

# Some Issues For Nonfat Dry Milk Price Discovery

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Boston



*Innovative Dairy Solutions*

## O-AT-KA - Then & Now



...1959

Today...



## Value-Added Products

	Bottled RTD Coffee & Tea		Bottled Flavored Drinks
	Bottled Cream Liquor Cocktails		Canned Nutritional Beverages
	Canned Coffee & Energy Drinks		Canned Evaporated Milk
	Canned Ethnic Beverages		Canned Pet Milk Replacers
			Milk Protein Concentrate Drinks & Shakes

## Packaging Options

<h3>Alumi-Tek Bottles</h3> 	<h3>Aluminum Cans</h3> 
<h3>Steel Cans</h3> 	<h3>Glass Bottles</h3> 





## Nonfat Dry Milk Confusion

- ◆ **What is the Price – this past week:**
  - ◆ CME: \$1.70 Friday close (weekly avg - \$1.715)
- ◆ **Price Survey Reports (previous week):**
  - ◆ DMN: Central States – \$1.75 avg “Mostly” \$1.72
  - ◆ DMN: Western – \$1.69 mostly
  - ◆ NDPSR - \$1.6049
  - ◆ California CWAP – \$1.55
  - ◆ NFDN Futures – May close on Friday - \$1.6470
  - ◆ International (bi-weekly):
    - ◆ DMN – Oceania \$2.13 EU \$1.86
    - ◆ gDT Auction - \$1.94



## The Nonfat Price Loop

- ◆ **Nonfat pricing is key to the issue**
  - ◆ Past/Present industry practice:
    - ◆ DMN – prior to NASS - widespread use but in era of less volatility
      - ◆ Not well documented and backwards looking
    - ◆ **Use of NASS/CWOP**
      - ◆ The “loop” - Last week’s price reported this week, sets next weeks price which feeds the following weeks price survey which sets the next weeks price that all feeds into the Class IV price at month end.....
      - ◆ Movement is even slower –



## Does it Matter?

- ◆ **For the U.S. as a whole:**
  - ◆ More difficult pricing for exporting – almost half of US powder exported now
  - ◆ Alignment with export markets more difficult
  - ◆ Increasing value at risk for buyers and sellers a little futures activity to hedge
  - ◆ Price volatility exacerbated – the more the lag the slower the correction
  - ◆ Resources misallocated
  - ◆ Class II lags exacerbated and creates additional issues

## Does it Matter?

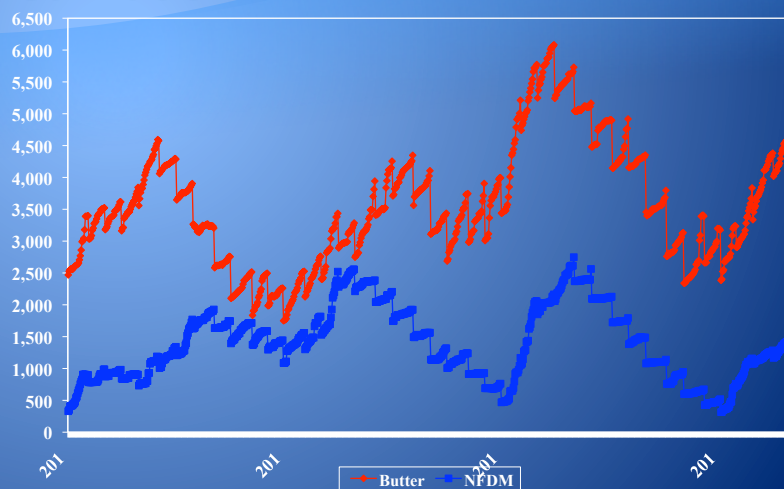
- ◆ **For us at O-AT-KA:**
  - ◆ Difficult to plan and hedge for our products like evaporated milk based on Class IV
  - ◆ Difficult for customers of our Class II products – can't forward price the ingredients – and they have alternatives
  - ◆ Difficult for our farmers – increasing amount of basis risk using Class III

## Nonfat Causes Problems with Class IV and Class II:

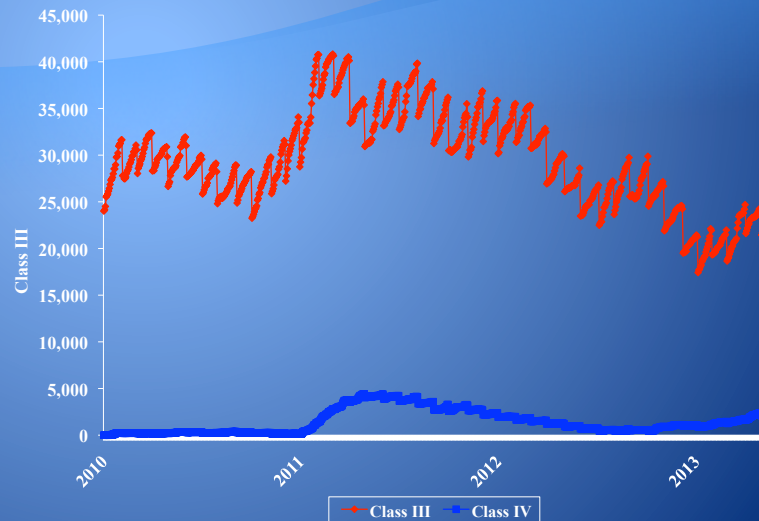


- ♦ Class IV is made up of butterfat and nonfat solids values driven by Butter and Nonfat dry milk pricing
- ♦ Nonfat pricing creates some Class IV Pricing problems:
  - ▶ Nonfat dry milk prices are confused (butter is better)
  - ▶ A major Class IV supply area is on a different price formula using CWAP – California
  - ▶ Farmers do not see Class IV valuation directly – creates additional confusion and lack of interest from producers
  - ▶ Survey lags and lack of timely price discovery leads to less ability to manage risk – futures liquidity

