

Guest Editorial – Cheese Market News April 21, 2017

Better ways to price whey

Two years ago, I wrote an editorial for Cheese Market News titled “What way to price whey?” which highlighted the problems with price discovery for a variety of whey products. While those problems persist, there are several solutions being developed that should improve price discovery for dry whey and lactose. An industry effort, led by American Dairy Products Institute’s whey task force, is proposing a new dry whey spot contract at the Chicago Mercantile Exchange (CME). In addition, Global Dairy Trade (GDT) is working to develop a multi-seller pool for U.S. lactose.

The trend in whey product production continues toward the higher protein, higher valued whey protein concentrates (WPCs) and whey protein isolate as global demand increases for those products. WPC-34 production has seen the sharpest downturn in the last two years while dry whey has remained relatively stable. Given the shift to the higher protein products, production of whey permeate and lactose also has increased. With strong global demand providing an opportunity for growing U.S. exports of these products, it is important to have credible and timely market prices for both buyers and sellers.

Currently price discovery for whey products is less than optimal or, in the case of high protein products, nonexistent. The benchmark price for dry whey is the weekly USDA National Dairy Product Sales Report (NDPSR) whose main problem is circularity — this week’s reported price is a reflection of last week’s price due to the number of NDPSR-based contracts included in the weekly report. At times, this circularity keeps the NDPSR price from being an accurate indicator of current cash prices. In addition, dry whey is a product where a significant amount of product is bought and sold by brokers/resellers, yet those prices are not included in the NDPSR price series. Daily price action by brokers/resellers is the tip of the spear when it comes to price discovery, so the NDPSR prices lack an important portion of sales each week. For lactose and WPC-34, USDA Dairy Market News reports weekly prices, but the price ranges are very wide and difficult to utilize due to the significant variation in product specifications and uses. The dairy industry has relied on these pricing mechanisms for a long time, but better options are being developed.

A proposal has gone to the CME to develop a new dry whey spot contract that would trade alongside cheese, butter and nonfat dry milk (NDM). If added, it would complete the suite of cash and futures contracts for dairy products currently offered by the CME. The development of a centralized cash market for dry whey at the CME would provide the dairy industry several key benefits:

- **Timely** — A cash price that reflects current market conditions as opposed to lagging indicators in USDA NDPSR and Dairy Market News reports. Improves timeliness of price transmission to the marketplace.
- **Broader Participation** — Allows for brokers and secondary sales where spot activity takes place.

- New Benchmark — Over time, the CME cash price could become a price discovery mechanism if the industry voluntarily chooses as it has in cheese, butter and, more recently, NDM.
- Reduces basis risk, thereby improving the effectiveness of futures and options contracts for risk management.

A new concept is being developed to improve price discovery for lactose — a multi-seller pool on Global Dairy Trade. GDT has built a reputation as the leader in the online trade of dairy through the growth and success of its core platform GDT Events, and the introduction of a new complementary trading platform, GDT Marketplace. A model is being considered where a group of manufacturers would contribute lactose to a pool that would be sold on the bi-weekly GDT Events auction. Arla Food Ingredients in Europe has been offering lactose on GDT Events for 18 months. A new U.S. market would provide an opportunity for U.S. production to be easily considered as an additional supply base. Like a CME dry whey price, a GDT U.S. lactose price would provide a timely price signal within a narrowly defined specification. In addition, a credible benchmark price could then be used to develop risk management tools (e.g. OTCs/swaps) that are lacking today.

The engagement of stakeholders across the dairy supply chain demonstrates the broad interest in improving price discovery in the whey complex. More work is needed on both initiatives to bring them to reality. Over the next few months, discussions will continue with the CME on how the industry can support a dry whey spot contract launch. The parties involved with the GDT multi-seller lactose pool will further develop the model with a target launch of late summer/early fall. After dry whey and lactose, the focus could shift to other products such as whey permeate and WPCs. While each initiative faces some hurdles, they can help move the industry to a better place in terms of price discovery for whey products enabling better U.S. participation in these growing protein complexes.