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DATE: July 22, 2011 **PAGES: 5**
TO: Directors & Members **FROM: John Kaczor**

SPECIAL NEWS ALERT: **MPC BOARD ENDORSES REP. PETERSON'S DAIRY REFORM LEGISLATION:** *(By Rob Vandenheuvel)* This week, MPC's Board of Directors formally endorsed dairy policy reform legislation unveiled by Congressman Collin Peterson (D-Minnesota). The legislation, which is expected to be introduced in the U.S. House of Representatives in the near future, is modeled after a proposal outlined by National Milk Producers Federation (NMPF) known as "Foundation for the Future." The legislation and a detailed summary can be read at: http://democrats.agriculture.house.gov/press/PRArticle.aspx?NewsID=1118.

Earlier today, MPC released a press statement announcing the Board's endorsement. For those that haven't seen that statement yet, it can be found at: http://www.milkproducerscouncil.org/072211_fftf.htm.

Over the past several years, MPC has been deeply involved in the debate over fundamental reforms to our national dairy policies. Along with fellow dairy producer groups around the country, MPC helped promote the "Dairy Price Stabilization Program" that was introduced in the U.S. House and Senate last year, bringing the issue of major dairy policy reform to the forefront in Congress. While that effort was ultimately unsuccessful in garnering enough support to move forward, it helped set the stage for the debate we will now be having on Congressman Peterson's legislative reform package.

As noted in the MPC press release, Rep. Peterson's bill includes three main pieces:

- **Dairy Market Stabilization Program (DMSP)** – This is a stand-by program that triggers in only when the "margin" (U.S. all-milk price minus feed cost calculation) dips below $6.00 per cwt for two consecutive months. The DMSP provides a temporary incentive for all dairies to cut back milk production. Once markets recover and the "margin" is greater than $6.00 per cwt for two consecutive months, the DMSP is lifted, and is on standby again until the next time the margin calculation compresses below $6.00 per cwt.

- **Dairy Producer Margin Protection Program (DPMPP)** – This is a safety net program that would replace the Milk Income Loss Contract (MILC) and Dairy Product Price Support Program (DPPSP). The DPMPP would provide "margin protection" for all dairies when the margin (again, U.S. all-milk price minus feed cost calculation) dips below $4.00 per cwt. Individual dairies can elect to increase their "margin protection" above $4.00 per cwt. for a pre-determined annual premium (this is called the "supplemental margin protection").

- **Reform of Federal Milk Marketing Orders (FMMO)** – In short, these reforms would remove end-product pricing and the use of make allowances for milk sold to all plants other than Class I bottling plants, and replace it with a competitive, market-based system.

NMPF staff have been traveling through the country, talking with dairy farmers about Foundation for the Future (Last week they were in Visalia, CA). As news reports have surfaced following some of those meetings, one of the concerns that has been repeated is that this plan would prevent our industry from growing our markets. Clearly, this argument illustrates a serious misunderstanding of what is actually being proposed in the bill.

The Dairy Market Stabilization Program, which is the part of the legislation that has inspired this stated "concern," is a stand-by program that when implemented (which we hope and expect to be a rare occasion), will create a temporary incentive to cut back milk production by 2, 3 or 4 percent (depending on how compressed on-farm margins are). It is a tool that when needed, will empower the community of roughly 60,000 dairy farmers to collectively cut back milk production for a limited period of time until market balance is restored and a profitable market price is again available for dairy farmers. At that point, the program is lifted, and is again put on the shelf as a stand-by program available the next time an imbalance occurs.

Looking at that policy, it is clear that for a vast majority of the time, U.S. dairy farmers will continue to operate as they do now – making whatever growth decisions are deemed appropriate by the individual dairyman.

As I look back, I can recall a well-attended meeting of dairymen in Tulare, CA in the spring of 2009. The meeting was called right in the middle of the worst financial period for any dairyman operating today. The focus of the meeting was to promote an effort to temporarily cut back milk sales, with hopes of bringing supply and demand back into closer balance. As I sat there and listened to the comments at the meeting, I saw a lot of folks in agreement with the idea. Everyone in the room knew what our problem was – we had more milk being produced in the U.S. than we had real markets for (selling to the government is not a real market). Everyone in the room also knew what had to be done to correct the problem in a timely manner – we had to temporarily produce less milk until demand caught up with supply. But everyone in the room also knew a third thing – that we had absolutely no tool to make this common-sense solution happen.

