Milk Producers Council

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DATE: November 13, 2009 **PAGES: 4**
TO: DIRECTORS & MEMBERS **FROM: John Kaczor**

MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks	*+$.0150*	$1.5750
Barrels	*-$.0825*	$1.4425

Weekly Average

Blocks	*+$.0375*	$1.5710
Barrels	*-$.0295*	$1.4740

CHICAGO AA BUTTER

Weekly Change	*+$.0250*	$1.5250
Weekly Average	*+$.0920*	$1.5250

DRY WHEY

WEST MSTLY AVG	w/e 11/5//09	$.3600
NASS	w/e 10/31/09	$.3439

NON-FAT DRY MILK
Week Ending 10/30 & 10/31

Calif. Plants	$1.1078	5,957,999
NASS Plants	$1.1215	9,706,953

CHEESE MARKET COMMENTS: Activity on the CME over the past two weeks seems to reflect a tight market for Cheddar blocks and a surplus of barrel cheese. *Dairy Market News* (DMN) reporters tell of barrel cheese that was bought and stored earlier this year is being used now which depresses sales of current production. Weekly reports to NASS over the past four weeks show steadily lower volumes of barrel being sold while block volume has held steady. DMN reports that some cheese packagers are backed up because of heavy orders. The current price spread between blocks and barrels, $.1325 per lb, reflects the market's short term response to a surplus of barrel cheese only, but it would not be surprising to see prices for blocks weaken a bit until barrel prices stabilize. DMN also reports that some milk is moving from cheese vats to butter churns, but there is still plenty of milk for cheese, and the higher protein component of current milk production is beginning to boost cheese yields. Monthly exports of all kinds of cheeses have been holding steady through the summer at about 18 million lbs.

BUTTER MARKET COMMENTS: Prices on the CME rose on Monday and held steady for the rest of the week. Trading volume was heavy. Much of it was offers, readily accepted at current or slightly higher prices. It looks like buyers have become believers – that butter availability is tightening to the point where there is concern about not getting enough product to fill orders. Part of that belief comes from continuing DMN reports that international buyers have not been put off by the recent price increases and are continuing to ask around. Domestic sales, boosted by retailer ads and normal seasonal demand, are strong. Exception to that is the restaurant industry, other than the fast food sector which is not a particularly heavy user of butter. The report of the sharp reduction in butter production in September, along with strong sales of other cream products, suggests that butter prices should continue to go higher. Rising domestic and international prices appear to have put an end to DEIP approved exports; the last one accepted was October 29th, for delivery before the end of the year. Exports of butter in September were slightly higher than the very low volumes earlier this year; the average price was about $1.20 per lb, likely reflecting DEIP subsidized sales. Question: who are those international buyers who apparently are willing to pay about $1.60 per lb for butter, plus shipment costs?

POWDER MARKET COMMENTS: Prices for lower volume shipments of nonfat dry milk last week, reported by NASS and by California plants, were sharply higher than previous weeks' levels. Prices for plants reporting to NASS rose by $.1022 per lb; prices for California plants rose by $.1438 per lb. Last week's prices included the last of the DEIP subsidized sales which ended on October 31st. These new levels reflect more current sales, although it's going to take a while to see where prices may be going. DMN missed the call this week by a wide margin by saying buyers are resisting the higher prices, and prices are steady to lower. That's what was happening two weeks ago. It will take a while because of the industry's practice of indexing current sales to past price levels and other factors. DMN reports that production of nonfat dry milk is slowing at least partly because of how much milk is being taken for all other uses. The California plant average price has jumped up to the point where it is finally within the range of the West's "mostly" price range; the NASS price is about $.10 per lb below the low end of the Central region's "mostly" price, which should bode well for future price movements. DMN reports manufacturers' stocks are light to moderate. Prices for dry buttermilk and dry whole milk are firm. Interesting statistic: U.S. exports of nonfat dry milk and skim milk powder in the July-September period were 20% lower than the same period a year ago while Australia's exports of skim milk powder were 38% higher, while their milk production for that period was 4% lower. Doesn't it continue to look like the major U.S. exporters get only what others permit them to have, or what extraordinary circumstances gift them? U.S. exports of nonfat dry milk for the year so far: 44% below the same period a year ago.

WHEY PRODUCTS MARKET COMMENTS: The highlight this week is the continuing strong demand for commodity-grade whey protein concentrate. The price range increased again and the mid-point is now up to $.815 per lb. WPC prices for the past four and a half months have been tracking closely to 2006's pattern which ended the year close to $.90 per lb. Prices for dry whey also edged upward. DMN reports that manufacturers' stocks of WPC are tight and much of the cash sales are being made from wholesalers' stocks. Production of dry whey continues to track with cheese production, and it's believed that it may have leveled off, at least for a short time, perhaps until the spring milk flush begins. Exports of dry whey for the first nine months of the year are about even with 2008's levels. Exports of WPC for the same period are about 10% higher.

