

The Market Administrator's BULLETIN

NORTHEAST MARKETING AREA

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Federal Order No. 1

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August Pool Price Calculation

The August 2004 statistical uniform price (SUP) for the Northeast Marketing Area was announced at \$15.57 per hundredweight for milk delivered to plants located in Suffolk County, Massachusetts (Boston), the pricing point for the Northeast Order. The statistical uniform price is calculated at 3.5 percent butterfat, 2.99 percent protein, and 5.69 percent other solids. The August producer price differential (PPD) at Suffolk County was \$1.53 per hundredweight.

August's statistical uniform price was \$2.07 per hundredweight below the July price; the August PPD was \$1.26 below last month's. All class prices declined from the previous month with the Class I price facing the largest drop—\$3.33 per hundredweight. ❖

New Administrator of USDA Dairy Programs

Dana Coale has been selected as the new deputy administrator of USDA's Agricultural Marketing Service Dairy Programs. In this position Ms. Coale is responsible for overseeing various programs, including the administration of the Federal milk marketing order program and the dairy producer promotion and research programs. Ms. Coale replaces Richard McKee who retired in April 2004. ❖

Review of Federal Order Price Calculation

There is sometimes a misconception that the USDA "sets" the federal order minimum class prices — the monthly prices that processors pay for milk and that collectively drive the statistical uniform price (SUP). While the USDA does calculate and announce class prices each month through federal milk marketing orders, they are not "set" arbitrarily.

Commodities Used

Class milk prices are based on competitive market surveys of certain wholesale dairy commodities (unaged Cheddar cheese, butter, nonfat dry milk powder, and dry whey powder). Thus, when there is a change in the supply of milk and the ability to make these dairy commodities and/or a change in the demand for these products, a corresponding price movement generally occurs in the federal order class price series.

Each week the National Agricultural Statistics Service (NASS) surveys plants across the country that are producing the surveyed commodities and reports a weighted average price for 40-pound blocks of Cheddar cheese, 500-pound barrel Cheddar cheese, Grade AA butter, and Extra Grade nonfat dry milk and dry whey. The summarized survey prices are (continued on page 2)

Pool Summary

- A total of 15,359 producers were pooled under the Order with an average daily delivery per producer of 3,971 pounds.
- Pooled milk receipts totaled 1.891 billion pounds, a decrease of 5.3 percent from last month on an average daily basis.
- Class I usage (milk for bottling) accounted for 45.6 percent of total milk receipts, an increase of 2.2 percentage points from July but the total volume was less.
- The average butterfat test of producer receipts was 3.57 percent.
- The average true protein test of producer receipts was 2.98 percent.
- The average other solids test of producer receipts was 5.67 percent.

Class Utilization

| Pooled Milk | Percent | Pounds |
|-------------------|---------|---------------|
| Class I | 45.6 | 862,261,147 |
| Class II | 20.2 | 381,170,877 |
| Class III | 24.1 | 456,751,246 |
| Class IV | 10.1 | 190,363,193 |
| Total Pooled Milk | | 1,890,546,463 |

Producer Component Prices

| | 2004 | 2003 |
|--------------------|--------|--------|
| | \$/lb | |
| Protein Price | 2.4663 | 3.1438 |
| Butterfat Price | 1.7941 | 1.2514 |
| Other Solids Price | 0.0676 | 0.0026 |

Class Price Factors

| | 2004 | 2003 |
|-----------|--------|-------|
| | \$/cwt | |
| Class I | 17.87 | 14.22 |
| Class II | 13.13 | 10.81 |
| Class III | 14.04 | 13.80 |
| Class IV | 12.46 | 10.14 |

Review of Federal Order Price Calculation *(continued from page 1)*

then used by federal orders to generate class prices and component milk prices. The formulas convert the survey's finished product prices (cheese, butter, nonfat dry milk, and dry whey) back to an equivalent price for raw milk by using make allowances and yield factors. In this manner, federal order class prices are a reflection of market supply and demand factors. (Copies of the price formulas can be obtained by contacting the Albany Office of the Market Administrator or at the USDA website www.ams.usda.gov/dairy/). The current price formulas were adopted following order reform in 2000, although there have been more recent modifications through the hearing and producer referendum process.

