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: June 12, 2015 **PAGES: 5**
TO: Directors & Members **FROM: Rob Vandenheuvel, General Manager**

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE		
Blocks	*+$.0400*	$1.7550
Barrels	*+$.0800*	$1.7225
Weekly Average, Cheddar Cheese		
Blocks	*+$.0080*	$1.7450
Barrels	*+$.0130*	$1.6995

CHICAGO AA BUTTER		
Weekly Change	*N/C*	$1.9000
Weekly Average	*- $.0690*	$1.8725

DRY WHEY		
Dairy Market News	w/e 06/12/15	$.4200
National Plants	w/e 06/06/15	$.4369

NON-FAT DRY MILK		
Week Ending 6/5 & 6/6		
Calif. Plants	$0.9360	12,683,916
Nat'l Plants	$0.9470	22,594,394
Prior Week Ending 5/29 & 5/30		
Calif. Plants	*$0.9343*	*24,219,529*
Nat'l Plants	*$0.9406*	*37,118,680*

***

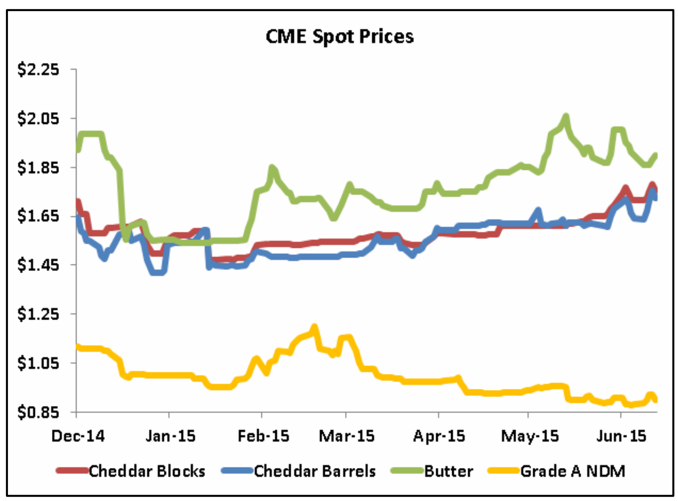
FRED DOUMA'S PRICE PROJECTIONS…

Jun 12 Est:	**Quota cwt. $16.60**	**Overbase cwt. $14.90**	**Cls. 4a cwt. $13.69**	**Cls. 4b cwt. $15.80**
Last Week:	**Quota cwt. $16.50**	**Overbase cwt. $14.80**	**Cls. 4a cwt. $13.71**	**Cls. 4b cwt. $15.58**

***

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

<u>*Milk & Dairy Markets*</u>

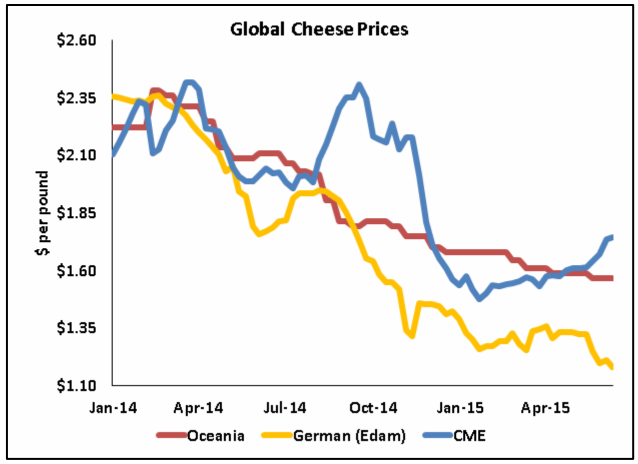


CME spot Cheddar blocks and barrels climbed to fresh 2015 highs Thursday. Although they lost ground on Friday, they still ended notably higher than last week. Blocks gained 4¢, closing at $1.755/lb. Barrels jumped 8¢ to $1.7225 after 22 trades. July through November Class III futures rallied roughly 20¢ this week, while deferred contracts languished.

Grade A nonfat dry milk (NDM) followed Cheddar's lead, climbing early in the week and then falling back. It closed at 89.75¢, up 1.75¢ from last Friday. CME spot butter retreated Monday but regained some ground Thursday and again Friday. It closed the week right where it began, at $1.90/lb. Butter futures shrugged off the late-week strength and closed a few cents lower than last Friday. Class IV futures were less than impressed. They settled between 9¢ and 30¢ lower.

