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
222 S. Thor Street, Suite 20 ~ Turlock, CA 95380 ~ (209) 250-1801
Fax (909) 591-7328 ~ office@milkproducers.org ~ www.MilkProducers.org

DATE: July 31, 2015 **PAGES: 3**
TO: Directors & Members **FROM: Rob Vandenheuvel, General Manager**

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE		
Blocks	*+$.0500*	$1.7475
Barrels	*+$.0375*	$1.6975
Weekly Average, Cheddar Cheese		
Blocks	*+$.0295*	$1.6975
Barrels	*+$.0360*	$1.6755

CHICAGO AA BUTTER		
Weekly Change	*+$.0350*	$1.9900
Weekly Average	*+$.0510*	$1.9345
DRY WHEY		
Dairy Market News	w/e 07/31/15	$.3825
National Plants	w/e 07/25/15	$.3759

NON-FAT DRY MILK		
Week Ending 7/24 & 7/25		
Calif. Plants	$0.8036	11,734,576
Nat'l Plants	$0.8022	18,249,413
Prior Week Ending 7/17 & 7/18		
Calif. Plants	*$0.8599*	*9,169,968*
Nat'l Plants	*$0.8472*	*14,847,951*

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FRED DOUMA'S PRICE PROJECTIONS…

Aug '15 Est *: Quota cwt. $16.43 Overbase cwt. $14.74 Cls. 4a cwt. $12.84 Cls. 4b cwt. $16.24
July '15 Final: Quota cwt. $16.01 Overbase cwt. $14.31 Cls. 4a cwt. $13.09 Cls. 4b cwt. $14.98

**Note: This August projection includes the recently-announced CDFA changes to the Class 4b calculation. At current dry whey market prices of $.3825/lb (based on the Dairy Market News survey), the new formula increases the projected Class 4b price by $0.48/cwt and the quota/overbase prices by an estimated $0.22/cwt.*

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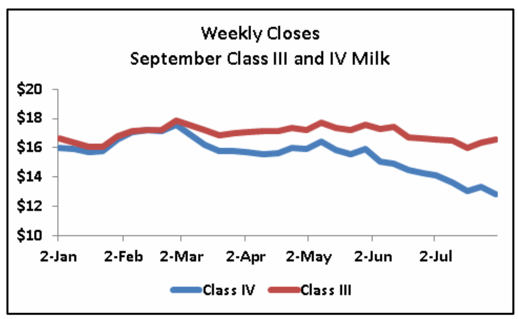
MARKET COMMENTARY: *(By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)*

Milk & Dairy Markets

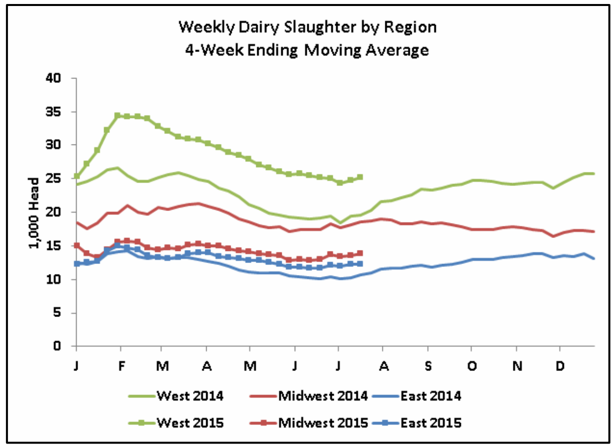
Bears are roaming freely at the world's commodity exchanges, from Chicago to London and Dubai to Dalian. But at the CME spot dairy market, the bulls will not be cowed. On Friday, CME spot butter traded at $2.00/lb. and closed at $1.99, up 3.5¢ on the week. Cheddar fared even better. Blocks ended at $1.7475, a nickel higher than last week. Barrels closed at $1.6975, up 3.75¢. Only the milk powder market acquiesced to outside pressure. Grade A spot nonfat dry milk (NDM) traded to new lows at 69.75¢ on Thursday and settled Friday at 70¢, down 1.25¢ on the week.



