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

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks	*+$.0450*	$1.7650
Barrels	*+$.1450*	$1.7850

Weekly Average

Blocks	*+$.0130*	$1.7340
Barrels	*+$.0430*	$1.7010

CHICAGO AA BUTTER

Weekly Change	*+$.0100*	$1.7700
Weekly Average	*+$.0035*	$1.7635

DRY WHEY

DAIRY MKT NEWS	w/e 10/07/11	$.6300
NASS	w/e 10/01/11	$.6055

NON-FAT DRY MILK
Week Ending 9/30 & 10/1

Calif. Plants	$1.5380	12,131,339
NASS Plants	$1.5164	17,599,927

CHEESE MARKET COMMENTS: USDA's report on August's dairy product production was released on Monday after the cash trading ended on the CME. Total cheese production was 12.6 million lbs higher than in July but cheddar production was 4.2 million lbs lower. Those numbers, when compared to the cold storage report for the same month, reported two weeks ago, show that commercial disappearance of cheddar and for all cheese was greater than production during the month. There was no cheese trading activity on Monday, as it appears cheese traders may have been awaiting the Monday report. That good news may have just what the market needed. Barrel prices gained $.145 per lb and blocks gained $.045 per lb for the week. Thirty carloads were traded. The most positive note for the week is that each day's activity ended with bids that raised the price for the day for each style. A price drop in Fonterra's cheese product in Tuesday's global auction was an apparent non-event. Fourth quarter class III milk futures prices moved up briskly, by an average $.83 per cwt; the November price increased $1.46 per cwt, to $17.87 per cwt. Cheddar futures showed similar gains for the week. All other cheese-related prices moved slightly lower, indicating a lack of conviction and plenty of skepticism about the direction of future prices. Milk production in Australia and New Zealand is booming; it is hard to not believe the short term milk supply could swamp demand down there, raising the question about what effect it may have up here. Up here, cheese sales are holding up well, but U.S. economic data continues to indicate the recovery from the greatest economic recession this country has suffered may not get much better soon, and there has been some talk about the economies of France and Germany weakening. Since the U.S. milk producers are beyond the "tipping point" all we can do is hang on right now and wait to see what happens.

BUTTER MARKET COMMENTS: The amount of butter in cold storage at the end of August was 22.1 million lbs lower than where it was a month before, and butter production was virtually unchanged during the month. Commercial disappearance appears to have out-paced production by about 20 million lbs. Prices for anhydrous milkfat in Tuesday's global auction continued to weaken, falling to a weighted average price of $1.68 per lb. The result apparently was ignored, but milk production in Oceania so far this year is 13% higher than for the same period last year. If nothing else, the huge drop in butterfat prices in that auction gives notice that the global shortage of the past year or so may no longer exist. The week's single sale on the CME didn't move the price, and a bid and an offer combined to recover the penny per lb that was lost last week. Butter futures prices for the nearby months are supportive of the cash prices, but fall away by December and beyond. *Dairy Market News* says buyers are beginning to lay in stocks for the coming heavy usage holiday season, even though the current prices look like they could move lower.

POWDER MARKET COMMENTS: The weak undertone to the nonfat powder market continues to cause buyers to hold back and prices to edge lower. Production of NFDM in August was 20 million lbs lower than in July and skim milk powder output was 1 million lbs lower. Stocks of NFDM fell by 21 million lbs during the month. DMN reports some nonfat powder in the West was sold for $1.39 per lb this week. The bottom of the "mostly" price range was only $.03 per lb above that level and the average price Dairy America got for their skim milk powder in Fonterra's auction, for shipment in November, was $1.38 per lb. Prices reported for shipments of

NFDM last week again moved lower, still close to the high end of the West's "mostly" price range for the week. The California plant average price continues to be above the national price. Re-sales of powder are pulling prices lower. Prices for buttermilk powder and whole milk powder also moved lower this week.

WHEY PRODUCTS MARKET COMMENTS: The supply of dry whey continues to fall while domestic demand remains strong throughout the country. Prices moved higher again this week and supplies are reported to be tight. Current prices for dry whey are higher than international prices and could be affecting export volume. On the other hand, the market for whey protein concentrate-34 has hit the brakes as buyers are said to be resisting current prices which are no longer competitive (on a per lb of protein basis) with nonfat powder products. DMN believes the domestic WPC market may be saturated at this point, and some scheduled shipments are being turned away. It looks like sellers may have no option other than to re-set prices.