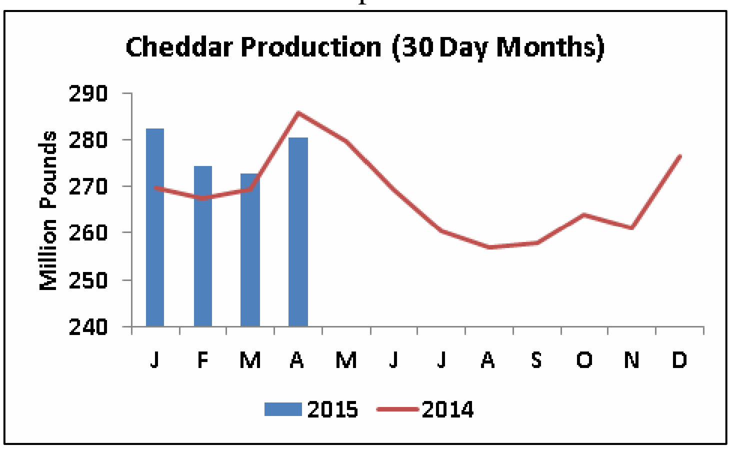
Dairy product prices continue to slip in Oceania and Western Europe. According to *Dairy Market News*, prices for butter, skim milk powder (SMP) and whole milk powder (WMP) have fallen 8.2%, 1.2% and 4.2%, respectively, over the past two weeks. Butter and SMP prices held steady in Western Europe, but WMP lost 0.9% and the whey powder market is 2.5% lower than it was at the end of last month. The price of German Edam has fallen 10.8% over the past month to its lowest level in more than a decade.

In the wake of the Russian import ban, it is not surprising to see the European cheese market slide. It is remarkable that U.S. cheese prices have not come under similar pressure. European exporters have been going head-to-head with U.S. merchants, and, given advantages in currency and absolute prices, they were expected to displace large volumes of U.S. cheese. In the first four months of the year, U.S. cheese exports have fallen 10.5% from the record levels of early 2014. However, they are still 24.8% above 2013 volumes. As the *Daily Dairy Report* noted earlier this week, "The fact that cheese exports have not fallen more steeply suggests that American exporters have won the loyalty of their customers, which is likely due to product specifications."



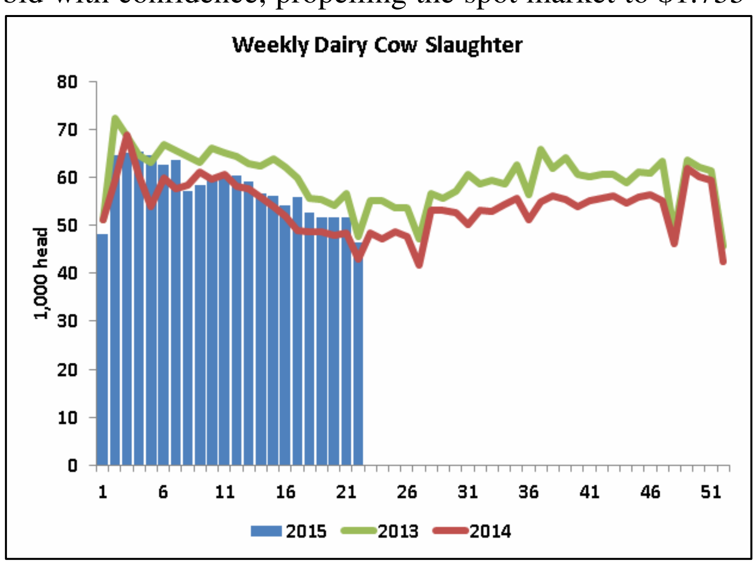
Responding to consumer demand, American cheesemakers have made large volumes of specialty cheeses, leaving less capacity for commodity cheeses. Although U.S. cheese output in April was 1.9% greater than in 2014, Cheddar production fell 1.8% from year-ago levels, and only Cheddar qualifies for delivery at the CME. Strong domestic demand and reduced Cheddar output have allowed for CME spot and nearby cheese futures prices to rally.

However, commodity cheese output is likely to rise. As *Dairy Market News* noted last week, "Specialty cheeses can slow overall cheese output… Manufacturers strive to keep longstanding specialty customers satisfied but also seek to balance the specialty capacity required to that end, against moving more milk volumes through plants by making non-specialty varieties." The U.S. cheese market, already besieged with product from overseas, may face pressure at home as well.



Furthermore, changes in market structure have become less rewarding for those looking to buy cheese today and sell it at a later date. In early May, spot Cheddar blocks were $1.61/lb. and nearby futures were $1.657. October through December cheese futures were over $1.80. The futures market provided the opportunity for traders to buy cheese and store it, recouping nearly 20¢ for their trouble.

This carry structure has likely encouraged end users to bid with confidence, propelling the spot market to $1.755 today. But spot cheese and nearby futures have rallied more quickly than deferred contracts, and the nearly 20¢ carry has diminished to around a dime. The appetite to purchase spot cheese has likely diminished as well, but cheese production has not. Cheese buyers have spent months filling their warehouses in anticipation of fall demand, and they are well stocked. If output remains strong, some cheese may have difficulty finding a home in the coming months.