The spot market seems eager to believe that summer heat and school milk demand will cause a seasonal rally strong enough to trump concerns about falling overseas prices and rising U.S. dairy product inventories at home and abroad. The U.S. dairy markets typically gain ground as summer gives way to fall, and so this week August and September Class III futures settled 13¢ and 24¢ higher than last week, respectively. Deferred contracts were mixed. If the back-to-school rally leaves anything to be desired, the Class III market is likely to face a reckoning in September.

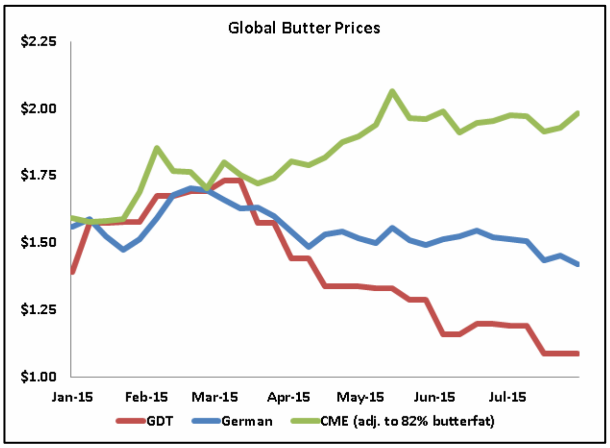
Class IV futures took the opposite stance. July through November futures settled 18¢ to 48¢ lower than last Friday, while deferred contracts moved upward. August and September contracts slipped below $13, widening the Class III-IV spread in those months to around $3.70/cwt. Dairy producers living in the cheese states are at a huge advantage to those whose milk goes to butter and milk powder processors.

Dairy producers in the West face lower milk checks and higher feed costs than their competitors in the center of the country and along the East Coast. This disparity has been readily apparent in the monthly Milk Production and weekly dairy cow slaughter reports. In the first half of the year, milk output in California and New Mexico was 3% lower than last year, and production in Oregon lagged 2014 by 1.7%. In contrast, year-to-date production is sharply higher in South Dakota (10%), Michigan (7.7%), Iowa (5%), Minnesota (3.9%) and Wisconsin (3.7%).



Regional culling trends draw the same dichotomous picture. Through mid-July dairy cow slaughter in Region 9, which includes California and Arizona, is up 11.9% from 2014. Slaughter is up 24.9% over the same period in Oregon, Washington and Idaho. In contrast, dairy culling in the Midwest and Plains has fallen 26.1% from year ago levels. This, along with the slow but persistent drip of herd dispersals in California has probably caused a decline in cow numbers. However, USDA's most recent Milk Production put the California dairy herd at 1.778 million head, down just 1,000 head from June 2014.

It seems likely that the California dairy herd is actually smaller than USDA reports, and that the indefatigable declines in California milk production have more to do with contraction in the herd than lower production per cow. The distinction is important. If milk production deficits can be explained away by unusually virulent mycoplasma in the spring and heat in the summer, then milk production is likely to rebound in the fall. But if there are fewer cows, milk output in California is likely to remain stubbornly low.



Cream prices are very high, even relative to the lofty butter market, and so manufacturers have often chosen to sell cream to makers of ice cream and dips rather than churn it. Thus the chasm between U.S. and international butter markets is likely to persist. Given very low whole milk powder prices, manufacturers in Europe and Oceania with flexibility are likely eyeing the U.S. butter market with relief, and switching their product mix to include more skim milk powder (SMP) and butter, some of which is likely to make its way to our shores.

Europe is awash in cheap milk powder, and the European Commission has agreed to extend the deadline for intervention purchases of both SMP and butter to the end of the year, eschewing the usual September 30 cutoff. As the *Daily Dairy Report* noted earlier this week, "[The program] could tighten available supplies of SMP because the product purchased by governments tends to stay off the market for longer periods of time compared to purchases by end users." The government could purchase up to 240 million pounds of SMP, the equivalent of 92% of record-high manufacturers' stocks of NDM in the U.S. at the end of May. If prices remain low, they could purchase an equal amount when volumes reset at the turn of the year. While this may reduce supplies for a time, milk powder will hardly be scarce. Stockpiles are large to the point of being burdensome in China and the U.S. and also in New Zealand, according to Friday's edition of the *Daily Dairy Report*, an unusual and disquieting situation for the island nation as it starts a new season.

