

# Milk Producers Council

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TO: DIRECTORS & MEMBERS

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## MPC FRIDAY MARKET UPDATE

### CHICAGO MERCANTILE EXCHANGE

Blocks  $-\$.0250$  \$1.0900  
Barrels  $-\$.0100$  \$1.0900

### CHICAGO AA BUTTER

Weekly Change  $+\$.0300$  \$1.2225  
Weekly Average  $-\$.0001$  \$1.1955

### NON-FAT DRY MILK

#### Week Ending 7/03 & 7/04

Calif. Plants \$.8134 14,516,472  
NASS Plants \$.8391 23,436,145

### Weekly Average

Blocks  $-\$.0060$  \$1.1090  
Barrels  $-\$.0028$  \$1.0960

### DRY WHEY

WEST MSTLY AVG w/e 07/09/09 \$.3200  
NASS w/e 07/04/09 \$.2811

**CHEESE MARKET COMMENTS:** Prices for blocks and barrels moved below the USDA support levels. Blocks dropped \$.025 per lb this week and are now priced \$.04 per lb below support. Barrels lost one cent. *Dairy Market News* (DMN) analysts did not report anything out of the ordinary to account for the continuing price weakness. The previous reports of more production than current demand, the fairly large inventories, and the full pipeline of product in the face of fair to indifferent consumer demand continues to be the defining story. Heavy selling of blocks on Thursday and Friday resulted in the week's losses. The market was still open when CWT issued its notice of a second herd retirement program this morning; that really should have at least steadied the market but either the release went unnoticed or sellers simply didn't care. Yes, there's money to be made in the way of profits from selling cheese from inventories later this year but the selling that is happening on the spot market right now just doesn't make any sense at all. Keep thinking less milk means less cheese means higher prices – some who are very knowledgeable see cheese prices in the \$1.70 range by Fall.

**BUTTER MARKET COMMENTS:** The three weeks of price decreases on the CME came to a halt this week. **The price rose \$.03 per lb.** Perhaps it was the announcement by Agriculture Secretary Vilsack earlier this week that the Dairy Export Incentive Program (DEIP) was re-activated for a full year (it had run for the final 39 days of the previous year, ending on June 30<sup>th</sup>). The DEIP includes 47 million lbs of butterfat in the form of butter and anhydrous milk fat products, and the indications gotten from the "trial" period that ended last week show that U.S. exporters were ready and able to move product off shore when the right kind of assistance is available. Most of the other important factors affecting butter prices also were positive: production has been declining, inventories were lower, and usage (except for exports) has been fairly good. Internationally, the supply-demand situation doesn't look very good; the European Union has 180 million lbs of butter in storage, purchased under their price support program, and world prices for the product, f.o.b. docks in New Zealand range from \$.79 to \$.95 per lb.

**POWDER MARKET COMMENTS:** Production of nonfat powders continues to ease downward as less milk becomes available, but sales to the CCC continue weekly and are expected to continue for the foreseeable future. That is, until the industry loses perhaps another 100,000 cows. The DEIP program generated 44.1 million lbs of exports with delivery periods ranging out to October. The major question being asked about those sales is whether they are extra, thereby representing about another 10 million lbs of sales per month, or whether they merely steal sales that would have been made anyway. The bonuses for those sales averaged about \$.09 per lb and are designed to provide to the sellers about what they would have gotten from making domestic sales. Milk production in California is headed for a pretty good decrease compared to last year, compliments of the devastatingly low milk prices and the CWT herd retirement programs. Check out the table in a following article that shows potential effects on dairy product production resulting from CWT's recently concluded HRP. DMN reports that some of that powder that was traded for low fat cheese and low fat milk for use in domestic feeding programs continues to seep back into the market. The theory still holds: the net effect of that program is a large

amount of additional use of dairy products of one kind or another and thereby a little less surplus of milk.

**WHEY MARKET COMMENTS:** DMN reports continue to show modest price improvements in the full line of products down stream from cheese production. However, dry whey prices show signs of leveling off, and resistance from buyers of whey protein concentrate products to higher prices continues to be expressed. The average of the West's "mostly" price for dry whey rose another half-cent this week.

