



Milk Producers Council

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MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks - \$.1100 \$1.7900
Barrels - \$.1400 \$1.7225

Weekly Average

Blocks - \$.1940 \$1.7900
Barrels - \$.2300 \$1.7510

CHICAGO AA BUTTER

Weekly Change +\$.0050 \$2.0925
Weekly Average +\$.0045 \$2.0915

DRY WHEY

WEST MSTLY AVG w/e 08/26/11 \$.5975
NASS w/e 08/20/11 \$.5708

NON-FAT DRY MILK

Week Ending 8/19 & 8/20

Calif. Plants \$1.5768 16,085,622
NASS Plants \$1.5537 17,885,361

CHEESE MARKET COMMENTS: This week's trading on the CME ended with what most market watchers believe, or at least hope, is a positive note. Weekly prices fell by \$.11 per lb for blocks and \$.14 per lb for barrels, but both were higher than the lows reached mid-week, at which time buyers eagerly returned. Trading was active – twelve carloads of blocks and twenty-five of barrels changed hands. The price drops over the past three weeks have left the NASS prices (for shipments made last week) well above current CME prices. The average block price per lb last week was \$.34 higher than this week's average CME price and the average price for barrels was \$.40 higher. Differences this extreme are rare; inventory values have plummeted and plants are expected to try to hold prices as high as they can for as long as they can, even though this week's cold storage report showed cheese inventories had sharply increased in July. The block prices are now \$.36 per lb below where they were four weeks ago, and barrel prices are \$.41 per lb lower. CME's futures traders followed the daily spot price changes this week with almost instantaneous price changes of the same sort, although with little net change for the week; the spot and futures markets are now fairly well balanced. The low point for the class III milk futures price for the year is sitting at \$17.95 for December.

BUTTER MARKET COMMENTS: USDA's report on the amount of butterfat products in cold storage at the end of July showed the stocks were still just below where they were last year. Dairy Market News says the butter market appears to be firm with steady to strong prices. Retail sales are steady and food service orders are picking up as more schools are opening around the country. Current butter production is holding about even with current sales and, despite the availability of extra cream from bottlers, the lower production season has arrived as less milk with lower butterfat content being produced. Current production is affected by the Labor Day planning and pre-sales activity, but butter makers really do not want to add anything to their current inventories unless a special opportunity appears.

POWDER MARKET COMMENTS: Production of nonfat powders in the West is continuing fairly strong, but is steady to lower in the central and eastern regions as manufacturers there cope with lower levels of milk production and higher demand for fluid milk. The demand for fluid milk is in part related to the short-term concerns about hurricane Irene which could affect the entire eastern seaboard. Powder prices are steady to lower, as buyers continue to anticipate lower prices will be available sooner rather than later. Even orders for export are reported to be fewer, or more tentative. DMN reports resale offerings are under cutting prices for direct sales in the West. Prices reported for last week's shipments of NFDM by the two major reporting agencies were each about \$.03 per lb lower than the week before – and the California plant average continued to mystify by being above the NASS price for a second week in a row. The market for buttermilk powder is weakening and prices were lower for the week. On the other hand, spot interest in whole milk powder, along with low inventories, caused prices to edge upward this week.

WHEY PRODUCTS MARKET COMMENTS: Everything seems well about the dry whey market, except for a comment from the central region by DMN about lower prices being offered by European seller to East Asian customers and a comment from the western region about competition from WPC sellers. And yet, DMN says domestic and export demand in the West and the East remains strong. That resembles a report issued by a committee. The facts are that the average price for dry whey shipments continue their string of weekly increases – the latest was an increase of \$.005 per lb. The West’s “mostly” price also edged upward, continuing to show strong interest in that fine wholesome product. Interest in whey protein concentrate-34 is lagging, in part because buyers are expecting to see lower prices. **MANAGERS COMMENT: (By Rob Vandenheuvel) While the market for dry whey products has had an ongoing impact on the California Class I minimum price formula, it has been an irrelevant factor in our Class 4b (cheese) formula since 2007. That will change next week, as the California Department of Food and Agriculture has re-inserted a variable dry whey factor in the California Class 4b formula (see article below).**

FRED DOUMA’S PRICE PROJECTIONS...

