



MCT COMPASS

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2004: The Year of the Bull

What a difference a year makes.

After 18 months of sour milk prices that curbed the industry's appetite for expansions, the U.S. dairy herd shrunk in 2003. This contraction was aided by the closing of the Canadian border and record high beef prices. Adding fuel to the dairy cull fire was the Cooperatives Working Together (CWT) program that took nearly 33,000 head to slaughter during October and November 2003.

As 2003 comes to a close, the U.S. dairy herd is 1.6% smaller than a year ago and a turn-around in cow numbers is not expected until the reopening of the Canadian border. However, the discovery of BSE in a dairy cow in Washington state last week will surely complicate the

outlook.

Historically, prior to 2000, the U.S. dairy herd declined by 1% annually, which was offset by a 2% gain in output per cow. Net-net, milk production increased by 1% and the industry was considered in balance.

What's different in 2004 is that milk production per cow is not expected to increase by 2%. Recent gains have been half that rate. With soybean prices 40+% higher than a year ago (nearly \$8/bushel, and possibly going higher due to potential new restrictions on feeding practices following last week's BSE finding) and rationed supplies of *Posilac* rbST, gains in output per cow will be capped near 1% for the first half of the year.

Monsanto Dairy Business is limiting sales of *Posilac* due to

manufacturing issues. *Posilac*, which increases milk per cow by 8-12 lbs. per day, is used by about one-third of the U.S. dairy operations, Monsanto says. The average dairy operator using *Posilac* supplements more than 50% of the herd at any one time. The company expects the current supply shortfall to last several months.

As a result, several industry analysts expect milk production to slip at least 60 million lbs., or 0.3%, each month as long as the shortfall continues. That's equal to a 39,000 head decrease in the U.S. dairy herd. The impact during the first month will be mitigated as some producers use up their existing supplies. The greater impact is expected in outgoing months.

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KEN'S CORNER



by Ken Meyers
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A review of the All-Milk Price (*see graph on p. 2*) illustrates that the dairy industry is caught in a "sawtooth" pattern of prices. Most years of higher prices are countered the following year

with low prices.

It reminds us that this industry does not turn on a dime. Dairy producers can only do so much in the short run, like change a feed ration or use more bST, to impact milk production and take advantage of higher milk prices ...and those two tools may be limited in 2004.

In addition, in preparing this article, I looked back at our 2003 outlook issue

(*see MCT Compass, December 26, 2002*) and am pleased to report that our crystal ball was operating exceptionally well that day. This year unfolded much the way we said it would; we forecast a Class III annual average of \$11.55, and it will come in about \$11.42. Our only miscalculation was on butter; we forecast a Class IV of \$10.80 and the actual average will be closer to \$10.00. **MCT**

Cheese nears price floor

The holiday selling period is complete and cheese production is rising seasonally. However, cheese prices will not drop all the way back to support like they did in previous years.

NMPF's CWT export assistance program has kicked in, with the intent of supporting the market by moving 11 million lbs. (276 loads) of blocks into export channels over

MCT Forecast					
	Block*	Barrel*	Class III	Butter*	Class IV
DEC	1.3381	1.2621	11.90	1.2969	10.61
JAN	1.3000	1.2450	11.70	1.2750	10.60
FEB	1.2850	1.2250	11.55	1.2850	10.62
MAR	1.2950	1.2550	11.50	1.3700	10.80
APR	1.3250	1.2850	11.65	1.3950	11.00
MAY	1.3550	1.3275	12.00	1.4050	11.10

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

the next two months.

We look for the butter market to slowly climb into the \$1.40s by late

spring. Inventories have shrunk dramatically since June and are now below year-earlier levels. **MCT**

Year of the Bull ...

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In sum, it'll probably be mid-year at the earliest before we see an increase in cow numbers or output-per-cow rebounds above the 1% rate. However, the BSE finding immediately sent the cull-cow price crashing off its historically high levels, which could slow the slaughter rate in 2004. USDA forecasts production to grow at 0.9% for the year, which is possible if the second half of the year is up 2% vs. 2003's low production level.

On the demand side, USDA notes "that the economy is projected to grow at a fairly good clip, the employment picture is improving, and consumers seem to be returning to more typical spending patterns." At retail, supermarket scanner data suggests that cheese sales were up 6% in the first 11 months of the year. At foodservice, the National Restaurant Association says

restaurant-industry sales are expected to increase 4.4% in 2004.

All in all, the tea leaves are pointing to higher dairy product prices in 2004.

Limited growth in milk production in tandem with a recovering economy is likely to boost dairy product demand and prices. The BSE finding will likely reduce cull-cow prices, which could keep more cows in the herd next year, but it's probably too early to speculate on the full effect of the incident.

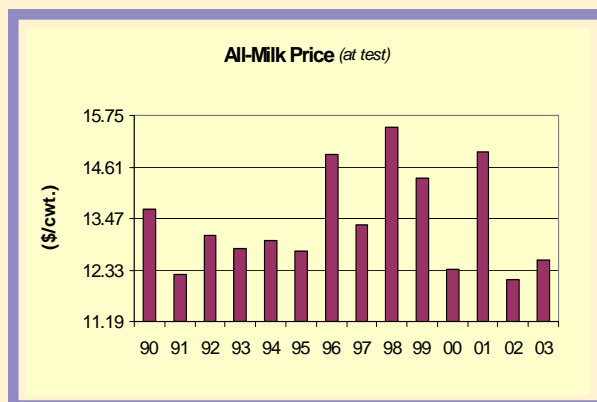
We see the CME 40 lb. block

cheese price and butter price ranging from seasonal lows of \$1.25 lb. to seasonal highs of \$1.60 per lb. On average, that puts the 2004 Class III average near \$12.50 (up from \$11.42 this year) and the Class IV average near \$11.25 (up from \$10.01 this year).

Global Outlook

World markets for dairy proteins, butterfat and powders are all stronger than in recent years. Oceania milk production is mixed — New Zealand is expected to post a 3-4% increase vs. the prior year, while Australia's production is still lagging. Oceania production is committed with very limited spot availability. Strong demand from Asia and Russia has helped tighten supplies.

Just to make the markets more interesting, the weak U.S. dollar compared to just about any other currency is impacting reported prices and deals priced in U.S. dollars. **MCT**



Since 1990, the All-Milk Price at test has averaged \$13.40 per hundredweight.