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FRED DOUMA'S PRICE PROJECTIONS…

Nov 13 Est:	**Quota cwt. $ 14.56**	**Overbase cwt. $12.87**	**Cls. 4a cwt. $12.60**	**Cls. 4b cwt. $13.66**
Last Week:	**Quota cwt. $ 14.47**	**Overbase cwt. $12.77**	**Cls. 4a cwt. $12.43**	**Cls. 4b cwt. $13.59**

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USDEC GETS IT RIGHT – AND WRONG: *(By J. Kaczor)* In a press release dated November 5, 2009, the U.S. Dairy Export Council (USDEC) reports on their recent presentation to the Office of the U.S. Trade Representative, the major negotiator for the U.S. on international trade matters. They did an excellent job of identifying a number of significant technical specifications that have been erected by some of our major trading partners which either prevent or at least impair U.S. exports of important dairy commodities to those countries. Examples given include China (whey products), Mexico (fluid milk), Canada (cheese), Algeria (skim milk powder), and India and Indonesia (most products). This is an example of one of the many things USDEC does very well. They have worked diligently to develop a massive amount of technical, administrative, and procedural information of great value to current and future U.S. exporters. Their reputation in that field is unmatched. Good job, USDEC.

What USDEC doesn't do well is when they occasionally assume credit when exports rise, give reasons when exports fall, and lobby positions on industry matters which clearly are outside of their realm of responsibility and expertise. The assumption of credit may be inadvertent, but it's not suitable. Because USDEC's expressed positions on most industry matters that we hear about are almost always identical to those of a national producer association or a national processor association, one has to wonder about their objectivity and independence. That is an important concern, because USDEC, in footnotes to their press releases, identifies themselves as an "independent membership organization." They are not that; they are a governmental organization because 80% of their operating funds come directly from USDA, 15% comes from Dairy Management, Inc., (which, according to not so distant court rulings, is itself a government program), and about 5% from cooperatives and other companies who use USDEC's services. This "independent membership organization" recently appeared before the House subcommittee on Livestock, Poultry, and Dairy and spoke out against an important industry program designed to help stabilize milk prices. We wonder how much coaching they were given for that appearance, and where it came from. Bad, divisive, and inappropriate, USDEC.

MPC PARTICIPATES IN CDFA PRICING HEARING: *(By Rob Vandenheuvel)* As regular readers of our newsletter are already aware, the California Department of Food and Agriculture (CDFA) held a hearing this past Monday to consider changes to the five minimum price formulas in California.

In our testimony, MPC supported both the proposals that were originally submitted:

- A proposal to permanently increase class 1, 2 and 3 prices (this was proposed by the Alliance of Western Milk Producers and would increase pool prices by about $0.10 per cwt).
- A proposal to temporarily (six months) increase all five class prices (this was proposed – and later withdrawn – by Western United Dairymen and would have increased pool prices in January-June 2010 by $0.50 per cwt).

While we supported these two proposals to increase producer prices, MPC felt there were two vital issues that also needed to be presented to CDFA. These issues – relating to how nonfat dry milk and dry whey are valued in the minimum price formulas – could play a huge role in the recovery of producer prices.

Both California and the Federal Milk Marketing Orders (FMMO) operate an "end product pricing" system that determines a minimum price for each class of milk based on the value of four basic commodities: cheese, butter, nonfat dry milk and dry whey. While these systems work similarly, there are key differences that make California producers vulnerable to getting significantly out-of-line with producers in the FMMO areas.

One of the big vulnerabilities is the way California values the whey solids stream versus how it's valued in the most of the rest of the country. The FMMOs continue to utilize a variable dry whey factor in their Class III formula that moves up and down as the NASS dry whey price moves up and down. In fact, their formula – which includes a make allowance of $0.1991 per pound and a yield of 5.9 pounds of dry whey produced for every hundred pounds of raw milk – is **already adding additional revenue for FMMO producers**. Unfortunately, California's class 4b formula includes no such variable dry whey factor. Instead, our formula includes a fixed $0.25 per hundredweight factor to account for the value of the whey stream. The table below compares the value that the whey stream adds to the FMMO Class III versus the California Class 4b at various dry whey values.