Aug 26 Final:	Quota cwt. \$21.20	Overbase cwt. \$19.50	Cls. 4a cwt. \$20.25	Cls. 4b cwt. \$18.60
Last Week:	Quota cwt. \$21.27	Overbase cwt. \$19.57	Cls. 4a cwt. \$20.17	Cls. 4b cwt. \$18.79

CALIFORNIA DEPARTMENT OF FOOD AND AG ANNOUNCES CHANGES TO CLASS 2, 3, 4A & 4B MINIMUM PRICE FORMULAS: (By Rob Vandenheuvel) This week, the California Department of Food and Agriculture (CDFA) announced that effective September 1, 2011, changes will be made to the Class 4a (butter/nfdm) and 4b (cheese) formulas. The changes to the Class 4a formula will also impact the Class 2 (soft products like yogurt & sour cream) and Class 3 (frozen products) minimum prices, since those two prices are directly tied to the Class 4a formula. The changes are in response to the public hearing held on June 30 - July 1. Here is a summary of the changes to the formulas:

Changes to the Class 4a formula (and indirectly, the Class 2/3 formulas):

- **CDFA is increasing the “f.o.b. California Price Adjuster for Grade AA butter” from \$.0309 per pound to \$.0485 per pound.**
 - The f.o.b. price adjuster is included in the formula to account for the fact that we use the Chicago Mercantile Exchange as our price discovery mechanism for butter, not a localized California price. CDFA has an internal policy of modifying this f.o.b. adjuster based on a rolling 24-month calculation of the difference between the CME Grade AA butter price and a survey of the price received for bulk butter sold in California.
 - **This change will reduce the future Class 2, 3 and 4a minimum prices by \$.0739 per hundredweight.**
- **CDFA is increasing the butter make allowance from \$.1560 per pound to \$.1635 per pound.**
 - **This change will reduce the future Class 2, 3 and 4a minimum prices by \$.0315 per hundredweight.**
- **CDFA is increasing the nfdm make allowance from \$.1698 per pound to \$.1763 per pound.**
 - **This change will reduce the future Class 2, 3 and 4a minimum prices by \$.0566 per hundredweight.**

So combined, the changes to the Class 4a formula will reduce the future Class 2, 3 and 4a minimum prices by \$.162 per hundredweight.

Changes to the Class 4b formula:

- CDFA is modifying the dry whey factor in the Class 4b formula. They are replacing the current fixed \$.25 per hundredweight factor with a “sliding scale” that will move the dry whey factor up and down in value as the dry whey market fluctuates. Included in the sliding scale will be a “floor” of \$.25 per hundredweight and a “cap” of \$.65 per hundredweight.

- The scale will be set as seen to the right.
- If this new whey factor were in place right now (with the dry whey price around \$.59 per lb), **the change would increase the August 2011 Class 4b minimum price by about \$0.35 per cwt.**

DMN Monthly Average Dry Whey Price (\$/lb)	Whey Factor in 4b Formula (\$/cwt.)
< 0.25	0.25
≥ 0.25 and < 0.30	0.30
≥ 0.30 and < 0.35	0.35
≥ 0.35 and < 0.40	0.40
≥ 0.40 and < 0.45	0.45
≥ 0.45 and < 0.50	0.50
≥ 0.50 and < 0.55	0.55
≥ 0.55 and < 0.60	0.60
≥ 0.60	0.65

- **NOTE: CDFA chose NOT to make any changes to the f.o.b. price adjuster or the make allowance for Cheddar cheese.**
 - These requests, which were proposed by Land O'Lakes (LOL), would have *reduced* the f.o.b. adjuster and make allowance, resulting in a *higher* Class 4b minimum price calculation.
 - While LOL only requested a very small change in the make allowance (\$.0022 per pound), the change in the f.o.b. adjuster was much larger (\$.0234 per pound). Had CDFA implemented this change to the f.o.b. adjuster for cheese (which was based on the rolling 24-month calculation just like with the butter f.o.b. adjuster), **the Class 4b minimum price would have been increased by \$.236 per hundredweight.**
 - Instead, CDFA "*recommends holding industry stakeholder meetings to review the methodology and parameters used in the calculation of the f.o.b. California Price Adjusters, especially for Cheddar cheese.*"

So let's take a look at what these changes mean for California's dairy families. While the new "sliding scale" dry whey factor will be an improvement over the current fixed factor of \$.25 per cwt, it still falls woefully short of bringing California's Class 4b formula in line with the Class III (cheese) formula used in the Federal Orders that most U.S. dairies operate in. In July, the dry whey factor in the Federal Order Class III formula added **\$2.05 per hundredweight** to the minimum price, or **\$1.80 per hundredweight more than the current \$.25 dry whey factor adds to the California Class 4b minimum price.** The difference of \$1.80 per hundredweight in dry whey factors was obviously the main reason that the FMMO Class III price was \$2.04 per hundredweight higher than the CA Class 4b price in July 2011 (\$21.39 per cwt vs. \$19.35 per cwt). The other differences in the formulas (CME vs. NASS, a different make allowance, difference in how the formulas are constructed) accounted for the remaining \$.24 in the Class III vs. 4b difference.