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#### **FRED DOUMA'S PRICE PROJECTIONS...**

<b>July 10 Est:</b>	<b>Quota cwt. \$ 11.12</b>	<b>Overbase cwt. \$ 9.42</b>	<b>Cls. 4a cwt. \$9.91</b>	<b>Cls. 4b cwt. \$ 9.13</b>
<b>Last week:</b>	<b>Quota cwt. \$ 11.15</b>	<b>Overbase cwt. \$ 9.46</b>	<b>Cls. 4a cwt. \$9.85</b>	<b>Cls. 4b cwt. \$ 9.27</b>

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**NEWS FLASH: AUSTRALIA AND NEW ZEALAND ARE CONCERNED ABOUT REACTIVATION OF THE U.S. EXPORT SUBSIDY PROGRAM:** (By J. Kaczor) If Australia's and New Zealand's concern about the U.S. dairy product export subsidy program, DEIP, wasn't already completely clear, it has become so this week, after U.S. Secretary of Agriculture announced on July 6<sup>th</sup> that the subsidies were activated for another year. "Concern" doesn't really describe their position; anger and disgust may be closer to what they feel.

The *Dairy Export Incentive Program* operates on a fiscal year that runs from July 1<sup>st</sup> through June 30<sup>th</sup>. It was last used in January 2004, before it was belatedly activated last on May 22<sup>nd</sup> when Secretary Vilsack announced that subsidies for an entire year's worth of qualified products was available over the next thirty-nine days. (The volume of products eligible for receiving "bonuses" during the year, and the amount of money available for the bonuses, is fixed by agreements reached in past World Trade Organization negotiations.)

**The DEIP program works.** After Vilsack's announcement U.S. exporters were quick to find customers who were willing to accept competitive offers. USDA's *Foreign Agricultural Service* (FAS) accepted 27 bids to support export of a total of 44.1 million lbs of nonfat dry milk, 13 bids for 4.1 million lbs of butterfat, and 4 bids for 300 thousand lbs of cheese. The volume of products initially announced for the new fiscal year are the balances carried over from the thirty-nine sales days that ended on June 30<sup>th</sup>. It's expected that a full year's allocation (150 million lbs of nfdm, 47 million lbs of butterfat, 7 million lbs of various kinds of cheese, and 75 thousand lbs of whole milk powder) will eventually be announced for this year.

So what's got our friends down under in such a dither? They believe – at least they are saying – that the subsidies offered by the European Union and the U.S. [the EU subsidies were activated in January, were increased several times from their initial levels, and apply to several times the volume in the U.S. program] are suppressing world prices. Just to be clear, when they refer to world prices they mean **their** world prices for **their** growing volume of exports. Here are excerpts from stories coming out of Australia this week: "*Farmers to be hit after U.S. extends subsidies,*" "*Outcry over new U.S. dairy export subsidies,*" "*Fonterra hits out at U.S. protectionism.*" Similar stories directed at the U.S. stretch back to late May. They have a nice ring to them, don't they?

Are the complaints about suppressing prices justified? Fonterra certainly thought so about the EU subsidies in January and February, but later acknowledged – at least they said – that those subsidies were being used in a responsible manner. EU then increased their subsidies, **but the dairy product export volume of Australia and New Zealand simply continued to increase during that period over the previous year's levels**, and Fonterra recently reported a major sale of virtually its entire uncommitted powder inventory to China. How about the U.S. program? Secretary Vilsack could not have been clearer when he stated that the U.S. approach is designed as a "*measured approach*" to help U.S. exporters "*meet prevailing world prices.*" He also cited continuing "erosion" in the international market and EU's continuing use of subsidies to capture sales as reasons for activating DEIP. Indication that the statement about how the U.S. program will operate responsibly is not merely window dressing is the fact that the amount of money available in DEIP to subsidize exports of nonfat dry milk averages out to about \$.55 per lb, while the approved bids through June 30<sup>th</sup> averaged about \$.09 per lb, and the highest was

likely lower than \$.20 per lb.

One of Fonterra's concerns is that the EU may respond to the U.S. program with further increases in their subsidies. That's a valid concern; those subsidies are one of the factors used by FAS in pinpointing competitive prices, but they cannot be controlled by the U.S. Another concern is how careful FAS is in determining "prevailing world prices" when evaluating specific bids for bonuses. An FAS principal who outlined his approach said "if a product doesn't sell, the price is too high," meaning that a higher bonus is therefore justified. Perhaps so, but that statement is a major oversimplification of why a specific price does not sell a product – products can be priced at prevailing world prices but not meet prevailing quality, service, or reliability standards, all of which have been included among reasons why some U.S. exporters are best at selling when their prices are the lowest offered, and not very good otherwise. World buyers have the right and ability to buy from whomever they want, and all U.S. exporters need to understand that factors other than price are of critical importance.