<u>Grain Markets</u>

With another week of favorable weather and general malaise in commodity markets, grain prices could do little but move lower this week. December corn ended at \$3.8125, down 21.5¢. November soybeans fell 24.75¢ to \$9.4025. Funds who bought more corn contracts with every report of flooding in the Eastern Corn Belt have been dumping them over the past couple weeks. There is a risk that corn and soybean prices will mirror the recent rally, falling too far, too fast and then suddenly reversing course.

Grain analysts will spend the next few months trying to determine exactly how much damage was done to crops in the Eastern Corn Belt and whether these losses can be made up elsewhere. The market must also contend with the possibility of adverse weather in August or an early frost. After the recent sell-off, a bounce is quite possible.

But with large crops in South America and dimming prospects for U.S. exports, it seems unlikely that feed prices will soar anytime soon.

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AN UPDATE ON THE MARGIN PROTECTION PROGRAM: *(By Rob Vandenheuvel)* This week, the U.S. Department of Agriculture (USDA) announced their milk-price-over-feed-cost margin calculations for June. For those of you who signed up for the Margin Protection Program (MPP), you'll recall that payments under the program are based on USDA's calculation of the "margin" between the U.S. All-Milk Price and a national average feed cost, based on a pre-determined formula that incorporates corn, soybean meal and alfalfa prices. Now that we have the full information for the first six months of the year, let's take a look at USDA's margin calculations for that period:

	U.S. All-Milk Price Per cwt	Nat'l Avg. Feed Cost Per cwt	"Margin" Per cwt	2-Month Avg. Margin Per cwt
January 2015	$17.60	$9.26	$8.34	$7.996
February 2015	$16.80	$9.14	$7.66	
March 2015	$16.60	$9.07	$7.53	$7.504
April 2015	$16.50	$9.02	$7.48	
May 2015	$16.70	$8.87	$7.83	$7.995
June 2015	$16.90	$8.74	$8.16	

As a quick reminder, producers who enrolled in the MPP were able to select either the basic coverage of $4 per hundredweight *(which only required the $100 administration fee)* or opt into a higher level between $4.50 - $8.00 per hundredweight *(which required a premium in addition to the administration fee)*. Payments are available when a two-month average (the last column above) falls *below* the margin level you selected.

Given the escalating cost of the premiums for coverage at $7 per hundredweight or higher, most California producers who enrolled likely opted for coverage no higher than $6.50 per hundredweight. Using that assumption, clearly none of the first three "bi-monthly" margins have come anywhere close to generating a payment for those producers, as the lowest margin reported was $7.50 for the March-April 2015 period.

This is not completely unexpected. Looking over the past ten years, the periods of time that would have generated meaningful MPP payouts were 2009 *(when the U.S. All-Milk Price fell below $12/cwt)* and 2012 *(when national corn prices rose to more than $7.50 per bushel)*. As the table shows above, the figures being reported by USDA indicate that 2015 is a challenging year, but not to the catastrophic extent of 2009 and 2012. That would explain why the MPP has not generated any meaningful payments to participating producers in the first six months of this year.

Of course here in California, our producers are experiencing much more financially challenging times than USDA's data would indicate, particularly on the price our dairies receive for their milk. Our overbase prices in the first six months of 2015 ranged from $13.83-$14.64 per hundredweight – a significant discount to the U.S. All-Milk Price. While some of that can be attributed to the California Discount on Class 4b milk that this newsletter has referenced many times, we have also experienced a much larger impact than most of the country from the dramatic drop in nonfat dry milk prices – a drop of more than 60% from their peak in 2014. More than 35% of California's pay price for milk is directly tied to the market value of nonfat dry milk.

As you may have heard by now, July 1 through September 30 is the 2016 enrollment period for the MPP. While dairies that signed up for 2015 must continue to participate for the life of the five-year Farm Bill, the level of coverage and percentage of production you select can be modified from year-to-year. Over the next two months, we will go into some of the tools that are out there to assist dairies in evaluating their options for participation in this program. In the meantime, MPC members wishing to discuss their options in more detail can contact me at (909) 628-6018 or rob@milkproducers.org.

PUBLISHING NOTE: ***(By Rob Vandenheuvel)*** **Due to traveling conflicts, MPC's *Friday Market Update* will not be published next week. Our next issue will be August 14th.**