Looking at this another way: If the dry whey market holds at its current level, California producers will have about \$.60 per cwt added to our Class 4b price as the "dry whey portion" – a small, but needed victory for California's dairy families. **Yet, the dry whey factor in the FMMO Class III formula has added AT LEAST \$.60 per cwt to the Class III price in EVERY MONTH since October 2009.**

Both LOL and the Dairy Institute (the main lobbying organization in Sacramento for the State's processors) proposed a "sliding scale" structure like the one implemented by CDFA. Both of these proposals included "floors" of \$.25 per hundredweight. However, LOL proposed a "cap" of \$1.00 per hundredweight and the Dairy Institute proposed a cap of \$.75 per hundredweight. CDFA chose neither of these options, and instead is implementing a scale with \$.65 per hundredweight as the cap. With that said, CDFA's proposal does start to provide additional value in the whey factor (above the base value of \$.25 per cwt) once the value of dry whey is above \$.25 per lb. Compare that to the Dairy Institute's proposal, in which the dry whey prices must be above \$.3499 per lb before dairy farmers get any additional value in the whey factor (above the base value of \$.25 per cwt). Given this fact, CDFA's "analysis" shows that the new factor they unveiled this week would have generated more revenue for dairy farmers over the past five years (a gain of \$.149 per cwt in the Class 4b price) than the Dairy Institute's proposal (a gain of \$.12 per cwt in the Class 4b price).

In CDFA's announcement, they specifically noted that when looking how the changes in the Class 2, 3, 4a and 4b formulas would have impacted California dairy families in the past five years, there would have been zero impact on producer prices. **In other words, over the past five years, the increase in the Class 4b price would have been exactly offset by the reduced Class 2, 3 and 4a prices.** While that five-year window includes the

profitable period of mid-2007 through late 2008, it also includes the **most devastating economic times ever experienced by the roughly 1,700 California dairymen currently operating**. CDFA has ample data on the skyrocketing feed costs being borne by our dairymen and the fact that our milk prices are, month-after-month, some of the lowest (if not *the* lowest) in the country.

Yet with full knowledge that dairies are facing this terrifying financial future, the best CDFA is willing to do is implement revised formulas that they believe could have **ZERO OVERALL IMPACT ON PRODUCER PRICES** over the long term. Unfortunately, it appears that CDFA believes California dairy farmers will produce all the milk we need regardless of the price paid for that milk. That's a key fact to remember – **we have major issues to resolve in the California dairy industry, and we cannot expect our State's Department of Food and Agriculture to lead the charge in fixing those problems; not when they have time-after-time endorsed a low-price-leader strategy when it comes to the milk prices paid to our State's dairy families.**

LOWER CHEESE PRICES REFLECT THIN MARKET AND UNCERTAINTY: (*By J. Kaczor*) The sharp drop in prices for block and barrel cheddar cheese on the CME over the past four weeks was not unlike many others that occur periodically for a number of reasons. They are given various names depending on the perceived reason and severity of the price changes, ranging from short term or technical adjustments, to “market corrections,” or “market crashes.” The good news is this one appears to be only a “correction.” Today's week ending and weekly average prices appear to have support not only from traders in the futures markets but also from some indications that current and future supply, consisting of production and imports, is not too far from being in balance with expected current and future usage.

USDA measures usage of major dairy products with a simple but effective monthly balance sheet calculation – beginning inventory, plus production, plus imports, minus ending inventory equals “disappearance,” or demand. The inventory numbers come from a monthly survey of cold storage facilities that store dairy and other products for 30 days or longer. They report the amount of cheese and other products in their warehouses on the last day of the month, regardless of when it was received. Usage includes retail sales, exports, use in other food products, and an unknown amount held by wholesalers, retailers, and others who carry short term supplies available for immediate disposition.

One of the possible reasons for the current price correction could be rumors that some manufacturers' cheese stocks were too large and were growing. That is consistent with most of the price changes on the CME over the past month having been initiated by offers to sell. There also were brief comments about discounted cheese being sold off the market. This week's report on the amount of cheese in cold storage at the end of July showing American cheese stocks higher than the previous month, for only the second time this year, appears to support a general belief that American cheese production has gotten ahead of demand. Next week's report on production in July will help to either verify or dispel that notion.