Consumers are greeting the arrival of summer with ice cream in hand. Ice cream makers have stepped up production in order to compensate for dumped product from two manufacturers battling listeria outbreaks. This is drawing heavily on cream supplies, reducing the amount available for butter churns.

For the week ending May 30, which included Memorial Day, dairy producers slaughtered 46,490 head, up 8.4% from the same week in 2014. So far this year, dairy cow slaughter is 4.4% ahead of last year's pace.

Grain Markets

Soybean futures parted ways this week. The July contract closed at $9.40, up a few cents. November soybeans ended Friday at $9.0425, down a dime from last week. The divergence reveals a market in transition. Soybean and soybean meal supplies are tight and moving very slowly from farmers to end users. But this year's crop is expected to be large and farmers in South America hold large inventories in the midst of a record-breaking harvest. Dairy producers and other end users can expect lower oilseed costs this fall, but they may have to put up with a few more months of stubbornly high prices. Soybean meal futures continue to hover around $300 per ton.

Grain costs, on the other hand, continue to slide. Corn futures lost 7¢ this week. The July contract settled at $3.53/bushel. USDA's monthly World Agricultural Supply and Demand Estimates held no real surprises for the corn or soybean markets. Changes to row crop balance sheets were unremarkable and widely expected. However, USDA's assessment of wheat production caught the trade off guard. Ahead of the report, market analysts anticipated a decline in winter wheat production, as heavy rains in the Central Plains may have damaged the crop. USDA instead raised its estimate of winter wheat production by 90 million bushels to 1.51 billion bushels, assuming that the rains allowed the crop to flourish after a rather dry start. Wheat futures have dropped nearly 30¢ in the wake of the report. Corn prices also came under pressure.

With the report behind them, the trade will once again focus on the weather. It's too wet in some areas, and a number of fields could require replanting. Young corn plants also face nitrogen leaching, which could crimp yields. For now, however, the trade is of the opinion that rain makes grain, and we've already got plenty of it.

***

PART TWO IN THE SERIES ON THE CA-FEDERAL ORDER: CLASSIFIED PRICES: *(By Rob Vandenheuvel)* With the CDFA hearing on our State's Class 4b calculation come and gone (we now just await the final decision by Secretary Ross, expected sometime in July), we can turn our attention back to an examination of the proposals for a California Federal Milk Marketing Order (CA-FMMO). For those of you who missed the first article in this series – delving into the issue of California's quota system and it's operation within a CA-FMMO – we are posting this series on our website at: http://www.milkproducerscouncil.org/cafmmo.htm.

In particular, this series is comparing the various proposals submitted to USDA for consideration in a CA-FMMO hearing. As a quick reminder, there are four proposals, submitted by the following parties (the first two are complete proposals; the last two are focused only on specific pieces of a CA-FMMO):

1. The three major California cooperatives (California Dairies, Inc., Dairy Farmers of America and Land O'Lakes) *(with unified support from the boards of California Dairy Campaign, MPC and Western United Dairymen)*
2. The Dairy Institute of California (on behalf of the California milk processors they represent)
3. The California Producer Handler Association (on behalf of Foster Dairy Farms, Hollandia Dairy, Producers Dairy Foods and Rockview Dairies)
4. Ponderosa Dairy (a large dairy farm Amargosa Valley, Nevada)

This week, we are discussing the calculation of monthly minimum prices under the proposed CA-FMMO. We will be focused only on the first two proposals above, as the last two do not propose any specific details on calculating monthly minimum prices.

<u>First, some background</u>

As you know, under both the California State Order and the Federal Milk Marketing Order systems, milk is divided up into various "classes" – depending on what the buyer of the milk is manufacturing. For instance, milk sold to be put into bottles and marketed as a fluid product is identified as "Class 1" milk in California (and "Class

I milk in the FMMO system). While the California and FMMO systems have slight variations in how they classify milk, they are not that different.

<table>
<tr><th></th><th>California “Class”</th><th>FMMO “Class”</th></tr>
<tr><td>Fluid products</td><td>1</td><td>I</td></tr>
<tr><td>Soft products – yogurt, sour cream, etc.</td><td>2</td><td rowspan="2">II</td></tr>
<tr><td>Frozen products</td><td>3</td></tr>
<tr><td>Butter/nonfat dry milk and related products</td><td>4a</td><td>IV</td></tr>
<tr><td>Cheese products</td><td>4b</td><td>III</td></tr>
</table>

Each month (except for California Class 2 and 3, which have bi-monthly prices), CDFA and USDA announce prices for each of these classes. Regular readers of this newsletter are well-aware of the significant gap between the California Class 4b price and the FMMO Class III price (the “California Discount”), but we rarely discuss how our prices differ in the other classes. That is primarily because the other California classes maintain a much closer relationship with their FMMO counterpart classes.

