



Milk Producers Council

13545 S. Euclid Avenue, Unit B ~ Ontario, CA 91762 ~ (909) 628-6018
801 S. Mount Vernon Avenue ~ Bakersfield, CA 93307 ~ (661) 833-2549
Fax (909) 591-7328 ~ office@milksproducers.org ~ www.MilkProducers.org



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FROM: John Kaczor

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks - \$.0225 \$2.1325
Barrels +\$.0050 \$2.1350

Weekly Average

Blocks - \$.0115 \$2.1435
Barrels +\$.0030 \$2.1310

CHICAGO AA BUTTER

Weekly Change +\$.0025 \$2.1025
Weekly Average +\$.0270 \$2.1020

DRY WHEY

WEST MSTLY AVG w/e 08/05/11 \$.5850
NASS w/e 07/30/11 \$.5591

NON-FAT DRY MILK

Week Ending 7/29 & 7/30

Calif. Plants \$1.5722 13,083,815
NASS Plants \$1.5832 17,237,246

CHEESE MARKET COMMENTS: The amazing run of cheese prices above \$2.00 per lb continued this week, with some apparent testing and teasing. The market for blocks was tested every day this week as sellers who had the milk to produce more cheese last month than was immediately needed came to the market with offers that were not unreasonable. Offers on Monday and Thursday combined to pull the price down by \$.02 per lb; sales from offers on the other days occurred at various prices below current levels before bidders entered to restore the beginning price or to minimize the loss. One carload of barrels sold Friday, followed by a bid to purchase for \$.005 per lb higher. The supply side was supported by last week's bullish report on cheese stocks and heat, and humidity in many parts of the country continue to affect milk production. This week, USDA's report on June cheddar cheese production showed cheddar production was the lowest it's been in three years and total production was not much higher than last June. Plants and buyers, however, are concerned about demand. The U.S. economy continues to barely grow, and consumer confidence is not much higher than it was at the depth of the recession. The concern about cheese demand is healthy for the industry; it is causing both sides to become cautious. After last week's burst of enthusiasm, futures traders also showed a bit of caution as class III milk prices moved downward by small numbers for the September to January period. It was also good to see another announcement by CWT this week for helping cheddar move off shore.

BUTTER MARKET COMMENTS: The even more amazing butter market moved up a fraction of a cent this week. The continuing weakness in anhydrous milkfat prices in Fonterra's auction this week was simply ignored (recent prices are \$.95 per lb below February's peak). It appears the focus of plants and buyers is squarely on the domestic market as milk production and cream availability continues to be affected by heat and humidity. Although butter production in June was 15 million lbs lower than May production, it still was higher than expected (23 million lbs more than last June). Food service usage of butter is lackluster (it's the economy) and the high retail prices have caused consumers to cut back. Futures prices for butter are still at or above \$2.00 per lb through November, and are above \$1.80 per lb through the middle of next year.

POWDER MARKET COMMENTS: Prices for whole milk powder and skim milk powder in this week's global auction were about unchanged from two weeks earlier. Comments attributed to "economists" in New Zealand say they see that as a sign that prices are bottoming out. The milk production picture down there for the coming year is still not clear, but the signs are for NZ to be up by about 5% and Australia to be up by 2%. Global demand, led by China, Russia, India, and several southeast Asian nations is still being projected to absorb those increases and more. U.S. production of nonfat powders in June increased on a per day basis from May's level and manufacturers' stocks of all powder products on hand at the end of the month were higher than they were a month before. That spells "weak sales" for the month. July production is expected to be lower because of higher usage of condensed skim and lower intakes of milk. Prices for the two major price reporting series for shipments made last week regained some of what was lost last week, with lower volume, repeating a familiar pattern. *Dairy Market News* reports export interest to be slowing down and domestic usage is steady at best.

WHEY PRODUCTS MARKET COMMENTS: It appears the shift to production of more concentrated dry whey products is continuing. That makes sense because that's where the money is for the plants. Production of dry whey in June was lower than in May while production of WPC was higher. Prices for WPC-34 held steady and DMN reports some continuing buyer resistance to further increases is growing. The west's "mostly" average price series edged upward again and the NASS price for shipments made last week was close to a penny per lb higher than the week before. Stocks of dry whey are reported to be tight in the east and west and adequate in the central region.

