Milk Producers Council

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

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE
Blocks +$.0025 $1.9225
Barrels -$.0850 $1.8750

Weekly Average
Blocks -$.0007 $1.9238
Barrels -$.0479 $1.8881

CHICAGO AA BUTTER
Weekly Change +$.0075 $1.5525
Weekly Average +$.0204 $1.5519

NON-FAT DRY MILK
Week Ending 6/27 & 6/28

Calif. Plants	$1.3359	14,633,975
NASS Plants	$1.3610	19,182,224

DRY WHEY
NASS w/e 6/28/08 $.2758 **WEST MSTLY AVG** w/e 7/03/08 $.2800

CHEESE MARKET COMMENTS: It was a slow pre-holiday week for the cheese market. Prices on the CME continue to adjust, mostly downward, but not by more than is expected. The general market conditions that have more or less prevailed now for an entire year continue, with neither buyers nor sellers wanting to build inventories. However, substantial amounts of discounted milk and cream continue to be offered to manufacturers outside of California, which is a sign of an orderly market (the milk found a home), but which can be unsettling to those who decline the offers. California plants who choose to sell into the Eastern parts of the country continue to get squeezed by plants in Idaho and Texas.

BUTTER MARKET COMMENTS: Use of cream for purposes other than butter-making continues to be strong and butter prices continue along a good path, about in line with last year's pattern. But it's summertime, and CWT appears to be losing its mind. There have been reports for over a month that Japan is desperate for butter; they are virtually out. So how did CWT respond? Illogically. They **subsidized a shipment to Japan**, apparently to offset the huge tariffs that are charged to protect the local producers. The volume wasn't large enough to influence U.S. prices by even a hundredth of a cent. Atta boy, CWT. In this case, every little bit doesn't even do a little bit, but it's sure to confuse our international competitors. That counts.

POWDER MARKET COMMENTS: Dairy Market News says the market for nonfat dry milk is steady, with the national weekly prices reported by NASS virtually unchanged. **The weekly average price for California plants ($1.336) is below the lowest end of the full range of spot sales for the week ($1.35).** Sales volumes are moderate, but they do not include sales of skim milk powder for the export market. Supplies of skim milk powder in Europe, New Zealand, and Australia are light, which should help to maintain export volumes for a few more months.

WHEY MARKET COMMENTS: Prices are steady to slightly lower. It's a buyers market for dry whey and whey protein concentrate. DMN reports that manufacturing plants prefer to get rid of product before it hits the drier. Where are the buyers? Speculators on the futures market appear to have given up for the year; prices through December are just about where the spot market is today.

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FRED DOUMA'S PRICE PROJECTIONS…

July 03 Est.	**Quota cwt. $18.74**	**Overbase cwt. $17.04**	**Cls. 4a cwt. $15.97**	**Cls. 4b cwt. $17.43**
Last Week	**Quota cwt. $19.10**	**Overbase cwt. $17.40**	**Cls. 4a cwt. $15.63**	**Cls. 4b cwt. $19.12**

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CORRECTION: *(By J. Kaczor)* In a list of changes and clarifications made in the final rule on reporting of sales to NASS, it was **incorrectly** reported last week that sales made under the DEIP program and sales supported by bonuses or subsidies should be included; **those sales should be excluded** because AMS believes they may not reflect current market values.

A STORY WORTH TELLING: *(By J. Kaczor)* While the report is still fresh, I'll explain why it was said last week that **NASS may be incapable of enforcing two of the most important newly effective provisions** in the final rule relating to mandatory reporting of dairy product sales. The provisions referred to are (1) the requirement to report forward-contracted sales that are based upon a defined price series, plus or minus a specified amount, and (2) the prohibition against reporting intra-company sales, including sales made between wholly-owned subsidiaries through a federation of dairy cooperatives, such as Dairy America.

Last week we mentioned a belief by some who have a right to be critical, that the NASS administration of the reporting program was casual at best and corrupted at worst. An investigation by USDA's Office of Inspector General (OIG) concluded early this year that the mistakes that were made were unintentional but NASS' administration of the reporting rules was inadequate and needed to be improved. The investigation and its results have the appearance of a whitewash. OIG's official conclusion was based upon their finding that **the errors made by a major seller over a five year period were consistent and continuous and therefore appeared to be unintentional.** You read that right. Seems to be a bit light on logic and investigative integrity, doesn't it? And no mention was made by OIG about reports that some NASS officials were aware of the reporting errors and did nothing about it. Add to that the fact that OIG's request for a visit with the firm that was filing the incorrect reports resulted in a meeting first with the firm's lawyers.