Fast forward to 2011. We still have no such tool. But as I explained above, under Rep. Peterson's legislation, we can. That is what's at stake in this debate – empowering dairy farmers to do what we all know we need to in the limited times it's needed. That type of power may scare the nation's processors, but it ought to put a huge smile on the face of the nation's dairy farmers.

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MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks	*+$.0975*	$2.1550
Barrels	*+$.0150*	$2.1250

Weekly Average

Blocks	*+$.0905*	$2.1400
Barrels	*+$.0125*	$2.1165

CHICAGO AA BUTTER

Weekly Change	*+$.0100*	$2.0400
Weekly Average	*+$.0050*	$2.0350

DRY WHEY

WEST MSTLY AVG	w/e 07/22/11	$.5750
NASS	w/e 07/16/11	$.5521

NON-FAT DRY MILK
Week Ending 7/15 & 7/16

Calif. Plants	$1.6137	14,131,787
NASS Plants	$1.6510	18,885,688

CHEESE MARKET COMMENTS: Last Friday's surprising ending to trading activity for block cheese on the CME, a bid to buy at 5.5 cents higher than the previous sale, left market watchers, well, surprised. This week's activity began where Friday's left off – a bid for blocks (and a sale) that raised the price by 6.25 cents. The rest of the week went the same; bids for blocks, 18 carloads sold, trading ending two days with unfilled bids, and the block price up by 9.75 cents for the week. Barrels rose by 1.5 cents from 3 bids over 3 days. This week's action marks the 6th week in a row where block and barrel prices on the CME have been higher at this point of the year than any of the past 4 years. What's causing this surprising strength? It appears part of the answer may be in what's happening to milk production. The report for June was released on Tuesday (see report below) and it was bullish in the sense that total production is not much higher than last year, and July's weather in many parts of the country is causing significant decreases in milk output and components. So, market watchers foresee cheese production to be slower than normal for a few more months and sales of cheese (including exports) appear to be holding up well in an economy that is generally considered to be not much better than recessionary. To cap off this week's report, USDA released its estimate of the amount of American cheese in cold storage at the end of June. It was, for a 2nd month in a row, lower than the preceding month and, for the 1st time in 3 years, lower than the same month a year before. As expected, CME's class III milk futures responded with a burst; the August price, at $21.32 per cwt, gained $1.12 this week and the September price, at $20.26 per cwt, gained $.62 per cwt. It's good to see some believers put their money on the line.

BUTTER MARKET COMMENTS: In contrast to the cheese market, the CME butter market was almost silent; bids on Tuesday and Friday moved the price up by a total of a penny for the week. The futures traders responded by moving the price **above** the spot level for the August-October period. The CME price is competitive with prices *Dairy Market News* reports for New Zealand and Europe ($2.12 and $2.68 per lb, respectively) and exports are "supported" by currency differentials which make U.S. products much more affordable than from anywhere else. However, the fundamentals for butterfat product prices do appear to be weakening. The winning price for anhydrous milkfat on Fonterra's auction this week, for shipments to be made in September fell to $2.05 per lb, $.90 lower than the peak that was reached in February. $2.05 for a pound of product consisting of 99% butterfat is equivalent to about $1.65 per lb of butter, which doesn't make sense. Then comes today's report on butterfat in cold storage. It wasn't surprising and it wasn't supportive of current prices. The cold storage stock at the end of June was 50 million lbs higher than it was two months earlier, and was close to where it was a year ago. Exports should help, as will lower milk production with lower butterfat content.

POWDER MARKET COMMENTS: Prices for nonfat dry milk are mixed and the market is unsettled and uncertain, says DMN this week. Shipments last week were higher than the week before and prices for the two major reporting series were off by a cent and a fraction. DMN hears from the marketplace that there may be a fundamental difference of opinion over the value of NFDM, with buyers pointing to growing stocks and "tepid" domestic demand, and sellers pointing to weakening prices internationally. The price for extra grade powder on the CME held at $1.61 per lb this week while the grade A price fell to $1.52 per lb. CME's futures prices for NFDM rose by $.0225 to $.04 per lb for the September-December period, averaging about $1.44 per lb for the four months.

