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Intricacies of NFDM Pricing

Few dairy products have as many reference prices as nonfat dry milk (NFDM), which complicates market pricing for buyers and sellers. Historically, NFDM was priced off the regional NFDM price ranges published by USDA's Dairy Market News.



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For each region, Dairy Market News typically provides two price series: a range and a "mostly" range. The range includes all prices reported to Dairy Market News surveyors, while the "mostly" range represents the majority of price quotes. Therefore, the range tends to have a lower low and a higher high than the "mostly" price range. As such, the "mostly" range is often the first indication of a change in market direction. For many years, the industry priced NFDM off the prior week's "mostly" price series. For example, a common quote for a Midwest buyer of NFDM was the midpoint of last week's "mostly" price plus transportation. As NFDM production grew in the West, the West "mostly" price range was also incorporated into many purchase agreements.

Under the auspices of Federal Milk Marketing Order reform in 2000, USDA's National Agricultural Statistics Service (NASS) began collecting and publishing weekly sales data from manufacturers of NFDM. Over the years, this price became known as the NASS NFDM price, and it was used to calculate Federal Order milk prices. By the mid-2000s, many sellers of NFDM discontinued using the midpoint of the "mostly" ranges for their pricing benchmark in favor of the NASS price. Both buyers and sellers of NFDM appreciated the transparency in the NASS prices and associated volume.

In 2010, legislation was passed that made reporting of weekly NFDM prices and sales volume by manufacturers mandatory. In 2012, USDA issued its final rule amending the Dairy Product Mandatory Reporting Program and transferred the data collection responsibilities from NASS to USDA's Agricultural

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Ken's Corner



*by Ken Meyers
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Changes in the dairy sector tend to be evolutionary rather than revolutionary. The CME spot NFDM market is on its way to becoming the benchmark price for NFDM. Nevertheless, it is likely to take a few years for the CME spot NFDM price to be the dominate pricing mechanism much like the CME spot butter and cheese markets are the common reference prices for those commodities.

One advantage of using the National Dairy Products Sales Report (NDPSR) NFDM price is that producers, processors, and end users can hedge with NFDM futures with no basis risk. That's because the NFDM futures contract is cash settled to the monthly average NDPSR NFDM price.

The NDPSR price is unlikely to be an exact replica of the CME spot NFDM price because the NDPSR price includes FOB plant sales completed within the past 30 days, whereas the CME spot NFDM price reflects today's cash price in Chicago.

A common criticism of the NDPSR NFDM milk price is that it has been slow to reflect market changes. Likewise, CME spot dairy product prices have been criticized because they are too volatile. Perhaps a combination of the two price series is what the industry needs to avoid circularity while including the most recent price transactions. **MCT**

Does NFDM Have Staying Power?

The CME spot NFDM market is trading like it never has before. Trading volume is up and prices are oscillating. After trading as low as

\$1.085/lb. during the last week of this month, the market gained 7¢ during the last trading day of the month to close at \$1.155. CME NFDM futures

followed suit and traded up their limit 4¢ in many outlying months. The rally in the spot and futures markets comes at a precarious time with U.S. NFDM stocks at record highs, the U.S. milk production beginning its seasonal rise, and EU milk production quota to be eliminated in May 2015. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Feb	1.5382	1.4849	15.50	1.7293	13.75	0.5200	1.0300
Mar	1.5650	1.5250	15.55	1.7000	14.10	0.4850	1.0700
Apr	1.5450	1.5000	15.50	1.6600	14.20	0.4700	1.1000
May	1.5200	1.4850	15.40	1.6300	14.35	0.4800	1.1300
Jun	1.5600	1.5250	15.60	1.6500	14.70	0.5000	1.1600
Jul	1.6350	1.6150	16.35	1.6700	15.20	0.5200	1.2100

* CME prices.

**NASS prices.

Spot trading picks up...

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Marketing Service (AMS). As a result, the NASS NFDM price evolved into the National Dairy Products Sales Report (NDPSR) NFDM price.

A third pricing source that until recently had taken a back seat to the USDA derived “mostly” and NDPSR prices is the CME Group (CME) spot NFDM price. The spot butter market has traded at the CME for more than 100 years. Spot Cheddar cheese trading began in 1997, followed by NFDM trading in 2000. For many years, spot NFDM trading was very sparse with less than 30 loads trading in a year. However, during the past two years, the industry has started to wean itself off the NDPSR price due to the price’s circularity. For instance, last week’s NDPSR price established the current week’s price. The majority of domestic NFDM sales have been tied to the NDPSR price; therefore, changes in the NDPSR price have been driven by the minority of spot prices. As a result, the NDPSR price has been slow to reflect changes in market conditions, which further delays sending appropriate market signals to dairy producers. Several sellers of NFDM,

however, are making strides by basing their product off last week’s weekly CME average NFDM price rather than the NDPSR price.

While it is unclear just how much NFDM is being priced off the weekly CME price, it is obvious that CME spot trading is much more active than ever before. Trading volume set a record 54 loads (about 2.3 million pounds) for the first week of February, followed by 44 and 22 loads, respectively, over the next two weeks.

During the past month, CME spot NFDM prices moved off lows not seen in the market since 2012. Sellers found an opportunity to shed stocks in a rising market, and end users who had been sitting on the sidelines waiting for additional price declines rushed to obtain some level of coverage. Spot NFDM prices peaked at \$1.20/lb. during the third week of February but have since found support near \$1.10. Meanwhile, the NDPSR price has moved modestly higher from 97.12 cents at the end of January to \$1.0189/lb. for the week ending Feb. 21. By comparison, end users who priced off the CME spot market have paid weekly benchmark prices of \$1.031 to \$1.1575/lb. So far in 2015, the move to CME NFDM pricing hasn’t been in the best interest of the buyer, but the year isn’t over yet. **MCT**



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