Class Prices Announced

There are four classes of milk. The price for fluid drinking milk (Class I) is announced by the 23rd of the month prior to the month the price is effective. For example, the August Class I price was announced on July 23. Class I prices are based on survey data from the most recent 2-week period prior to the price announcement date (see example 1). The prices for other classes (Class II includes "soft" products such as ice cream, yogurt, cottage cheese, and cream; Class III includes the "hard" cheeses like American, mozzarella, Swiss, but also cream cheese; and Class IV includes butter

and dried milk products) are announced by the 5th of the month following the month they are effective. For example, the August Class II, III, and IV prices were announced on September 3. These prices are based on the most recent 4- or 5-week period commodity survey prices (see example 2).

Because the two price announcements are based on different survey data, it is entirely possible for commodity prices to increase or decrease significantly within the time period used to calculate class prices for a particular month. This situation occurred earlier this year when rapid price increases in the cheese market resulted in an April Class III price that was higher than the April Class I price. When a price inversion occurs, it can result in a negative producer price differential (PPD). Even though producers may receive a higher SUP or blend price at the time, the price inversion and corresponding negative PPD value can cause confusion.

Chicago Mercantile Exchange Influence

Adding to the confusion is the reporting and sometimes comparison to dairy commodity prices on the Chicago Mercantile Exchange (CME). The CME operates a cash market where chese and nonfat dry milk are traded daily, and butter trading occurs three times per week. In general the survey prices reported by NASS (and used by federal orders) and the CME trading prices track each other closely. However, due to the method of collecting and reporting the NASS price there is at least a one-week lag between the NASS and CME prices with the NASS prices generally following changes first occurring on the CME.

For 2003, CME block prices averaged only 2 cents higher than NASS prices; barrel prices were 1 cent lower; and butter prices were 2 cents higher. The NASS prices tend to not peak as high as the CME prices, but in contrast they do not drop as far either. Due to their easy access and frequent reporting many people in the dairy industry look at the CME prices as an indicator of the current supply and demand situation and a precursor of future federal order price levels. California, which is not regulated by a federal marketing order, uses CME prices in its state milk marketing order pricing. ❖

Example 1

NASS Dairy Products Prices—July 23 Release

| Commodity | July 10 | | July 17 | |
|-----------------|----------|------------|----------|------------|
| | Dol./Lb. | Pounds | Dol./Lb. | Pounds |
| Cheddar Cheese | | | | |
| 40 Lb. Blocks | 1.5958 | 7,489,342 | 1.5164 | 9,237,096 |
| 500 Lb. Barrels | 1.5586 | 9,272,745 | 1.4669 | 11,692,580 |
| Butter | 1.8741 | 2,719,328 | 1.8486 | 2,875,270 |
| Nonfat Dry Milk | 0.8590 | 17,409,519 | 0.8522 | 22,275,846 |
| Dry Whey | 0.2624 | 10,724,145 | 0.2574 | 9,768,967 |

U.S. prices weighted by sales volumes reported by participating manufacturers.

Example 2

NASS Dairy Products Prices—September 3 Release

| Commodity | July 31 | | August 7 | | August 14 | | August 21 | | August 28 | |
|-----------------|----------|------------|----------|------------|-----------|------------|-----------|------------|-----------|------------|
| | Dol./Lb. | Pounds | Dol./Lb. | Pounds | Dol./Lb. | Pounds | Dol./Lb. | Pounds | Dol./Lb. | Pounds |
| Cheddar Cheese | | | | | | | | | | |
| 40 Lb. Blocks | 1.4459 | 9,129,245 | 1.4743 | 8,830,695 | 1.4947 | 8,277,269 | 1.5072 | 9,321,606 | 1.5537 | 7,156,097 |
| 500 Lb. Barrels | 1.4475 | 8,627,868 | 1.4811 | 9,599,973 | 1.5085 | 8,601,147 | 1.5288 | 9,388,573 | 1.5644 | 10,674,258 |
| Butter | 1.7139 | 3,099,520 | 1.6650 | 3,292,724 | 1.5339 | 2,710,936 | 1.5395 | 2,672,294 | 1.5592 | 2,112,271 |
| Nonfat Dry Milk | 0.8596 | 31,248,684 | 0.8573 | 17,306,610 | 0.8614 | 20,182,852 | 0.8583 | 18,257,397 | 0.8544 | 18,632,427 |
| Dry Whey | 0.2335 | 10,762,366 | 0.2311 | 10,794,562 | 0.2244 | 9,201,132 | 0.2196 | 11,276,152 | 0.2154 | 11,439,549 |

