What is needed for higher prices is more cheese usage from consumers and more foresight on the part of buyers who should know that there should be far less cheese produced by mid summer. USDA's report on May milk production showed there were 43,000 fewer cows than a year earlier, but production per cow increased by 11 lbs for the month; total milk was up by 0.1%. Cheese buyers: June's milking herd should be more than 100,000 smaller than last year, and one more decent herd removal program could result in a herd size no larger than what it was four years ago.

BUTTER MARKET COMMENTS: Butter prices also lost ground early in the week, but held steady Wednesday through Friday. Trading activity was generally light, although 14 car loads moved on Friday. DMN says buyers are actively, steadily, building inventories for use later in the year. Retail sales are fair. The good news this week is that the Commodity Credit Corporation sold its entire inventory of butter at an average price of $1.164 per lb. Butter production remains fairly heavy, but is expected to fall rather abruptly as summer weather sets in with fewer cows to produce milk.

POWDER MARKET COMMENTS: FAS approved seven subsidized exports of butter so far; the total volume is 17.3 million lbs. The subsidies ranged from a low of $.05 per lb to a high of $.09 per lb. FAS says they had to reject several requests that called for higher bonuses. Sales continue to be made to the CCC, although again well down from earlier levels. The national average price last week increased by 1.3 cents per lb while the California plant average remained about unchanged. The California average is now more than 3 cents per lb below the national average. California producers have Dairy America to thank for that. Nonfat dry milk production is somewhat higher than expected, with more milk arriving at plants because of school closings. Regular export volume remains low; questions arise regarding the ultimate effect on total nfdm exports as DEIP sales continue. Prices for dry buttermilk and whole milk powder are about where they were a week ago, although whole milk powder is showing signs of weakness.

WHEY MARKET COMMENTS: The market for dry whey continues to be firm and prices continue to rise. DMN reports that exports remain strong and domestic demand, although showing signs of resistance to higher prices, continues to clear the market of production. Whey protein concentrate prices were unchanged for the week.

FRED DOUMA'S PRICE PROJECTIONS…

June 19 Est:	**Quota cwt. $ 11.31**	**Overbase cwt. $ 9.61**	**Cls. 4a cwt. $10.05**	**Cls. 4b cwt. $ 9.52**
Last week:	**Quota cwt. $ 11.36**	**Overbase cwt. $ 9.66**	**Cls. 4a cwt. $10.07**	**Cls. 4b cwt. $ 9.61**

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MPC DIRECTOR PETE VANDER POEL, JR. PASSED AWAY THIS WEEK: *(By Rob Vandenheuvel)* This past Tuesday, Tulare dairyman and MPC director Pete Vander Poel, Jr. passed away after a year-long battle with brain cancer. Pete, 47, is survived by his wife, Vivien, his two sons, Pete and Brad, and his two daughters, Ally and Madison. Pete, who served on the MPC board of directors since 2005, was a huge asset to MPC and to our industry, and he will be greatly missed by his friends and colleagues. On behalf of the board and staff of MPC, our thoughts and prayers are extended to the entire Vander Poel family in this difficult time. The family has requested that those wishing to do so make memorial donations to the following: Hospice of Tulare County (900 W. Oak, Visalia, CA 93291) or UCSF Foundation/Neuro Oncology Fund (P.O. Box 45339, San Francisco, CA 94145-0339). Please include "In Memory of Pete Vander Poel" with your donation.

EMPATHY, CONCERN, OR INDIFFERENCE ABOUT WORLD MILK PRICES: *(By J. Kaczor)* The phrase "misery loves company" refers to a sense of consolation felt by someone who is facing problems from knowing others are in the same situation. The U.S. dairy industry is definitely facing problems, going through one of the worst financial crises in its history. However, the consolation referred to above may not apply to feelings about what's happening within the U.S. It's certainly no secret; the losses incurred and the sense of helplessness has touched every state in the Union and virtually every milk producer. Stories, local and national, about persistently low milk prices, high and rising costs, and monumental losses have been printed daily for some time. For various reasons, the feelings of some producers about what is happening elsewhere in the U.S. may range from frustration to satisfaction, skipping right over consolation.