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FRED DOUMA'S PRICE PROJECTIONS…

Oct 7 Est:	**Quota cwt. $19.04**	**Overbase cwt. $17.34**	**Cls. 4a cwt. $18.09**	**Cls. 4b cwt. $16.08**
Last Week:	**Quota cwt. $18.88**	**Overbase cwt. $17.18**	**Cls. 4a cwt. $18.02**	**Cls. 4b cwt. $15.80**

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MOMENTUM JUST KEEPS BUILDING FOR THE 'DAIRY SECURITY ACT' IN CONGRESS: *(By Rob Vandenheuvel)* Dairy policy reform continues to generate interest in Congress and around the country. There's a growing recognition that the current system of dairy safety net policies simply isn't working and that Representatives Collin Peterson (D-Minnesota), Mike Simpson (R-Idaho) and the rest of the co-sponsors of H.R. 3062 – the "Dairy Security Act of 2011" – are providing a "once-in-a-lifetime" opportunity to make fundamental, much-needed change.

A couple things to point out to the readers of this newsletter: First, National Milk Producers Federation (NMPF) has put together several documents on the Dairy Security Act. Those documents can be found on their website at: http://futurefordairy.com/resources/downloadable-resources.html. I strongly encourage all our readers to take some time and read the material provided on the website. Included in those documents is a list of organizations and cooperatives that have endorsed the legislation. Those groups include:

Cooperatives:

Continental Dairy Products
Cooperative Milk Producers Association, Inc.
Dairy Farmers of America
Dairylea Cooperative Inc.
Farmers Cooperative Creamery
Foremost Farms USA
Land O'Lakes, Inc.
Lone Star Milk Producers
Maryland & Virginia Milk Producers Assoc., Inc.
Michigan Milk Producers Association
Northwest Dairy Association
Prairie Farms Dairy Inc.
Select Milk Producers, Inc.
St. Albans Cooperative Creamery, Inc.
United Dairymen of Arizona
Upstate Niagara Cooperative

National Organizations:

American Farm Bureau Federation
Holstein Association USA
National Council of Farmer Cooperatives
National Milk Producers Federation

State/Regional Organizations:

Dairy Producers of New Mexico
Idaho Dairymen's Association
Milk Producers Council
Missouri Dairy Association
Oregon Dairy Farmers Association
Washington State Dairy Federation
Wisconsin Farm Bureau Federation

On a related note, the International Dairy Foods Association (IDFA) – the main lobbying organization for our nation's processors in Washington, DC – is clearing feeling the heat. This past week, IDFA announced a television/newspaper/internet campaign urging consumers to tell the Government to "Get Out of My Milk." The campaign alleges that government intervention in the dairy industry has resulted in artificially high milk prices. This comes on top of a press release IDFA put out last month accusing dairy farmers of supporting a bill that "may cause [the] neediest to go without nutritious dairy products." The message in that press release was simply that the Peterson/Simpson legislation would have generated additional dairy farmer revenue in 2009 and made it more difficult for feeding and nutrition programs to buy an adequate supply of milk and dairy products. In other words, **IDFA is saying that the roughly 60,000 dairy farmers in the U.S. owed it to our country to sacrifice the billions of dollars in dairy farmer equity by selling our milk at prices significantly less than what it cost to produce it, all in the interest of making low-cost dairy products available to the public**. The ironic thing, of course, is that these same dairy product processors were asked to make ***no*** such sacrifice in 2009 as they benefited from government policies (the same policies that are now blasting in their advertising campaign) that provide government-guaranteed make allowances that virtually guarantee company profits regardless of what price they are paying for their milk. **Shameless…**

Fortunately, new evidence this week demonstrated that the message (or could we say "propaganda") that IDFA is peddling in Congress has not been effective in stopping progress on the Dairy Security Act. Yesterday, it was announced that Senator Dick Lugar (R-Indiana), a member of the Senate Agriculture Committee and a former Chairman of that committee, introduced the Rural Economic Farm and Ranch Sustainability and Hunger (REFRESH) Act. This legislation, which would fundamentally reform our agriculture, conservation and nutrition programs in an effort to cut about $40 billion in government spending, **includes the provisions of the Dairy Security Act as the dairy portion of the bill**.

The industry is facing extremely turbulent waters ahead, and our industry leaders in Congress stand ready to throw us a lifeline – **a lifeline that not only addresses the fundamental problems and inequities of our current safety net programs** (MILC and Price Support programs), **but does so in a way that actually saves the government money**. And to top it off, IDFA has made it clear through their actions that they are scared to death that it might actually pass and that dairy farmers might have a chance to collective control our own future. As exciting as this is for dairy farmers, and as encouraging it is to see the growing list above of organizations/cooperatives endorsing the legislation, the obvious question I have is this: Where is everyone else? Why isn't every dairy farmer organization in the country included in the list above? As dairy farmers, you should demand answers to that very question. **If your cooperative or trade association is not on the list above, call their offices and ask them why**. IDFA is counting on dairy producers passively standing on the sidelines, and it's time to show them what a unified dairy producer sector really looks like. **So please, pick up the telephone!**

SCRATCHING HEADS AND CROSSING FINGERS: FONTERRA'S AUCTION AND FUTURE PRICES: (*by J. Kaczor*) According to a recent comment made by a New Zealand bank economist, Fonterra's globalDariyTrade auction is one of several major indicators of the New Zealand economy. That is probably so, provided the winning prices are indicative of prices for the much larger volume of the same product lines exported from that country by means other than the auction. Dairy products represent a large portion of Oceania's exports regardless of the means of sale, and are certainly the major indicator of Fonterra's financial well being. Should it not follow then, if the auction prices do reflect broader values, they also should be an important indicator for export prices for all major exporting nations. If only that would be so.