U.S. prices weighted by sales volumes reported by participating manufacturers.

Supply and Demand

July milk production was up 0.7 percent over the previous year in the top 20 states. Regionally, the Western states of Texas, California, Idaho, Arizona, and New Mexico accounted for much of the increase while the Midwestern states of Minnesota and Wisconsin and the Northeast states of New York, Pennsylvania, and Vermont showed declines. Although milk cow numbers were still below year-ago levels in July, each month since April, the total number of milk cows has been closer to previous year levels. Through July, the culling rate has trailed last year's rate by 17.4 percent nationally. Total herd numbers in New York, Pennsylvania, and Vermont still declined by a combined 30,000 cows. Since March, milk production per cow has averaged at or below 1 percent of previous year levels.

Through June, commercial disappearance of all milk was up by about 1.6 percent in 2004 over the previous year. In fact, during the second quarter when dairy prices were peaking, there was a bigger percent increase over the previous year than the first quarter (1.8 percent and 1.3 percent respectively). Commercial disappearance of American cheese was higher than the previous year in both first and second quarters, 3.5 percent and 1.3 percent, respectively. The smaller increase in the second quarter coincided with peaking dairy prices. Commercial disappearance of butter was down 7.6 percent in the first quarter of 2004, compared to 2003; however, butter rebounded in the second quarter with a 9.4 percent increase over the second quarter of 2003.

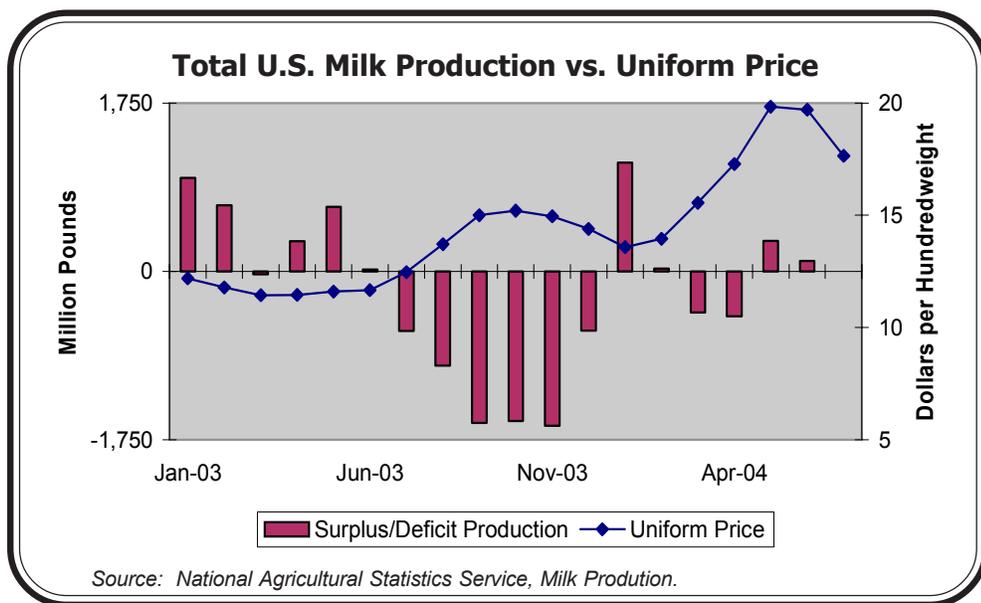
The latest USDA Cold Storage Report showed American cheese inventories in July 2004 up 12.5 percent versus July 2003. Total cheese inventories were up 8.1 percent compared to July 2003. Butter inventories were down 34.1 percent in July 2004 versus the same month last year.