There are many examples that could be mentioned. Two touch California producers. **California producers may rightly feel frustrated** because they have, as a whole, been producing less milk in one way or another for ten straight months, while some producers in some states have been expanding over the same period. **On the other hand, satisfaction may be felt by producers in the East and Midwest that California producers are paying the price for their monumental growth** over two decades that resulted from a combination of natural advantages and weak corporate leadership – and which did contribute to more milk being produced in California and the U.S. than could be readily marketed. Case in point: sales of California nonfat dry milk to the Commodity Credit Corporation since last October totals 258 million lbs; sales by plants in the other 47 lower states totals zero.

But, over-riding the regional differences within this country, which are part of the industry fabric, are the hard questions all U.S. producers are facing: how much longer will this continue; what is keeping milk prices so low; at what point does it no longer make sense to continue. These common questions, arising as they do from the collapse of milk prices late last year, leads to another question "why us?" And that leads to a look at what is happening elsewhere and perhaps, finally, at least a small sense of consolation.

At the heart of the collapse of domestic and international milk prices in the U.S., Western Europe, and Australia/New Zealand is the world-wide economic recession which was preceded by a record run-up of virtually all commodities, from field crops, to dairy, to oil and minerals. The recession (and the accompanying financial crisis) resulted in a significant reduction in international demand, including **that small portion of world milk production that is traded internationally**. Those countries who rely on exporting surplus dairy products suddenly found themselves with a huge problem: a surplus of dairy commodities, and few buyers with less available credit – and nowhere to go.

Here's a glimpse of what's happening in Western Europe, where milk production has, overall, not been increasing and milk prices vary by country and are negotiated between producers, milkplants, and wholesale customers. Milk prices began to fall last year, and have continued to fall through at least last month. Most reports say that producers are receiving prices that barely cover feed costs. A major cooperative in Great Britain, representing ten percent of the nation's milk supply, became insolvent early this month, closed several plants, and left many producers with nowhere to ship their milk. Since last August, producers in France, Belgium, and

Germany have resorted to blocking traffic, dumping milk, sit ins, depositing manure in front of government buildings, burning tires and hay, and otherwise protesting milk prices too low for them to exist. Is Western Europe the problem? Don't think so. Until early last year, milk production and domestic consumption there was well balanced – and then domestic consumption began to slip and their export volume also moved lower.

A different picture emerges from New Zealand and Australia. Their milk production is much lower than either the U.S. or Europe. Combined, these countries produce about 50% more than the amount of milk produced in California alone, and they consume only about 15% of their production. When their exports began to fall, prices followed, and producers in both countries are now just about where U.S. producers have been since December. Recent stories by analysts in New Zealand paint a grim picture: **Fonterra's forecast for prices for the next production year beginning in July will cover the costs of only those who have no debt**; all others are facing severe cash flow shortages and their lenders are pulling back. They are at the mercy of the international marketplace, and their leaders are placing much of the blame on the U.S. and Europe for the decline in dairy commodity prices (or more precisely, for the lack of price recovery once prices hit bottom at the beginning of the year).

Should U.S. producers care about what's happening to milk producers in other parts of the world? Empathy for those producers might be appropriate and, if it helps, some consolation that what you are enduring is shared by countless others who are doing nothing more than a very good job of producing one of nature's most nutritious products. It should be easy to feel their pain because it's a lot like what you are dealing with right now.

But let's take another look at those numbers. It appears that the industry leaders in Australia and New Zealand **believe they are entitled** to very much more than their fair share of the international dairy product market. They've been at it for a long time and they do a very good job in serving their extensive customer base, but entitlement? On the other hand, Western Europe's milk production is huge, but has been fairly well balanced with domestic consumption and regular exports. The same can be said for the U.S., although over response to record high prices in 2007 and early 2008, along with "windfall export volume" generated just under **three percent** more milk than was assured of a market – and that over-production is being remedied this year.

The facts show that New Zealand and Australia have been producing about 500% more milk every year than they use internally, and their projections of production this next year show further increases. They have the unique competitive means to channel their milk supply from plant to plant in order to take advantage of the most profitable output at any particular time, including manufacture and sale of Milk Protein Concentrate to U.S. customers. Western Europe's supply this year is projected to be level to or lower than last year's output. The U.S. supply is projected to be lower this year as well as the next. Neither the U.S. or Europe have the means to control milk production or usage. That is why governments in Europe and the U.S. have taken actions that are compliant with World Trade Organization agreements **to reduce existing surpluses by subsidizing exports.**

That brings us to a few questions that may need answering. Should we care what happens to global dairy prices if domestic prices in the U.S. and Europe can be insulated from global prices? It's quite possible that when milk prices recover later this year in the U.S. because of the sacrifices being made by U.S. producers, global dairy commodity prices may remain much lower until global economic conditions substantially improve. If that happens, should we care, pretend to care, or derive just a bit of satisfaction that the piper must be paid by those who call the tune?