Coming off a year of record high milk production and profits, Fonterra's forecast for the year beginning with July was a record high, and was called conservative and realistic. The forecast came in late May when the weighted average price for all products in the auction was $2.02 per lb. Two months later the average price had fallen to $1.72 per lb, and this week, three months into the new year, it was $1.56 per lb. Not to be dissuaded, Fonterra recently reaffirmed their May forecast – which should give U.S. exporters and milk producers hope for better prices for the year ahead. The basis for that hope is because Fonterra is in a class by itself when it comes to knowledge about international dairy trade. Fonterra has the most volume, the most contacts, the most extensive distribution system, excellent ability to shift their milk supply between product lines to maximize value, and arguably the best sense about what may lie ahead. The May forecast mentioned expected continuing price volatility, global economic uncertainties, and increased competition on the one hand and, on the other, the virtual certainty of increasing demand from more people with more money wanting to improve their well-being by consuming more dairy products. Time-lines for potential problems were not given because they can happen randomly or are caused by matters beyond control of the industry. However, there seems to be almost complete consensus that long term global demand, over the next ten to fifteen years, will increase and will challenge major exporting countries to match that growth.

Despite the sharp downward price movements covering delivery periods when their milk production was nearing or was at its peak, Fonterra benefited from what looks like a short-term shift in currency valuations. The New Zealand $ versus the U.S. $ fell by 17% from August 1st to October 4th, the day this week's auction was held and prices were confirmed. Perfect timing, that. The currency shifts offset almost all of the decrease in the weighted average prices for New Zealanders over that time. Prices fell, but Fonterra was paid with U.S. dollars which had grown in value. That is partly why the initial price forecast was re-affirmed. However, it doesn't work that way for U.S. exporters because export prices are set in U.S. dollars. The value of U.S. exports over this same period dropped by whatever amount their prices fell. Would currency value hedges have protected against some of those losses?

Still, prices for the three main products in the auction (smp, smp, amf) are now down to or lower than where they were a year ago, and the likelihood of the U.S. $ maintaining the strength it had gotten from Europe's financial troubles is not great. Dairy product export prices also are being pressured by huge increases in milk production in the southern hemisphere. Argentina's milk output so far this year is about 15% above where it was last year, New Zealand's production is 13% above last year's, and Australia's is also moving higher. U.S. milk production through August has turned upward but is still does not amount to 2% above last year, and Europe's production is leveling off at about 2% higher. Fonterra has already said they will be using some of their increased supply to produce products with lower value, but said that would not affect their projections. That sounds like nonsense, doesn't it? Every bit of that additional milk production from the southern hemisphere has only one outlet – convert it to products that will sell and ship them out. Sell it, smell it, or stock it, someone recently wrote. Buyers know that and are expected to act in their own interests. The best outcome for everyone would be for China, Russia, and India to continue to require higher volumes of dairy products to help to keep global demand in reasonable balance with the short-term milk production surge from the southern part of the globe.

There appears to be a growing number of commentators and organizations who believe the auction prices do reflect changes, either generally or specifically, in global dairy product demand and supply. That is about all that can be expected from such a diverse universe of buyers and sellers. The auction now has 427 qualified bidders located throughout the world. Recently, about 150 of them have been actively bidding. Some may simply want to get information on starting prices and volumes offered, which is now given only to qualified bidders. However, *Dairy Market Ne*ws reporters have been using the auction's winning prices as one of several measures of product values they report for New Zealand and Australia. And the most significant supporter of the winning prices for Fonterra's Spot Month (now re-numbered as the 2nd contract period covering deliveries in the second full month following the auction) is NZX, the major stock market in New Zealand, which uses the winning prices to cash settle their popular futures contracts for wmp, smp, and amf.

