January 31, 2002

MCTCOMPASS

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Butter economics considered

Perhaps no commodity suffers from as much price volatility as the butter complex.

From 1995 to 2001, the CME Grade AA butter price has averaged $1.27. But only about one-third of the time has the price been found within 15¢ either way of that average. The difference between the high and low in any given year has averaged 93¢. During four of the last seven years, the annual average has deviated at least 30% from the previous year's average.

Last year, butter averaged $1.67, a whopping 41% higher than the year before, but still a dime shy of the all-time record of $1.77 in 1998.

One of the balancing tools to keep butter prices in check is increased butterfat imports.

Under USDA's imported butter licensing program, 15.4 million lbs. of butter and 13.2 million lbs. of butteroil may enter the United States at a low tariff rate and additional volumes of butter and butteroil may be imported at a tariff rate of in excess of 70¢ per lb. Typically, when the U.S. price exceeds $1.55, it attracts high-tier imports.

While U.S. butter makers churned about 60 million lbs. less butter last year than in 2000, imports helped make up most of the shortfall. In 2001, 26.1 million lbs. of butter and 14.6 million lbs. of butteroil were imported above quota, in addition to the normal licensed imports.

When we think of the market for butterfat, we typically think of butter itself, but in truth only 13% of the fat in milk is used to make butter. The largest user of butterfat is the cheese industry, which takes 43% of all the milkfat that comes out of the cow. The fluid milk sector takes 22% and soft manufactured products like ice cream use another 22%.

Looking at milk production, we can understand why there was a shortage of butterfat last year. On average, milk contains 96.3% skim and 3.7% butterfat. Milk production in 2001 was down 2.3 billion lbs. from the prior year. That means cows turned out 85.1 million lbs. less butterfat in 2001. When competition for butterfat

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KEN'S CORNER

by Ken Meyers
President
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There's a growing disconnect between the butter price and the supply-and-demand fundamentals of the market.

As January comes to a close, cream is excessive, churns are operating 24/7, stocks are growing, end-user demand is moderate ... and yet the wholesale price of butter is holding above $1.30.

Fat users (like ice cream processors) are exasperated by the volatility, the irrationally high prices and lack of transparency in this market. The common belief in the industry is that buyers are supporting this market as a means to prop up the Class I mover, much the way they did with the cheese market a couple years ago when cheese prices drove the Class I.

Because the butter market is so thin, prices are susceptible to spikes during periods of peak butterfat demand. That means the weeks leading up to Easter, the period in early summer when ice cream plants ramp up, and the weeks in the fall when churns are gobbling up cream for the holiday buy-in, all bets are off. ❑

Price recovery not expected until June

Increased supplies should keep a lid on cheese prices for most of the first half of the year, though tight cream supplies are expected to provide some strength to the butter market.

We don't expect the Class III to move back above $12.00 until the second half of the year. ❑

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV
JAN	1.3246	1.2970	11.90	1.3454	11.98
FEB	1.2500	1.2225	11.75	1.3000	11.75
MAR	1.2350	1.2100	11.20	1.3600	11.80
APR	1.2200	1.1950	11.15	1.3550	11.70
MAY	1.2475	1.2175	10.90	1.4450	11.60
JUN	1.3050	1.2800	11.25	1.5200	12.00

** Block, barrel and butter are monthly averages of CME prices.*

Farm Bill waits

Congress returned to business last week, but the Farm Bill remains on the back-burner.

Timetables keep shifting; now Senate aides aren't sure when deliberations on the Daschle-Harkin bill will resume. Some say agricultural policy could move onto the Senate agenda in early February. Others say it may get pushed back until after the brief President's Day recess. The most cynical policy-watchers fear a deal isn't realistic until much later this year, after the fall Congressional elections.

As many as 40 amendments await debate on the Daschle-Harkin Senate bill and support and opposition have fallen along party lines. The Democrats weren't able to garner enough support to force a vote on the Daschle-Harkin bill, yet Republicans didn't have enough votes to get their alternative passed, either. A plan pitched by Sen. Richard Lugar would have provided payments to farmers that would be used to purchase income insurance. ❑

Butter economics...

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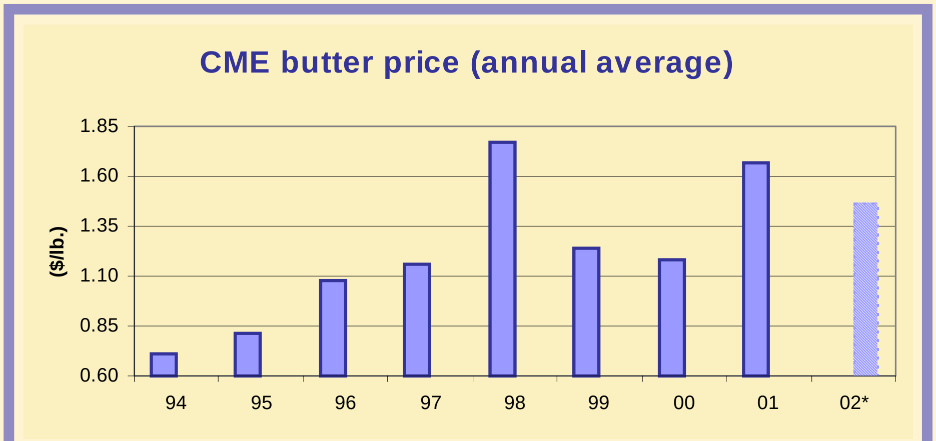
rose in the heat of the ice cream season, prices surged.

Where do we go from here? We enter 2002 with more than double the level of butter stocks in any previous year. Further, with milk production expected to rebound in 2002, butterfat supply should increase.

However, these factors could be offset by the opening of two large cheese plants in California this year. These facilities will pull additional milk and fat away from the churns in what used to be the nation's largest butter producing state. We already got a small taste of this in 2001, when cheese production in California increased 10%, while butter output dropped about 6%.

The volatility in this market will continue in 2002, because that's the nature of the beast. But we expect lower butter prices overall this year, with an annual average of $1.44 to $1.48. ❑



We expect the butter price to average $1.44 to $1.48 this year, down about 20¢ from last year's level, but with continued week-to-week volatility.

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