

Fix the Milk Price Discovery System

Supply Management
Panel

February 9 2010



For the record: Growth Management Programs may or may not work.

- A key functional component of the GMP's is to determine supply/demand balance in setting growth.
- Regardless of the layers, understanding balance requires a functioning and transparent price discovery system.
- Oligarchies (a handful of firms pricing product) are not efficient at setting prices. The GMP's have not addressed this fundamental problem.

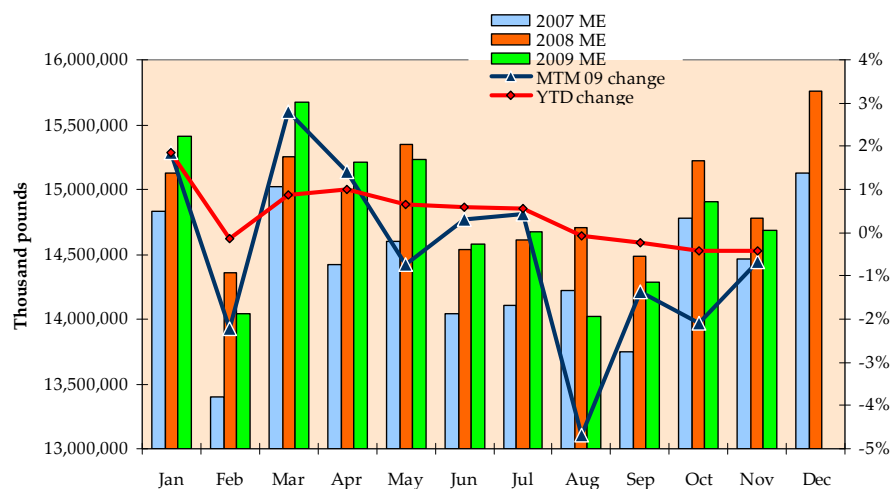


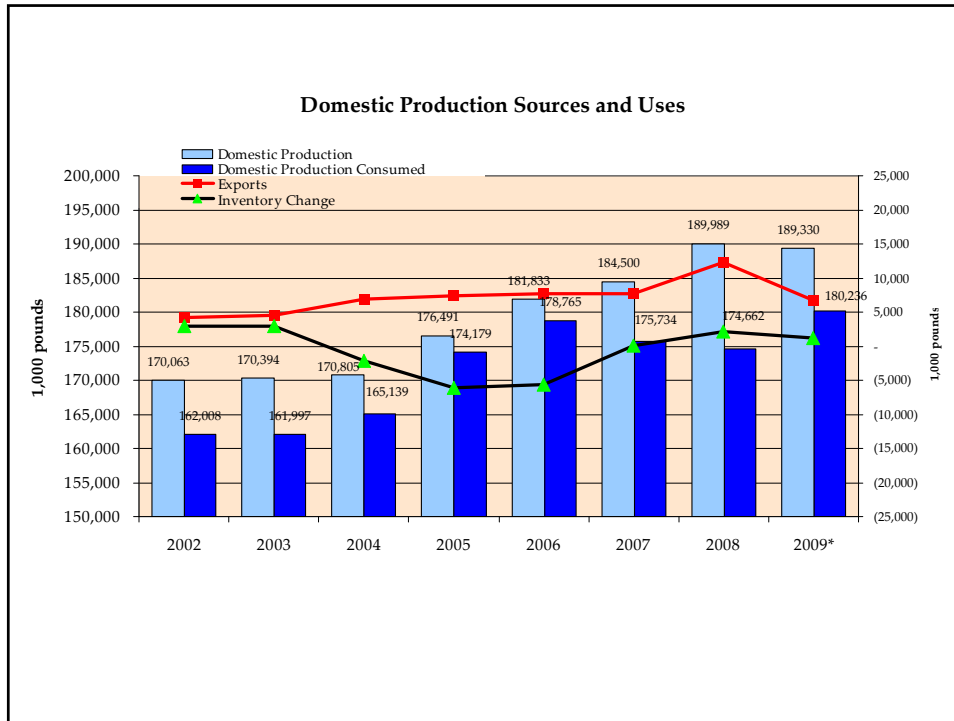
The milk price discovery system is dysfunctional:

- Continued lift in manufacturing make-allowances and FMMO consolidation (supported by Stephenson...one of the GMP price modelers) has shifted *nearly all of the pricing risk* in the supply chain to the milk producers.
- Dairy product pricing is now set by a handful of firms and their behavior moves the market.
- The USDA system is now full of non-reconciled reports (milk production, NASS pricing surveys, among others) and continued low-ball price projections.
- Unregulated milk product imports (MPC's) continually flood the market, not just when the price is high.



Milk Equivalent Production: Fluid, Yogurt, NFD+export, Butter, Cheese,





Fix the system!

1. Roll-back a portion of the make allowances to distribute a greater share of pricing risk throughout the supply chain.
2. Address pricing power consolidation by replacing FMMO's in some regions with co-op owned MAC's which can much better send regional balance signals and able to write direct priceXsupply contracts
3. Require quarterly milk-flow reconciliation by NASS and the inclusion of 100% reporting on dairy commodity price points.
4. Require a quarterly sources/uses report on the who and where of milk pooling.
5. Use the CWT tax to fund a NZ-style export board to actually sell product instead of coddling NFDM exports with the competitor, Fonterra.



Major GMP critiques

- Why will use of the USDA to forecast and price milk market balance work any better with another layer of bureaucracy? Why expand a broken price discovery system?
- Controlling supply is just another lethargic price distortion the market will price around unless the price discovery system is fixed.
- Milk pricing does not happen in a world market vacuum. GMP does not address currency cross-rates nor unregulated MPC imports (Will Fonterra be charged a market access fee?).
- The Nicholson-Stephenson model analysis has several unanswered questions and troublesome assumptions, the greatest of which is how it can project a flat-line price.
- I expect GMP to further consolidate pricing power because this is not recognized as a core problem. This means price risk will overwhelmingly remain at the farm level.



For further informaton

- <http://milkmarketwatch.com>
 - Updated milk market newsletter, blog, and fundamental analysis
- Email: mhoekema@mhoekema.com