WHEY PRODUCTS MARKET COMMENTS: The west's "mostly" price for dry whey edged upward once again this week, as production eased off in line with cheese output. Exports continue to be strong and steady. Domestic demand is steady, and supplies are reported to be tightening as more condensed whey in the western region is being channeled into WPC products. Demand for WPC products continues to be fair to steady, with exports well below last year's levels. Buyers for lower end products are said to be looking elsewhere for animal protein feeds, and buyers for all dairy protein products continue to evaluate alternative products and sources.

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FRED DOUMA'S PRICE PROJECTIONS…

July 22 Est:	**Quota cwt. $21.30**	**Overbase cwt. $19.60**	**Cls. 4a cwt. $20.27**	**Cls. 4b cwt. $19.35**
Last Week:	**Quota cwt. $21.17**	**Overbase cwt. $19.47**	**Cls. 4a cwt. $20.23**	**Cls. 4b cwt. $19.09**

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MILK PRODUCTION GROWTH IN JUNE CONTINUES TO WEAKEN: *(By J. Kaczor)* The weather pattern for milk production across the U.S. in June was quite different from the pattern in May. It was good to better across the northern tier of states and the west and poor to worse in the south and the southwest. Regardless of the changes that occurred, the pattern of milk production in June for most states and for the U.S. didn't change much from one month to the other. Generally, milk production increased where it had been increasing and decreased where it had been decreasing. The total number of milk cows increased by 10 thousand from May, average daily production per cow edged lower by less than a lb, and total daily milk production decreased by 6 million lbs. Compared to the same month a year ago, June had 81 thousand more milk cows, 4 lbs more milk per cow, and 175 million lbs more milk – another record of milk production for the month.

The monthly increases in milk production over the year before have steadily decreased from the high point of 3.3%, reached last September, as an increasing number of states' production move to the negative column either with fewer cows or with less output per cow, or a combination of the two. Six states have reported less milk production for three straight months, reflecting in part horrendous weather and its lingering effects. June's relatively weak milk production, and more of the same expected for July, should give short term support for current dairy product prices.

The table on the right records the number of cows and total milk production for June 2010 and 2011 for the top ten milk producing states, other groupings, and for the U.S. Four of the top 10 are in the western region. Idaho moved into 3rd place in May and Texas appears to be on pace to eventually supplant Pennsylvania for the 5th spot. The top 23 milk producing states in June supplied 93% of the nation's milk with 92% of the industry's cows. The three states in the top 10 showing production decreases have been in the negative column since April. Thirteen of the top 23 states had lower production per cow than last June. Texas led the way with an increase of 75 lbs for the month; California was 2nd with an increase of 45 lbs.

Reasons for the lackluster performance include inadequate milk prices, high feed costs, credit issues, and lack of confidence that milk margins will recover fast enough to justify making long term commitments.

	Number of Cows (1,000)		Milk Production (Million Pounds)		
	2010	**2011**	**2010**	**2011**	**Pct Change**
California	1,754	1,773	3,394	3,511	3.45
Wisconsin	1,262	1,266	2,246	2,209	-1.65
Idaho	562	578	1,073	1,127	5.03
New York	610	610	1,080	1,083	0.28
Pennsylvania	541	543	898	880	-2.00
Texas	410	434	728	803	10.30
Minnesota	470	471	785	749	-4.69
Michigan	359	367	718	719	0.14
New Mexico	325	328	676	689	1.92
Washington	250	262	493	524	6.29
Top Ten	6,543	6,632	12,091	12,294	1.68
Next 13	1,813	1,830	3,095	3,100	0.16
Next 27	773	748	1,167	1,134	-2.83
Fifty States	9,129	9,210	16,353	16,528	1.07