NASS Dry Whey	FMMO Class III Whey Value	CA Class 4b Whey Value
$0.25	$0.31	$0.25
$0.30	$0.61	$0.25
$0.34	**$0.88**	**$0.25**
$0.40	$1.22	$0.25
$0.45	$1.52	$0.25
$0.50	$1.83	$0.25
$0.55	$2.13	$0.25
$0.60	$2.44	$0.25
$0.65	$2.74	$0.25
$0.70	$3.04	$0.25
$0.80	$3.65	$0.25

As you can see from the table, California producers **are in danger of falling significantly out of alignment with producers that operate in Federal Order areas**. Even at the current dry whey value – $0.3439 according to the most recent NASS report – there is a gap of $0.63 per hundredweight between the $0.88 per hundredweight value that dry whey is adding to the Federal Order Class III price versus the fixed $0.25 value that is added to the California class 4b price. **And if the dry whey market continues to strengthen as it has been doing in recent months, that gap will continue to grow exponentially.**

So what did MPC offer at this week's hearing? MPC put forth an alternative proposal that if implemented, would allow producers to get a share of the whey stream revenue. Our proposal would maintain the fixed $0.25 per hundredweight fixed factor, and whenever the NASS dry whey price moves up above $0.35 per pound, producers and processors would share the additional revenue from that whey stream. The table on the next page is the same as the table above, but adds an additional column to show how MPC's proposal compares to the current California and FMMO formulas.

NASS Dry Whey	FMMO Class III Factor	Current CA Formula	MPC's Proposal
$0.25	$0.31	$0.25	$0.25
$0.30	$0.61	$0.25	$0.25
$0.34	**$0.88**	**$0.25**	**$0.25**
$0.40	$1.22	$0.25	$0.40
$0.45	$1.52	$0.25	$0.54
$0.50	$1.83	$0.25	$0.69
$0.55	$2.13	$0.25	$0.83
$0.60	$2.44	$0.25	$0.98
$0.65	$2.74	$0.25	$1.12
$0.70	$3.04	$0.25	$1.27
$0.80	$3.65	$0.25	$1.56

Looking at this chart, one question that may come to mind is, "Why did MPC put forth a proposal that provides California producers with less of the whey stream revenue than producers in the FMMOs?" The answer is quite simple: we structured our proposal to be so generous because of the importance of getting this policy in place **now**. While the issue of how to value the whey stream revenue in California's formulas is certainly not a new issue, it's one that has been controversial in recent years. That is why MPC felt we needed to craft a generous proposal that had a legitimate possibility of garnering immediate support from both the producer and processor sectors. **We needed a deal now to make sure producers get at least some of the revenue from the rising whey market in the coming year.**

As I listened to the testimony at the hearing, one disappointment of mine was that no cheese maker expressed any support for the proposal, or even interest in making a counter proposal. While I'm sure those cheese makers love having a fixed $0.25 per hundredweight whey factor (since that means they get to keep ***all*** the revenue from a potential run-up in whey values), I had hoped that at least one cheese maker would recognize that this was an extremely generous proposal by MPC and work with us on it.

However, a much larger disappointment of mine was in the response – or lack of response – to this proposal by the producer sector. California producers stand to miss out on a substantial revenue stream if the whey market continues to strengthen. And while MPC reached out to several producer groups and cooperatives, the response was total silence. Not a single producer group or cooperative even took a formal position on our proposal – many simply stated they were "neutral" on the issue. I can only hope that CDFA is able to look past that and give producers some share of the revenue from the whey stream. If not, the individuals and groups that lead the producer sector of our state will look incredibly foolish for not supporting this proposal.

As I try to make logic of the whole thing, I can wrap my head around why our state's cheese makers wouldn't take a big interest in the proposal. While it's an extremely generous proposal – giving a huge share of the whey revenues to the processors – it's still not as generous as the fixed $0.25 per hundredweight factor we have now in the formula.

But why any group in the state that claims to represent producers wouldn't support this proposal is beyond my comprehension. The cooperatives and producers groups had witnesses at the hearing to express their support for the Alliance of Western Milk Producers proposal – an increase of $0.10 per hundredweight for California producers. My comments are not intended to diminish that proposal – MPC supported it as well. By why didn't those same groups take a position on our common sense proposal that makes sure our producers don't completely miss out on a run-up in the whey market? These groups are clearly not against it – if they were, they would oppose it. So why take no position at all? These are just some of the questions I hope each of you will ask the individuals and groups that represent you as producers.

MPC submitted a post-hearing brief to amplify some of the parts of our testimony. For those interested in reading the full post-hearing brief, you can find it at www.milkproducerscouncil.org/110909posthearing.pdf.