PROPOSAL ONE – The Cooperatives

This piece of the proposal is simple and straightforward (never thought I’d use the word “simple” on a FMMO proposal, right?). In short, the Cooperatives’ proposal would calculate all four of the CA-FMMO classes in ***exactly the same way*** it is calculated in the other ten FMMOs.

In the case of Classes II, III and IV, this proposal would result in monthly prices equal to the Class II/III/IV prices used in every one of the ten FMMOs around the country. **No more “California Discount.”**

In the case of Class I, a common base price is used in each of the ten FMMOs, but bottling plants ultimately pay for their milk based on the county they are located in, and each county has a different “Class I differential.” For instance, in May 2015, the base price for Class I was $15.83/cwt. A Class I plant in Seattle, WA (King County) had a Class I price of $17.73/cwt (their differential is $1.90/cwt above the base price each month). Under the cooperatives’ proposed CA-FMMO, a Class I plant in Los Angeles County would have a Class I price of $17.93/cwt (the LA County differential is $2.10/cwt above the base price). The Class I differentials for each county in the U.S. were established a number of years ago by USDA, and the cooperatives’ proposal simply utilizes that existing map/schedule.

So as you can see, while the Class I prices under the cooperatives’ proposal would differ based on the location of the plant, they are still proposing the exact same base price and differential system that exists in each of the ten current FMMOs.

As an illustration, below is a comparison between the actual average California class prices we saw in 2014 vs. the prices that would have been in place under the cooperatives’ proposed CA-FMMO. *(Also noted is the approximate percentage of the California pool that each class made up in 2014.)*

2014 Annual Average Prices	Actual California	CA-FMMO Coop Proposal	Difference	% of the CA Pool
Class 1 (CA) and Class I (FMMO)*	$25.03	$25.39	+$0.36	13%
Class 2/3 (CA) and Class II (FMMO)**	$22.90	$23.34	+$0.44	8%
Class 4a (CA) and Class IV (FMMO)	$22.00	$22.09	+$0.09	33%
Class 4b (CA) and Class III (FMMO)	$19.93	$22.34	+$2.41	46%

** For an apples-to-apples comparison, the actual Southern California Class 1 price was compared to the proposed LA County Class I price.*
*** I simply averaged the Southern California Class 2 and Statewide Class 3 prices for the California figure.*

PROPOSAL TWO – The Dairy Institute of California

The Dairy Institute of California (DIC), on behalf of their processor members, has proposed that USDA go a different route – one *unlike any* of the ten current FMMOs (which is ironic, as they publicly criticize the Cooperatives' for proposing other provisions different from the ten current FMMOs).

The DIC proposal asks USDA to establish California-specific monthly prices for each of the classes. While manufacturers in the rest of the country are operating under the same pricing formulas, the DIC is proposing that their members be subject to a unique (and most likely lower) price in California.

Specifically, the DIC proposes that rather than base the monthly milk prices on national average prices for cheese, butter, nonfat dry milk and dry whey (which is what the current FMMO formulas use), USDA should use a "Western" average price. Further, they ask that USDA use a "Western" estimate of manufacturing costs to use as a make allowance in the formula, rather than the make allowances currently used in the FMMO formulas.

In the absence of this new "Western" data (since USDA is not already reporting such data), the DIC is proposing that we use the national price data, but discount it. They propose the following discounts from the national average prices reported by USDA:

- The national Grade AA butter price minus $0.0208/pound
- The national nonfat dry milk price minus $0.0257/pound
- The national 40-pound block cheddar price minus $0.034/pound
- The national dry whey price minus $0.0084/pound

It's difficult to fully analyze the impact of this proposal, as their official request is that USDA begins conducting a new Western survey of dairy product prices and dairy manufacturing costs that they are not already reporting. But using just the "fallback" numbers they propose using in the absence of such Western data, we can estimate that **their proposal includes a CA-FMMO Class III formula that would generate a price about $0.85/hundredweight below the Class III price used in the ten current FMMOs**. The other three formulas would be discounted as well, although to lesser degrees.

CLOSING NOTES

For years, up to and including testimony at last week's CDFA hearing, we have heard cheese manufacturers and representatives from the Dairy Institute arrogantly proclaim that if California producers want "Federal Order prices," we need to accept "Federal Order rules." In a future issue of this newsletter, we'll get into those "Federal Order rules," but what I will say for now is that they are certainly including very flexible "Federal Order rules" in their proposal; and ***still*** they are proposing that California prices under such a FMMO be ***steeply discounted*** to the prices used in the other ten FMMOs.

The bottom line is that our State's manufacturers – and specifically our State's cheesemakers – have gotten spoiled with some of the lowest-cost milk in the country. They will defend it to the bitter end, using whatever argument advances that interest, even if it runs completely contrary to long-standing claims they have made.