FRED DOUMA'S PRICE PROJECTIONS...

Aug 5 Est:	Quota cwt. \$21.65	Overbase cwt. \$19.96	Cls. 4a cwt. \$20.15	Cls. 4b cwt. \$19.64
July '11 Final:	Quota cwt. \$21.23	Overbase cwt. \$19.54	Cls. 4a cwt. \$20.07	Cls. 4b cwt. \$19.35

CONTINUING TO LOOK AT THE FACTS BEHIND REP. PETERSON'S DAIRY LEGISLATION: (*By Rob Vandenheuvel*) As I noted in last week's MPC Newsletter, it's been a few weeks now since Congressman Collin Peterson (D-Minnesota) unveiled a "discussion draft" of legislation he plans to introduce in the U.S. House of Representatives in the near future. The draft legislation largely mirrors the proposal called "Foundation for the Future," as outlined by the National Milk Producers Federation (NMPF). Since Rep. Peterson unveiled his draft bill, there's been a lot of information disseminated among the industry – some of it true, some of it not, and some of it technically true, but certainly intended to sell a specific message.

In an effort to shed some light on the facts surrounding Rep. Peterson's draft bill, last week I began by looking at the "Dairy Market Stabilization Program" (DMSP), which is one of the three pieces in Rep. Peterson's bill. If you missed that article, you can find it at: http://www.milkproducerscouncil.org/072911_factsondmsp.htm.

This week, I'll be taking a look at the **Dairy Producer Margin Protection Program** (DPMPP), the second of the three pieces in the bill. This is the part of the bill that would create what many are calling the "margin insurance program."

Before going into the details of the DPMPP, we need to understand how our current federal dairy policies serve as a "safety net" for the nation's dairy farmers. Most of the federal funds spent on the dairy industry are spent on two programs, the Milk Income Loss Contract (MILC) and Dairy Price Support programs. When milk prices begin to fall (due to falling values for butter, nfdm, cheddar cheese and dry whey), it's a general indication that our national milk supply is exceeding the demand for the dairy products that milk is being used to manufacture. When that happens, the first program that triggers in is the MILC program. This program provides a direct payment to dairy farmers when milk prices drop below a certain level. Because the program does nothing to address the underlying reason for the drop in milk prices (supply exceeding demand), Congress has instituted a cap on the amount of money available under this program. That cap is currently 2.985 million lbs of milk production (about the annual production of a 125-cow dairy producing 65 lbs of milk per cow per day; or about 6 weeks worth of production for a 1,000-cow dairy also producing 65 lbs of milk per cow per day). Because of budgetary concerns during the last Farm Bill discussion, the MILC program is actually set to have a more restrictive cap of 2.4 million lbs starting in September 2012.

The second main program of the dairy "safety net" is the Dairy Price Support program, which is available to buy butter, nfdm and cheddar cheese at specified prices. While the program is designed to help clear excess inventories of these products, the resulting milk prices paid to dairy farmers when all three of these products are at "government support levels" is about \$9-\$10 per hundredweight.

So clearly, these programs do not provide an acceptable "safety net" for the dairy industry. And neither of the programs addresses the supply-side of the supply/demand equation. In fact, one could argue that the MILC

program slows down the recovery for the dairy industry by providing additional revenue to dairies – albeit capped by the production limits – without creating any direct incentive to bring supply back into balance with demand.

So now let's look at Rep. Peterson's draft legislation. **Rep. Peterson is proposing that the dairy industry take on a new strategy in setting up our federal "safety net."** He's proposing that when we are facing a milk supply that is outpacing demand, our first line of defense be a program to directly address that imbalance, i.e., the temporary activation of the Dairy Market Stabilization Program (again, more details on that in last week's newsletter: http://www.milkproducerscouncil.org/072911_factsondmsp.htm). And if that program is unable to act quickly enough to turn the falling dairy farmer margins around, Rep. Peterson has included the Dairy Producer Margin Protection Program to provide direct cash payments to dairy farmers during those periods of low dairy farmer margins. **Since he is including a program to directly address the supply/demand balance, Rep. Peterson and the Congressional Budget Office have been convinced that hard production caps are not necessary for this new direct subsidy program.** Instead, all dairies – regardless of size – would be able to receive payments on 75% of their historical milk production.