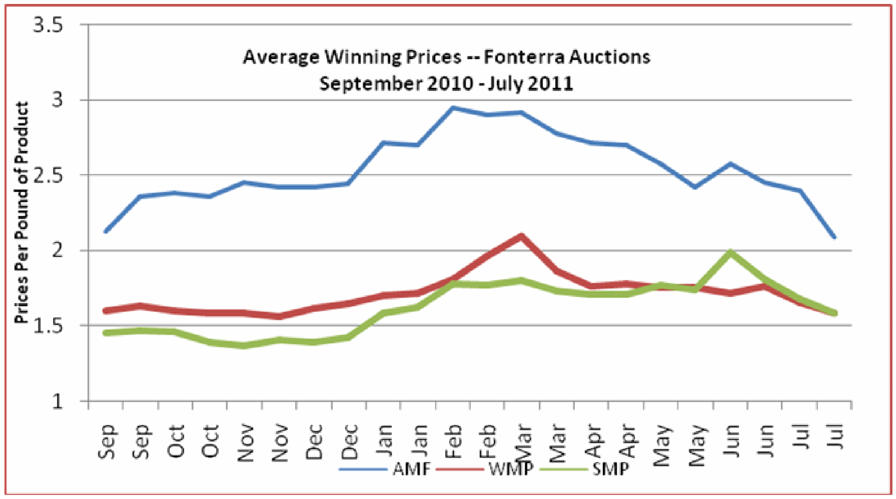
Exceptions to the above are generally limited to the western and southwestern parts of the country. Colorado producers are gearing up for the opening of a large new cheese plant; Texas producers appear to be ignoring record heat and low precipitation, Arizona, California, Idaho, Oregon, and Washington are adding cows whose daily production is increasing. Some of these exceptions are on sound footing, based on local or regional developments involving new plants or expansions or cooperative programs offering hope for growing markets and fair prices. July's hot and humid weather in many parts of the country and continuing high feed costs are presenting further challenges for milk producers, while higher milk prices should be signaling further expansion. And so it goes.

PRICES CONTINUE TO WEAKEN IN FONTERRA'S LATEST AUCTION: *(By J. Kaczor)* Winning prices again fell across the board for the three major products offered in Fonterra's July 19th auction. All prices are now at their lows for the year. Prices for anhydrous milkfat fell by the most and are now below where they were last September. Prices for whole milk powder and skim milk powder are still slightly higher than last September. The delivery periods covered by this auction include September (contract 1), October-December (contract 2), and January-March (contract 3). The auction's rules require shipments of products bid in contracts 2 and 3 to be spread as evenly as possible over all months covered in the contracts.

The AMF prices range from $2.05 per lb for September deliveries up to $2.25 per lb for the 3rd contract period. Prices for skim milk powder begin at $1.64 per lb, dip to $1.57 per lb, and end at $1.60 per lb. Prices for whole milk powder range from $1.58 per lb up to $1.61 per lb for the 3rd delivery period – at which point WMP once again is priced higher than SMP – the first time since May.

The chart on the next page shows the paths for the winning weighted average prices for all styles offered for each product. It's not clear to what extent Fonterra's current very strong sales to China is affecting the prices for the powders. No major change for the powders has been made to the volumes forecasted to be offered in these auctions over the next 12 months, despite the obvious impact those sales are having on Fonterra's total supply.

The latest update on volumes to be offered over the next year for these products are the following: 916 million lbs of WMP, 241 million lbs of SMP, and 188 million lbs of AMF. These volumes reflect a recent increase of about 19% for AMF and a recent decrease of about 5% for WMP. SMP volumes to be offered have been relatively level.



In addition to these three products, Fonterra also occasionally offers buttermilk powder, small quantities of rennet casein and milk protein concentrate (70% protein), and, in this auction, has added a cheese product to their product line. The cheese apparently is intended to be used as a base for manufacturers of processed cheeses and cheese products.

The final notable change is coming in October when Dairy America will be offering skim milk powder for auction. At this point the volumes and f.o.b. points to be offered by DA are not known. DA's product will be offered in a separate contract period (a new contract #1) for shipment in the month following the month of the auction. October's auctioned product is for shipment in November, etc. Fonterra's contract periods will follow their present pattern, but will be numbered 2, 3, and 4.