Like it or not, Australia and New Zealand are going to have to learn to live in a competitive world situation where they don't set all the rules. It may help them to calm down if they review some of the other well known reasons they themselves have mentioned as to why prices for international dairy product sales, and prices, have fallen. Meanwhile, they and some other major international players continue to push for a final WTO agreement to abolish all dairy product subsidies and domestic price supports. That would be good for them, but not so good for many others. The U.S. dairy industry's position on that matter is "free trade agreements must be fair trade agreements." That means tariffs, quotas, various and sundry product definitions that effectively act as trade restrictors, and maybe even a close look at large marketing cartels that operate almost as state-operated agencies, must be added to the review, in the interest of fairness.

**CWT ANNOUNCES ANOTHER HERD REMOVAL PROGRAM!** *(By J. Kaczor)* This morning CWT announced another herd removal program is underway. Having just completed the removal of the last cows involved in the program that began with the bidding period that ended on May 1<sup>st</sup>, **producers who are members of CWT have until July 24<sup>th</sup> to submit bids** for a second chance to close down their operations this year. While bids can come in at any level, this round sets **\$5.25 per cwt as the maximum bid to be accepted**. The recently added provision that a successful bidder initially be paid 90% of the amount bid with the remaining 10% plus interest paid a year later after verification that the producer did not engage in active milk production on the facility where the milk had been produced continues to apply, as well as the requirement that all milk production facilities in which the bidder has an interest be included in the bid. Two additional changes apply to this round: no producer who **successfully** bid in an earlier herd removal program will be accepted this time, and any bidder who is initially approved who opts out before the cows are tagged for removal will be excluded from future cow removal programs.

DMN reports that, through June 20<sup>th</sup>, 186 thousand more dairy cows were slaughtered this year than last. That number includes about 70,000 from the recently concluded HRP. The balance of the 101 thousand cows in that program will show up in the next three weekly reports.

Following is a recap of the potential effect on production of some major dairy products resulting from the HRP that just ended. The figures represent the amount of product that could have been produced per month from the milk that was associated with the cows that were removed.

Cheese	15,000,000 lbs
Dry Whey	8,000,000 lbs
Butter	6,500,000 lbs
Buttermilk Powder	650,000 lbs
Nonfat Dry Milk	12,500,000 lbs

Expect to see **some combination** of the cheese/butter/powder numbers drop away from the production reports published by NASS, starting with the month of July (a partial effect) and continuing on through the summer and into the Fall. The effects of the newly announced HRP will begin to show up in the report for September.

**MPC TO PRESENT THE HOLSTEIN ASSOCIATION PLAN AT NATIONAL MILK PRODUCERS FEDERATION TASK FORCE MEETING:** *(By Rob Vandenheuvel)* On July 20<sup>th</sup>, MPC will join Holstein Association USA and Dairy Farmers Working Together (a group of dairy farmers out of Vermont) in presenting the “Dairy Price Stabilization Program” (DPSP) to the National Milk Producers Federation (NMPF) Strategic Planning Task Force. As the readers of this newsletter know, the DPSP is a program that is identical in concept to the Growth Management Plan, which MPC has been discussing for the past two years. The NMPF Task Force was made up of industry leaders throughout the U.S. If the industry is going to seriously consider a long-term policy proposal such as the DPSP, this group will have to play a leadership role in that.

Over the past couple months, there has been growing support for the DPSP. Many individuals have logged their support for the plan on: <http://www.holsteinusa.com/association/dairyprice.html>. In addition a growing number of groups have endorsed the DPSP, to MPC and Dairy Farmers Working Together, a growing number of groups have endorsed (at least in concept) the Holstein Association plan, including:

- Addison County Young Farmers (*Vermont*)
- California Dairy Campaign
- Dairy Farmers Working Together (*Vermont*)
- Farmers Union Milk Producers Association (*Pennsylvania*)
- Lanco-Pennland Quality Milk Producers (*Maryland/Pennsylvania*)
- Pennsylvania Holstein Association
- Washington State Dairy Federation
- Western United Dairymen.