So here is how the DPMPP would work:

- Cash payments would be paid when the national milk-price-minus-feed-cost calculation goes below \$4 per hundredweight.
- Every dairy would be able to receive payments on 75% of their historical milk production (when the program is implemented, your historical milk production will be determined by your dairy's highest annual production in the past three years)
- The payment would be based on the average margin over a two-month period (January-February, March-April, etc.).
- If the average margin over a particular two-month period is less than \$4 per hundredweight, the payment will be the difference between \$4 and the announced margin calculation. For example, if the margin was \$3.50 per hundredweight for the July-August 2011 period, a cash payment of \$0.50 per hundredweight would be paid on 75% of your historical production.

The bullets above pertain to the "base program," which is paid entirely by the federal government. A "supplemental program" is also included in Rep. Peterson's legislation, which gives individual dairies the option of receiving payments when that margin calculation is higher than \$4 per hundredweight. Dairies that choose to participate in this supplemental program can elect to have it cover up to 90% of their historical milk production, but it will carry an annual premium. For instance, dairies choosing to collect cash payments whenever the calculated milk-price-minus-feed-cost margin falls below \$6 per hundredweight would pay an annual premium of \$0.155 per hundredweight on the percentage of milk they choose to cover in this supplemental program.

You might be curious how the DPMPP compares to the MILC payment structure. To illustrate that, let's look at how a fictional U.S. dairy would have fared in 2009 – the year in which dairies needed a cash influx more than any other year in recent history. And for this example, let's assume that this fictional dairy chose only to participate in the "base program," at no cost to the dairy. **Of course, this will be an incomplete example, since in 2009, no program existed to quickly generate temporary milk production cutbacks (like the Dairy Market Stabilization Program),** but for comparison purposes, we'll ignore that important fact for now. For the months of January – August 2009, the average margin calculation under this program would have been about \$2.57 per hundredweight, well below the trigger of \$4 per hundredweight used in the base program (I say "about \$2.57" because USDA could implement the program in a couple different ways, but \$2.57 per hundredweight is a conservative estimate).

During those 8 months when the calculated margin is less than \$4 per hundredweight, a 1,000-cow dairy producing 65 lbs of milk per day per cow would have received about \$170,000 in direct payments. Under the MILC program – assuming that same dairy was fortunate enough to select the highest paying months (since they would only receive payments for about 6 weeks worth of production), it would have received about \$55,800, or less than one-third of the amount under the DPMPP outlined above.

With Congress scrambling to cut spending anywhere it can, a logical question is why they would be willing to implement a program that is so much more generous than the current MILC program? The answer to that question is explained above – Rep. Peterson and the Congressional Budget Office believe that by implementing a program (the Dairy Market Stabilization Program) to temporarily and quickly cut back the national milk production – even by only 2 or 3 percent – it is much less likely that dairy farmer margins would fall to the levels we saw in 2009, thereby avoiding some, if not all, of the payments under the DPMPP. **That is a huge difference between what we saw actually happen in 2009 and what Rep. Peterson is proposing in his draft legislation.**

Now while my illustration of a 1,000-cow dairy makes sense out here in the Western U.S., I can already hear my friends in other parts of the country telling me that for their much smaller dairies – particular those under 125-cows that fall under the production limits in the MILC program – the current system provides a pretty reasonable cash payment system. No argument here. But what Rep. Peterson is proposing in his draft legislation is a very valuable tool for dairy producers: a program to quickly cut back milk production when necessary. And on a pounds-per-dairy basis, those temporary cutbacks will be coming primarily from the larger dairies in the country. **The MILC program may have provided some significant cash payments for those smaller dairies in 2009, but it did absolutely nothing to incentivize those larger dairies to temporarily cut back their milk production, which ultimately is what we needed to re-gain supply/demand balance.**

One final point. As I've traveled throughout California, I've heard from a number of folks that they are concerned that since the DPMPP would calculate a national milk-price-minus-feed-cost margin using national average costs and prices, an area like California with higher-than-average feed costs and lower-than-average milk prices would be treated "unfairly" when compared to other regions of the country that have different milk and feed economics. I certainly understand the argument being made, but as you can see in the example above, the DPMPP actually does a much better job of providing direct payments to the larger dairies more common in California and the Western U.S. Further, we need to remember that any dairy legislation must be approved by at least 218 Members of the U.S. House of Representatives and 60 Members of the U.S. Senate – an impossible hurdle to jump if we're taking such a California-focused policy position.