Dairy America joined the auction this week, offering two kinds of low heat and medium heat skim milk powder products – regular grades and upgraded versions. Their products are scheduled to ship during the month immediately following the auction, which is the new Contract #1. The winning prices for Dairy America's low heat and medium heat skim milk powder in this auction, for shipment in November, averaged $1.382 per lb, $.056 per lb lower than Fonterra's comparable SMP products, for shipment in December. Apparently, the bidding was successful but Dairy America is the only one who can judge if the prices were satisfactory. The new auction rules prohibit timely public announcement of the volumes offered by competitors, their starting prices, and their volumes sold. An exception to that are the three Fonterra products covered by NZX, which require pertinent information to be publicly reported in order for that market to be open and fair. The winning prices for DA's offerings could have been affected by a number of factors and considerations. They include bargain hunters, buyers testing the system, some unwilling to pay the same or similar prices to DA that are bid for Fonterra's like products, and an unwillingness to complicate existing buying patterns. More specific factors affecting interest or results could include the following: location of DA's shipping points and buyers locations could result in unfavorable transportation cost differences, volumes offered may not have been sufficient, applicable tariffs could add to buyers' costs, currency valuations could be an issue, questions about quality and service may still need answers, and alternatives such as prices negotiated the old fashioned way may simply be too ingrained for some to make much of an effort to change. Give it time, it might work well, and the industry may benefit from a much needed additional bit of price transparency.

LEGISLATION ADDRESSING THE 'ETHANOL MANDATE' INTRODUCED IN CONGRESS: *(By Rob Vandenheuvel)* It's been a while since we've written about our Federal policies that support the corn-based ethanol industry, but that doesn't mean that efforts to scale those programs back have stalled in Congress. As a refresher, here are the three main government supports enjoyed by our nation's corn-based ethanol industry:

- ***Ethanol Blender's Tax Credit*** – A tax credit worth $.54 per gallon available to the oil/gas companies that blend ethanol with their fuel. This tax credit, which cuts taxes paid by oil/gas companies by an estimated $6 billion per year, is set to expire on December 31, 2011.
- ***Ethanol Tariff*** – This tariff of $.54 per gallon applies to ethanol products that are imported into the U.S. This tariff is set to expire on December 31, 2011.
- ***Renewable Fuel Standard*** – This is the "ethanol mandate" that in 2011 requires that oil/gas companies blend 13.95 billion gallons of renewable fuel with their gasoline. Of this 13.95 billion gallons, 12.6 billion gallons comes from corn-based ethanol. As a note, in order to produce 12.6 billion gallons of ethanol, it's expected that about 40% of our national corn supply is needed. And looking out into the future, this mandated minimum volume requirement will continue to ramp up each year until it reaches 15 billion gallons of corn-based ethanol in 2015. This is a long-term policy with no immediate expiration in place.

As you can see, the first two items in the list above are scheduled to expire at the end of this year. The third item is a longer-term policy that extends out to 2022. MPC and a host of other groups around the country *(ranging from livestock agriculture to environmental groups to taxpayer advocates)* have been working collaboratively to urge Congress to allow the blender's tax credit and import tariff to expire as planned. In these times of tight budgets in Congress, it's certainly our hope that Congress will take the position that a $6-billion per year tax credit payable to the oil and gas companies that blend ethanol with their fuel is not the best use of government funds.

This week, a bi-partisan group of 26 Congressmen jointly introduced H.R. 3097, the "RFS Flexibility Act of 2011." This bill, which was led by Reps. Bob Goodlatte (R-Virginia) and Jim Costa (D-California) would force EPA examine the U.S. corn "stocks-to-use ratio" twice per year. If that ratio, which USDA reports each month on how our year-end corn stocks are expected to compare to our corn usage, is below 10%, the EPA will be forced to reduce the RFS's mandated minimum volume requirement applicable to corn-based ethanol. As the stocks-to-use ratio drops lower, the reduction to the RFS will be increased, until reaching the maximum reduction of 50% in the case where the stocks-to-use ratio drops below 5%.

This is an important step in weaning the now-mature corn-based ethanol industry off the government supports they have enjoyed in recent years. This common-sense approach will still allow corn-based ethanol plants to produce all the ethanol they can sell in the market, but begins to get the government out of the business of forcing that demand regardless of market needs.

MPC greatly appreciates the support of the 26 members of Congress that have co-sponsored H.R. 3097. In California, that list includes Reps. Costa, Joe Baca, Dennis Cardoza, and Tom McClintock. We also appreciate the support by California dairy organizations provided by **California Dairies Inc.** and the **Alliance of Western Milk Producers**, as well as dairy organizations throughout the country such as the **Washington State Dairy Federation, the Idaho Dairymen's Association, Dairy Producers of New Mexico, Southeast Milk Inc.** and **Darigold**. **In the coming weeks and months, it is our hope that this list of supporting organizations and the list of co-sponsors will continue to grow for this much-needed reform of our nation's ethanol policies.**

MPC'S OCTOBER BOARD MEETING TO BE HELD NEXT TUESDAY: *(By Rob Vandenheuvel)* Our October Board of Directors meeting is scheduled for next Tuesday (October 11th) 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.