We have also started to hear some of the opposing arguments to the DPSP. The most prominent argument against the plan is that it is government intervention into our industry (*as if the government isn't already heavily involved in the U.S. dairy industry*). Some even go as far as to compare it to the quota systems in Canada or Europe. Frankly, these arguments fall apart as soon as you actually read the DPSP.

To those who have really studied the DPSP, it is clear that it is **nothing** like the government-run quota systems in Canada and Europe. The European and Canadian systems create a huge differential between “quota” milk and “surplus” milk. That quota is fixed and permanent. Quota can be transferred from producer to producer, but it requires a massive transfer of capital (around \$30,000 per cow in Canada) from the new or expanding producer to the retiring producer, which severely hampers the continuing producer from investing capital in production efficiencies. This also creates a real barrier to new producer entry and a tremendous disincentive to expansion. As a practical matter, it has stymied the modernization of the producer sector and forced Canada and Europe to enforce strict import restrictions to maintain domestic milk production.

**The DPSP, on the other hand**, is a uniquely-American concept that merely creates a modest financial incentive for dairies to actually manage how much milk they are producing. While there is a “base” utilized in the DPSP, it is earned and expands with the market. It does not accrue a value, because it cannot be transferred. It does not accumulate value, because the price to earn it is modest and producers can choose when it makes sense for them to expand and therefore earn additional base. The revenue generated by the earning of base goes to the continuing producers who have decided to hold their production to allow increased market demand to be captured by those producers who seek to capture it.

In reality the American dairy industry operating under the DPSP would look much more like any other industry operating in a relatively free market. If someone wants to start a new business in a mature industry like the dairy industry, they need to earn market share. They do this by either putting out a better product or service, or putting out that product or service at a cheaper price, or both. What they are not able to do is simply show up and command a pro rata share of the market, like we have been able to do in the dairy industry.

In the past, I have included in this newsletter some of the “frequently asked questions” we’ve gotten on the Growth Management Plan. Those Q&A’s, along with other material, has been posted on our website, and I encourage anyone interested in this debate to check it out: <http://www.milkproducerscouncil.org/GMP.htm>. Recently, we have gotten other questions and concerns raised about the DPSP, and next week I’ll go into some of those other arguments.

I realize that not everyone will embrace this plan. Quite frankly, I'm sure we all would prefer to operate in an industry where we can produce as much milk as possible and always be profitable. Unfortunately, we're finding out the hard way that doesn't work. We have to make adjustments to our industry if we want to have a viable future. MPC is supporting the DPSP because we believe it would keep our supply in better balance with demand, while maintaining the flexibility and growth-oriented nature of the U.S. dairy industry. Would it solve every problem in our industry? Of course not. But until and unless we do something to address these imbalances in supply and demand that lead to the massive boom/bust cycles in the milk price that are getting worse with each cycle, we simply don't have a sustainable industry.

So for those that don't like this plan, here is my challenge: **Bring your alternative to the table.** If you don't like this plan, bring your ideas and let's have a debate. **The status quo is not an option.** An industry where only those with massive outside fortunes can survive the downturns is not a healthy industry. **The time for this debate is now** and simply lobbing bombs at the DPSP without coming up with alternatives is not an honest debate.

**REMINDER – CONGRESSIONAL COMMITTEE TO EXPLORE DAIRY CRISIS AT NEXT TUESDAY'S HEARING:** *(By Rob Vandenheuvel)* As I noted in last week's newsletter, the House Agriculture Subcommittee on Livestock, Dairy and Poultry has scheduled a hearing on July 14<sup>th</sup> at 10 a.m. ET **“to review economic conditions facing the dairy industry.”** For those of you interested in tuning in, it will be broadcast live on the Committee's website (<http://agriculture.house.gov/hearings/audio.html>) at 7 a.m. Pacific Time on Tuesday, July 14<sup>th</sup>.

**MPC MONTHLY BOARD MEETING NEXT TUESDAY AT THE CHINO OFFICE:** *(By Rob Vandenheuvel)* Next Tuesday (July 14<sup>th</sup>) at 11 a.m., MPC will be holding its monthly board meeting at the Chino MPC office (5370 Schaefer Avenue, Suite A, Chino CA 91710). As always, **all MPC members are welcome (and urged) to attend and participate in our board meetings.** Lunch will be provided, so if possible, please RSVP with Debi at the MPC office (909-628-6018).