## Futures Open Interest for Nonfat is weak but..



## Class IV Open Interest is really bad

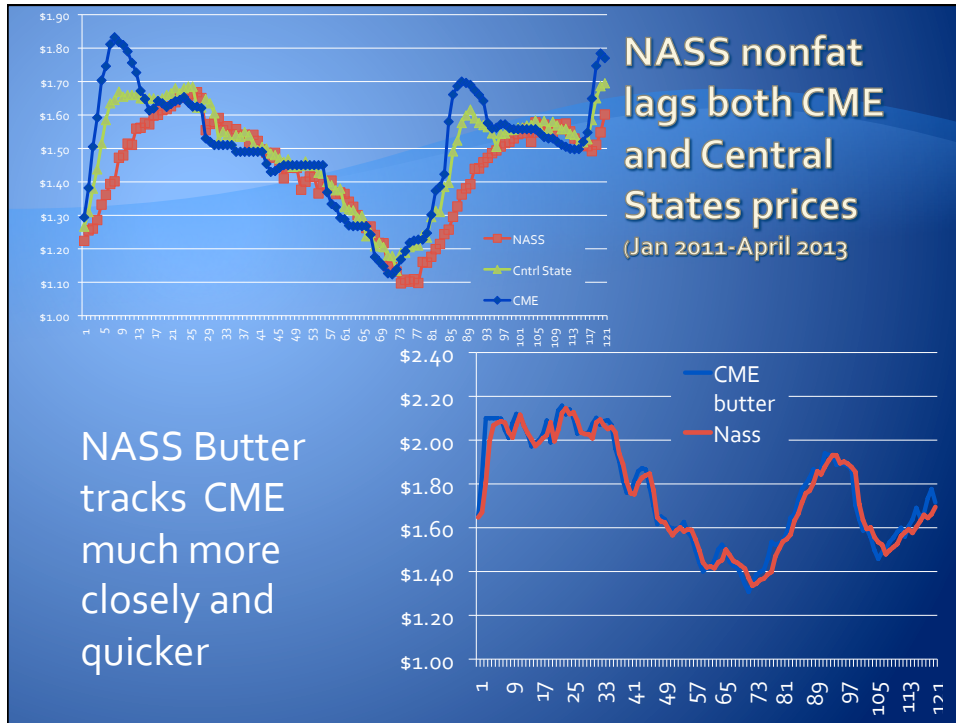


## Breaking the Loop

### ◆ Ideas for change:

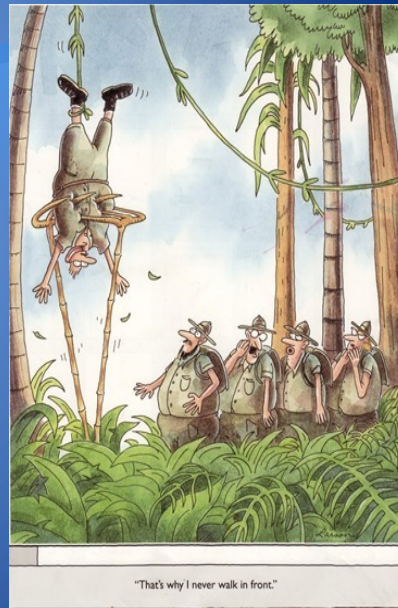
- ◆ *Industry practice* – use CME? What's old is new again?
  - ◆ Butter seems to work "better"
    - ◆ Last week's average or date of order of CME sets this week's selling price
    - ◆ Correlation between CME spot butter and NASS is .97
    - ◆ With NASS ndm vs. Central States : .87 and vs. CME: .62





## Breaking the Loop

- ◆ Ideas for changing nonfat:
  - ◆ *Industry practice* – use CME? What’s old is new again?
    - ◆ No regulation will enforce use
    - ◆ Industry needs to find credibility between buyers and sellers
    - ◆ Need to build liquidity – trades on CME are few (but getting better)
    - ◆ Use electronic – anonymous
    - ◆ Get rid of extra grade
    - ◆ Others ways to facilitate?



## What if ?

### ◆ Other ideas?

- ◆ U.S. Style gDT?
  - ◆ Interesting auction set up – takes time to administer ... every day... every week?
- ◆ Just go back to DMN but improve?
  - ◆ ADPI working on suggestions for improvements to reports
- ◆ Use futures –
  - ◆ Use as is?
  - ◆ Use a physical contract – try to peg contracts to that price?

### ◆ Dairy Innovation Center Study

- ◆ Mike McCully