Rep. Peterson is proposing a set of safety net programs that would first-and-foremost give us the tools to get our supply and demand back into balance more quickly, which will result in our dairies generated market-based revenue, not government checks. **That's a vast improvement over the current system, and one that we as an industry should support.**

AUCTION PRICES ARE STEADY TO LOWER AS GLOBAL INSTABILITY AND GROWING COMPETITION INTRUDE ON INTERNATIONAL TRADE: *(by J. Kaczor)* After a late winter/early spring rally, the winning prices for the three major products in this week's internet auction are now back to about where they were a year ago. Prices for whole milk powder and skim milk powder were about unchanged from the previous auction but anhydrous milkfat lost \$.144 per lb. The skim milk powder price remains slightly higher than WMP, as traders on New Zealand's commodities exchange continue to use the winning prices for the low volume of SMP offered for sale in the auction, along with the thinly traded futures prices for that product. Prices for all three products are well below their highs reached earlier this year.

The only one of these three products mentioned above that presently seems fitting as a reliable representation of true value is WMP. The weighted average price for all styles and delivery periods of WMP in this week's auction was \$1.576 per lb, unchanged from the auction held two weeks ago. Prices for the three contract delivery periods were essentially flat. The maximum volume available for bidders was 48.5 million lbs, 13 million higher than two weeks ago. Fonterra's current forecast of WMP volume for the next twelve months is 906 million lbs, 55 million lbs lower than what it was two months ago.

The average price for SMP was \$1.578 per lb, also reflecting essentially flat prices over the full seven months covered by this auction. The forecasted volumes for the next twelve months for SMP and AMF are higher than they were two months ago, and appear to balance out the reduction forecasted for WMP. The other products

presently included in the auction, buttermilk powder, rennet casein, milk protein concentrate, and cheese for further processing, do not presently have sufficient volumes to warrant coverage at this point.

Currency valuations can have great effect on international commerce. Although difficult to pinpoint, prices on Fonterra's auction are likely to have been influenced by the remarkable strength of New Zealand's "Kiwi" and Australia's "Aussie" over the recent past. A buyer with weak currency (relative to the seller) and a set budget can afford less of a product at a given price, which pressures the seller to lower the price. The same factor influences prices in an auction; bidders can limit their bids to fit their budgets. Initial reports from New Zealand regarding this week's auction downplay currency issues and attribute the weakening prices to a natural response to forecasts of higher milk production from Oceania, Europe, the U.S., and Argentina, and to concern that the global economy may be "losing steam."

The weak U.S. dollar should be helpful to Dairy America when they first offer skim milk powder in Fonterra's auction in October. The terms of sales are expected to be identical to those presently applicable for buyers, namely deliveries f.o.b. port or place where the product crosses the border. Dairy America's volumes are expected to supplement Fonterra's, which is heavily influenced by the seasonal pattern of milk production down there. With all other things being equal (product quality, service, reliability, shipping distances, tariffs), but with a more steady volume stream than Fonterra's and "supported" by a cheap currency, Dairy America's success in this endeavor is all but assured.

Is there too much of a good thing? This week there were two reports of other pending international dairy product auctions. Argentina was the first, citing a current growth of 16% in milk production and the need to support dairy farmers and manufacturers with a monthly auction of milk powders. The report said the first such government-sanctioned-organized auction will occur in August. The second report was from Europe where, with backing from Rabobank, *Dairy Auctions Online* (DAO), "a platform for trading European sourced dairy products," is looking for an October or November kickoff. One guess is that Argentina's announcement may elicit an invitation from Fonterra to join *globalDairyTrade* in what they hope is a growing list of world-wide sellers. Another guess is that DAO is making a belated run at the two European companies Fonterra had invited into GDT.

MPC'S AUGUST BOARD MEETING TO BE HELD NEXT TUESDAY: *(By Rob Vandenheuvel)* Our August Board of Directors meeting is scheduled for next Tuesday (August 9th) at 11 a.m. in the Kern County Farm Bureau Board Room. The address is 801 S. Mount Vernon Avenue in Bakersfield. All current and prospective MPC members (both regular and associate) are welcome to attend. Lunch is provided, so please RSVP to office@milkproducers.org.