Milk Movements

During August, bulk milk shipments received by handlers pooled on the Northeast Order that came from handlers pooled on other federal orders totaled 24.8 million pounds. These orders include Appalachian (Order No. 5), Mideast (Order No. 33), and Upper Midwest (Order No. 30). Bulk shipments to other federal orders for August totaled 21.3 million pounds. Shipments were sent to Appalachian, Florida (Order No. 6), and Mideast.

Supply and demand continues to shape trends in dairy pricing. The chart shows the amount of surplus or deficit production and the uniform price each month. The chart also depicts higher or rising prices when production is in deficit and low or falling prices when production is in surplus. Recently, stronger demand coupled with shorter milk supplies have resulted in strong prices for dairy products and higher pay prices to producers.

A look at the current situation shows growing demand for cheese, but not at a rate that has slowed the growth of cheese inventories. Butter inventories are currently low, but at the same time demand has been mixed this year. There has been a lack of evidence that



would suggest milk production would be increasing substantially in the near future. The number of cows has increased some, but cull rates have been low. Lack of major milk production gains combined with solid, if not stellar, product demand offer an environment that will support current uniform price levels in the \$14.00 to mid \$15.00 per hundredweight range through the remainder of the year, based on current market information. ❖

Normally during the end of summer and into the fall months, there are a large volume of shipments between the Northeast Order and orders located in the southeastern United States. In August, the Northeast Order received 12.2 million pounds from Order No. 5 and shipped 20.7 million pounds to Orders No. 5 and 6. This equaled a net amount of 8.5 million pounds shipped South, the smallest volume in the past 3 years. ❖



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Computation of Producer Price Differential and Statistical Uniform Price*

| | <u>Product Pounds</u> | <u>Price per cwt./lb.</u> | <u>Component Value</u> | <u>Total Value</u> |
|--|-----------------------|---------------------------|------------------------|-------------------------|
| Class I— Skim | 844,544,052 | \$10.80 | 91,210,757.62 | |
| Butterfat | 17,717,095 | 2.1277 | 37,696,663.03 | |
| Less: Location Adjustment to Handlers | | | (2,698,827.17) | \$126,208,593.49 |
| Class II— Butterfat | 26,576,249 | 1.8011 | 47,866,482.13 | |
| Nonfat Solids | 31,799,415 | 0.7856 | 24,981,620.47 | 72,848,102.60 |
| Class III— Butterfat | 17,376,925 | 1.7941 | 31,175,941.13 | |
| Protein | 13,625,865 | 2.4663 | 33,605,470.87 | |
| Other Solids | 25,812,938 | 0.0676 | 1,744,954.61 | 66,526,366.61 |
| Class IV— Butterfat | 5,833,140 | 1.7941 | 10,465,236.44 | |
| Nonfat Solids | 16,580,302 | 0.7112 | 11,791,910.76 | 22,257,147.20 |
| Total Classified Value | | | | \$287,840,209.90 |
| Add: Overage—All Classes | | | | 38,760.77 |
| Inventory Reclassification—All Classes | | | | (225,756.19) |
| Other Source Receipts | 76,568 | | | 2,309.85 |
| Less: Producer Component Valuations | | | | (267,508,759.85) |
| Subtotal | | | | \$20,146,764.48 |
| Add: Location Adjustment to Producers | | | | 8,971,688.82 |
| One-half Unobligated Balance—Producer Settlement Fund | | | | 568,648.93 |
| Total Pool Milk & Aggregate Value | 1,890,623,031 | | | 29,687,102.23 |
| Less: Producer Settlement Fund—Reserve | | | | (760,569.85) |
| Producer Price Differential @ Suffolk County, MA (Boston) | | \$1.53 | | 28,926,532.38 |
| Statistical Uniform Price @ Suffolk County, MA (Boston) | | \$15.57 | | |

* Price at 3.5 percent butterfat, 2.99 percent protein, and 5.69 percent other solids.