



MCT COMPASS

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USDA turns it loose

When it rains it pours, especially when the sitting administration wins the mid-term elections handedly. Major decisions impacting dairy policy that could have offended any constituent were put off until after election. Now the floodgates appear to have been opened.

Class III/IV Final Decision

The day after the election, USDA released its Final Decision regarding changes in the Class III and IV pricing formulas that had been in limbo since March 2001.

In the Federal Orders, milk prices are determined from product price formulas; the Class III comes primarily from the price of cheese and the Class IV from the price of butter and powder. USDA's Final

Decision fine-tunes the formulas that convert product prices into milk prices.

For example, the new formulas reduce the yield of the finished products to reflect the loss of milk from the farm to the plant. As a result the butterfat component price in Class III and Class IV is about 2¢/lb. lower and the skim milk component price in Class IV falls by about a dime. Net-net, the Class IV price averages about 13¢/cwt. lower at 3.5% butterfat.

What the Class IV price loses, the Class III price gains.

In the existing Class III formula, USDA subtracts 100% of the butterfat value from the protein value. In the Final Rule only 90% of the butterfat will be subtracted from the protein price because not

all the butterfat is captured during cheesemaking. Retaining 10% of the butterfat value in the protein price results in a higher Class III skim price.

However, just to keep us all guessing, the actual level of enhancement changes as the relationship between the NASS butter price and the NASS cheese price changes.

For example, at \$1.20 butter and \$1.30 cheese, the Class III skim price increases 15¢ while the Class III price reported at 3.5% butterfat increases just 7¢ (because the new formula yields a lower butterfat price). By inverting the prices – that is, a NASS butter price of \$1.30 and a cheese price of \$1.20 –

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KEN'S CORNER



**by Ken Meyers
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A month ago, I chastised USDA for dragging its feet on a number of issues, includ-

ing the tilt and DEIP. Little did I know that the department had a slew of announcements to make as soon as the

election votes were tallied.

The tilt is causing some angst in a number of circles, but in the long run it sends the proper signals to the marketplace. It'll probably be the last tilt we'll need for awhile, and it should inject some life into the moribund Class IV futures. It also will make U.S. powder more competitive with other ingredients, both dairy and non-dairy, both domestic and international.

USDA has taken pats on the back

for putting in the new safeguard duty on over-quota American cheese, but the move is effectively meaningless. Product already on the water is exempt, and the extra duty comes off Jan. 1. Any new shipments that might reach our shores before then can go into bond until the New Year.

In the meantime, best wishes for a great Thanksgiving to your families from ours. □

Markets enjoy boost

The cheese and butter markets enjoyed a nice rally last week following the support price tilt, but we fear a drop-off in butter after the holidays and the accumulation of inventories in the New Year.

Our forecast calls for butter to retreat near the new support level of \$1.05 in the first couple months of 2003.

Cheese supplies have been gradually tightening and we expect

MCT Forecast					
	<u>Block*</u>	<u>Barrel*</u>	<u>Class III</u>	<u>Butter*</u>	<u>Class IV</u>
NOV	1.0900	1.0700	9.85	1.0450	10.55
DEC	1.1400	1.1150	10.00	1.1150	10.70
JAN	1.1875	1.1575	10.35	1.0750	10.45
FEB	1.2500	1.2200	10.70	1.0750	10.30
MAR	1.2650	1.2350	11.20	1.1400	10.25
APR	1.2700	1.2400	11.30	1.1750	10.45

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

prices to run higher in 2003. Blocks are forecast to trade in the mid- to upper-\$1.20s from February through

April, translating into Class III prices averaging better than \$11.00 for those three months. □

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the Class III skim price increases by 31¢ and the price at 3.5% butterfat increases 22¢. In other words, the greater the difference between butter over cheese, the larger the price enhancement on Class III.

One implication of this complex change in the Class III formula is a negative impact on the margins of lower-fat, higher-skim cheeses like Mozzarella. This is bad timing for Mozzarella manufacturers already facing a glut of supply due to additional capacity and lackluster sales.

At this point it's presumed the Final Rule will be approved by producers in all the Orders, despite grumbling from the Northwest. Producers there contend the Rule increases their competitive disadvantage versus California.

Past USDA actions to reform the Orders have been met with stays and injunctions, but barring

any court action, the new formulas are likely to be implemented by March 2002.

The Tilt, et al

After a year of speculation, USDA finally tilted the support prices of butter and powder. The announcement was somewhat sugarcoated with the release of more DEIP and the addition of a new safeguard duty on over-quota American cheese imports.

Though USDA is setting itself up for criticism, the tilt was probably the most market-oriented dairy measure of this administration. The value of skim milk powder has declined over the last few years and purchase prices were clearly out of whack.

After USDA dropped the powder purchase price a dime to 80¢ and raised the butter purchase price 19.5¢ to \$1.05, the processor community (through IDFA) promptly ripped USDA for elevating the butter support above the

commercial price. Meanwhile, producer organizations (NMPF, Alliance) quickly claimed that lowering the powder price would cost producers millions of dollars in lost revenue.

So far, the move has only served to buoy the butter market. It may take awhile for the cash powder market to follow the support price all the way down. (After the last tilt in May 2001, it took six months for the cash price to follow through.) Meanwhile, the commercial butter market is trading above support with no product being offered to the government. Moreover, butter futures for 2003 suggest that traders do not expect prices to drop back to support.

As soon as the first load of butter heads to CCC caves, look for USDA to unlock DEIP for butter. Under WTO rules, USDA can subsidize the exports of 46.5 million lbs. of butterfat this fiscal year. □