A THIRD PERSPECTIVE ON SB 362: *(By Rob Vandenheuvel)* Over the past two weeks, this newsletter has addressed SB 362, a bill that would expand the California producer-handler exemption to include all milk produced and processed by the five producer handlers in the state. The bill recently passed the California State Senate and now makes its way to the Assembly, where it will be considered by the Assembly Ag Committee in the upcoming weeks.

Two weeks ago, I wrote an article that laid out the producer perspective on the bill (http://www.milkproducerscouncil.org/updates/060509.pdf). Last week, I included an article by the producer-handlers laying out their perspective (http://www.milkproducerscouncil.org/updates/061209.pdf). This week, I'm including a third perspective – from the processors. With producer-handlers competing directly with other fluid milk plants, the processors have a vested interest in how these plants are regulated. The following is an article submitted by Bill Schiek, Economist at the Dairy Institute of California:

The Processor Perspective on the Producer Handler Exemption *(By Bill Schiek, Dairy Institute of California)*

Last week, the Producer Handlers made their case regarding SB 362, a bill moving in the California legislature that would allow five "Type 70" Producer Handlers, also known as Producer Distributors (PDs), to increase the volume of milk that they are allowed to exempt from pooling. The PDs maintain that they are a small percentage of the total pool, and therefore, allowing them a larger exemption will not impact things very much. In reality, the five producer handlers are a significant share of the market in which they compete and increasing the size of their exemption would be devastating for the industry.

Current law allows the PDs to exempt a substantial portion of their quota milk from the Class 1 pool obligation of their processing operations. On the exempted portion of their Class 1 sales (about 21 million pounds per month according to CDFA), PDs currently have a cost advantage over the state's fully regulated Class 1 plants that has averaged $1.87 per hundredweight during the most recent twelve months.

Using their existing cost advantage, the PDs have doubled their share of the Class 1 market since 1995, increasing it from 14% of the market in January 1995 to as much as 25% of the market by the spring of 2008. During the same period, the share of fully regulated Class 1 plants (plants that are not PDs) fell from 86% of the market to 75%. The PDs did lose some business to out-of-state competitors in 2008, but in the last couple of weeks, they have recaptured much of that business, a testimony to their ability to use the cost advantage from their existing exemption to compete successfully with Nevada processors. In short, the PDs simply do not need any more of an advantage than the one they already have.

Under SB 362, the PDs would be allowed to effectively exempt all their own farm production from pooling. According to CDFA data, the PDs farm production that would be eligible for exemption under the legislation amounts to about 600 million pounds per year or about 50 million per month. CDFA data indicate that the current PD exemption costs the pool about $3.7 million per year, or about $2,200 per producer. Under SB362, the initial, **additional** annual cost to the pool would be $10.9 million, or $6,400 per year for each producer. The PDs cost advantage over fully regulated plants on their exempt milk would grow to an average of $3.57 per hundredweight in Southern California and $3.30 per hundredweight in Northern California, based on the most recent 12-months' price data. What's more, the milk volume on which they have this advantage would more than double immediately upon passage of SB 362.

Fully regulated Class 1 plants are unable to compete with such a large cost advantage. PDs will be able to go after the most desirable and profitable business segments and grow their share of the Class 1 market rapidly, putting fully regulated plants at greater risk of failure. To maximize their advantage, PDs will have a tremendous economic incentive to grow their farm production so that it is equal to their Class 1 sales, currently about 120 million pounds of milk per month. The proceeds of these sales, which were intended for all California dairymen to share in, will be lost from the pool. The value of these losses, beyond those of the current exemption, would be $37.1 million per year or about $21,900 per producer. Unfortunately, the cost to producers is likely to grow even larger as PDs increase their Class 1 sales.

The bottom line: PDs do not need any additional pooling exemption in order to compete with out-of-state packaged milk or with out-of-state bulk milk, of which they currently import a major share. What SB 362 will do is give a big advantage to PDs at the expense of producers and fully regulated Class 1 processors. It will allow them to increase their share of the market and cannibalize the Class 1 revenues that all producers were meant to share. Dairymen, their families, and their employees will lose money and market access.

The Class 1 processors that are not PDs will lose business and revenue, putting their employees' jobs at risk. SB 362 is a bad deal for California's dairy industry, period.