Which brings us to the question of NASS' capability. In response to OIG's "recommendations", a number of steps were taken by NASS that should help them do a better job. An annual Validation Worksheet was re-worded to remove ambiguities, the schedule for visiting the plants was updated, the reporting forms were revised to reflect the final rules, guidelines for field office use were improved, and AMS now has the authority to audit the reports. Those changes should help, but the same people in NASS who were among those who "assured" AMS last year that the numbers were correct are still on the job. They are the one's who will be relied on to spot the potential loop holes and self-serving interpretations that may be created and used by reporting firms in complying with the two provisions listed above.

Too harsh you say? Consider that six months after NASS had assured AMS that there were no errors in the nonfat dry milk reports, and four months after the errors by the major seller of nonfat dry milk were exposed, AMS audited the seven largest reporting firms and found six of them to have reporting "discrepancies". Consider that a Validation Worksheet is completed every year by all 39 reporting firms and is reviewed with the firms by NASS officials. That Worksheet for nonfat dry milk includes a series of ten questions. Each of the ten questions begins with the words "*When reporting nonfat dry milk sales data to NASS, did you or can you,"* – and then requires a yes or no answer to the rest of the question. Everyone answers "yes" and NASS is filled with satisfaction for the good job that was done. Does anyone reading this think that any of those who filled out the Worksheet didn't understand that a "yes" answer (meaning "I can") was virtually meaningless and could be misleading? Under that circumstance, without an audit of all reporting firms, there is no way to determine if any of the sales reports that were submitted over the past four years or so were correct. It's over. Forget about it. Hope for the best. You have NASS at your back.

BUTTER AND POWDER CONTINUES TO ABSORB INCREASES IN MILK PRODUCTION: *(By J. Kaczor)* The usage pattern of milk produced in May is almost identical with the pattern for March and April, and that does not bode well for the prospects for future milk prices. With fluid milk sales steady at best, cheese production about even with last year and production of cottage cheese, sour cream, yogurt, and ice cream lower, it fell to butter and powder plants to dispose of the additional milk that was produced in May.

During May milk production increased by 3%. Butter production increased by 20 million lbs (+16%), nonfat dry milk by 14 million lbs (+12%), and skim milk powder by 33 million lbs (+250%). Skim milk powder sales (that's the product whose sales do not get reported to anyone) now is believed to represent more than one half of all the nonfat powder products that are exported. Cheese production increased by 4 millions lbs, or 0.5%. May was a cold, wet month, so a 5% decrease in production of ice cream was not unexpected. Chalk up the weak usage numbers to the very weak domestic economy, where most consumers are finding they have considerably little discretionary funds to spend for anything other than basic needs.

California is the same as the U.S., only different. The difference is the loss of one cheese plant and the gain of one butter-powder plant since last year, a lot of inter-state shipments of packaged milk (both ways), and no rain. Cheese production was 9% lower than last May, butter production was 28% higher, nonfat dry milk was 9% higher, skim milk powder was **estimated** to be 50% higher, and ice cream production was 14% lower. California's usage in the lowest priced class of milk (butter-powder) has risen to 36% of pool milk, up from 26% a year ago. Only 22% of pool milk is used for Class 1, 2, and 3 usages.

CDFA HOLDS HEARING ON TRANSPORTATION SUBSIDIES: *(By Rob VandenHeuvel)* This past Tuesday, the California Department of Food and Agriculture (CDFA) held a public hearing on proposals to increase the transportation subsidies that are taken out of the Class 1 revenues and used as incentives for producers and co-ops that serve fluid milk plants.

As you may recall from the May 23rd edition of this *Update*, MPC had proposed that any increases in these subsidies should be recovered from the marketplace by increasing the minimum Class 1 price that dairy farmers receive for their milk. Unfortunately, CDFA determined that MPC's proposal was outside the scope of the hearing and was therefore not accepted. Despite this, I still testified at the hearing on the proposal's merits, hoping to get the Department and the industry thinking seriously about the future of these transportation subsidies.

From April 2007 to March 2008, more than $31.5 million was taken out of the pool to pay for these subsidies. With about 5.86 billion lbs of raw milk sold to Class 1 plants during those 12 months, these subsidies represent almost $0.54 per cwt that is taken out of the producers' share of the Class 1 revenues. And that is before the Department even considers the proposals this week by CDI, DFA, the Dairy Institute, and Humboldt Creamery to increase these subsidies even further.

Dairy producers are getting squeezed – paying higher fuel costs on their farm, on the feed they haul to their farm, and on the milk and manure they haul off their farm. How long can the industry continue to stick producers with bills that ought to be paid by the consumers? Apparently taking $0.54 per cwt out of the Class 1 revenues is not enough. If the proposals put forth at the hearing are accepted, we could be seeing a 20%+ increase in these subsidies. Will $0.65 per cwt be enough? When will it stop?

It is my hope that MPC's alternative proposal will spur some thinking throughout the industry about how we can adequately serve the Class 1 markets without continuing to dig further into producers' pockets. The public receiving a high-quality product from the dairies and the increased costs of delivering that product to the marketplace must ultimately fall on those consumers.

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