Regardless of these short term price changes there is concern about the continuing use of CME cheese prices by most manufacturers and wholesalers to determine prices for all cheese produced and sold in the U.S. These prices directly or indirectly affect prices for about one half of all milk that is produced in this country. The concern includes the CME itself, the circularity of the pricing system, and the questionable representation of the sales base. U.S. cheddar production so far this year is only 30.2% of total cheese production, and continues to become a smaller percentage and falling volume. The basis for California is ridiculously smaller because only CME block prices, adjusted by the prices received for sales of block cheese are used – which means the California 4b (cheese milk) price is determined by prices received for about 6% of all cheese produced in the state. [June cheddar production in California was 14.9% of total cheese production; block production ~ 50% of cheddar production; sales of block cheese ~ 80% of block production.]

National Milk Producers Federation's *Foundation for the Future* includes a feature they believe will result in more fair prices for milk used to make cheese and other products – by removing regulations designed to ensure obligations for paying uniform minimum prices – but they want Congress to make that change instead of having

the matter debated in a public hearing. To some, that seems to be a questionable idea coming about by questionable means.

CDFA LISTENING SESSION ON MONDAY TO DISCUSS U.S. CONGRESS'S 2012 FARM BILL: *(By Rob Vandenheuvel)* Next Monday (August 29th), CDFA will be holding a “listening session” at the Fresno County Farm Bureau office (1274 West Hedges in Fresno) from 1 – 3 p.m. With the U.S. Congress expected to consider a Farm Bill next year (the current Farm Bill expires in September 2012), CDFA Secretary Karen Ross is asking that the various agricultural industries participate in this and other listening sessions held throughout California. As stated in their press release, “The listening sessions will offer an opportunity for individuals and organizations to provide comments that will help determine California’s farm bill priorities.”

As you all know, there is a growing debate in Congress over major reforms to our dairy safety net policies. Some in Congress have indicated they would like to have a dairy policy reform bill approved by Congress before the 2012 Farm Bill. However, if that does not occur, the 2012 Farm Bill would be the next opportunity to implement much-needed reforms to our Federal dairy policies. The current safety net programs we have (MILC and Price Support programs) are woefully inadequate for our California dairy families, so we have a huge incentive to see that fundamental reforms are successfully pushed through Congress.

Dairies interested in participating in the listening session and sharing their perspective with CDFA leadership should plan on attending Monday’s meeting. If you can’t make Monday’s meeting, two additional listening sessions will be held next month:

September 7, 2011, 9 – 11 a.m.
San Diego County Farm Bureau
1670 E. Valley Parkway
Escondido, CA 92027

September 8, 2011, 3 – 5 p.m.
Monterey County Agricultural Commissioners Office
1428 Abbott Street
Salinas, CA 93901

If you have any questions, please feel free to contact Milk Producers Council at (909) 628-6018.

REMINDER: TIME TO REVIEW YOUR MILC CONTRACT: *(By Rob Vandenheuvel)* As we noted in last week’s newsletter, October 1st marks the start of a new fiscal year for the Federal Government, and therefore a new fiscal year for the Milk Income Loss Contract (MILC) program. While we’ve written numerous articles in this newsletter about efforts in Congress to reform and improve our “safety net” programs, as it stands now, the MILC and the Dairy Price Support programs continue to be our main safety nets for U.S. dairy farmers.

The MILC program provides cash payments to dairy farmers when the milk price drops below specific thresholds. There is no indication that the milk price will be low enough to trigger a payment under the MILC program in the near future. However, given the volatility in dairy markets, we simply don’t know whether the program will trigger in for any of the months between October 1, 2011 and September 30, 2012.

The MILC program limits the payments made under the program to 2.985 million lbs. This is only about 3 months worth of milk production for a 500 cow dairy producing 65 lbs/head/day. Therefore, since these larger dairies may only be collecting payments for weeks or months, it’s important to choose months with the highest payment rates in order to maximize the amount received under this program.

So why does that matter right now? If your dairy is enrolled in the MILC program and you’ve chosen October of each year as your “start month,” it’s possible that you’d benefit from changing that. If you keep your start month as October, and payments begin later in the fiscal year, you will have no choice but to begin collecting the subsidy payment as soon as it’s available, regardless of whether it’s an optimal month for your operation to do so. And if you’d like to change your month from October to a later month, you have only until September 14th to make that change. If you have any questions about the MILC program or your dairy’s specific MILC contract, feel free to contact either your local Farm Services Agency office or Milk Producers Council at (909) 628-6018.