



MCT COMPASS

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Who Moved the Cheese?

When people think of cheese in the United States, it's often Cheddar cheese that first comes to mind. Cheddar has long dominated the U.S. cheese industry by its volume of production and the role it plays in establishing both cheese and milk prices.

The only wholesale cheese exchange in the U.S., the Chicago Mercantile Exchange (CME), trades 40 lb. block and 500 lb. barrel Cheddar cheese (but not the more popular 640 lb. cheddar blocks). It is estimated that over 90% of the U.S. cheese production, from Mozzarella to Limburger, is priced at a premium or discount off of the CME Cheddar block price. Both the California and the Federal Order milk pricing plans use only Cheddar cheese prices to

derive a price for milk used to manufacture cheese regardless of its style.

Cheddar cheese, along with Colby, Monterey and Jack, make-up the American cheese production category. In 2000 American cheese production totaled 3.63 billion lbs. and represented 44% of total cheese production in the U.S. At that time, Cheddar cheese made up 77% of the total American cheese production.

It may come as a surprise to some that Cheddar cheese production is declining as a percent of American cheese production, and American cheese production is decreasing as a percentage of total U.S. cheese production. Cheddar cheese production declined by 50.2 million lbs from 2000 to 2003, and its share of American cheese production fell 2% to

75%. Meanwhile American cheese and total cheese production both increased.

From 2000 to 2003, American cheese production increased by just 41.0 million lbs. This pales in comparison to the 370.0 million lb. increase in total cheese production which was driven by a 262.1 million lb. gain in Italian cheese production with Mozzarella production accounting for 78% of the gain.

From a policy and pricing perspective, it is interesting to note that Cheddar cheese is no longer the dominant cheese in the U.S. Mozzarella production surpassed Cheddar cheese production in 2001 by 21.1 million lbs. In 2002, Cheddar

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KEN'S CORNER



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Cheese hats may be changing from Cheddar yellow to Mozzarella white as the

italian-type cheese surpasses the traditional Cheddar cheese in total production.

Steady gains in Mozzarella production indicate a change in consumer preferences. This is probably indicative of a larger trend towards increased demand for speciality cheeses like Hispanic and other Italian varieties.

As Cheddar cheese production takes a back seat to Mozzarella production, the industry needs to question whether the time has come for a wholesale Mozzarella market to compliment the CME Cheddar market.

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Where's the milk?

Lower milk production, driven by fewer dairy cows, is expected to keep the dairy markets rising in 2004. USDA reports that the U.S. dairy herd fell below 9.0 million head for the first time in December 2003 and is 1.7% below the prior year.

Just how high prices go will depend upon the ability of dairy producers to entice milk from

MCT Forecast					
	<u>Block*</u>	<u>Barrel*</u>	<u>Class III</u>	<u>Butter*</u>	<u>Class IV</u>
FEB	1.3958	1.3586	11.88	1.7132	12.01
MAR	1.5000	1.4750	13.40	1.8500	12.85
APR	1.5650	1.5400	13.85	1.9500	13.20
MAY	1.6300	1.6000	14.75	2.0300	13.55
JUN	1.7200	1.6950	15.50	2.1000	14.00
JUL	1.7500	1.7250	16.25	2.1000	14.20

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

their cows despite bST rationing and higher feed prices and the

consumers willingness to pay for higher priced dairy products. **MCT**

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production, aided by a 2.7% increase in milk production, rebounded and was 26.4 million lbs. greater than Mozzarella production. However, in 2003, Mozzarella production once again topped Cheddar production, this time by a sizeable 181.5 million lb. margin.

Cheddar cheese production is expected to be even lower in 2004 due to anticipated tighter milk supplies and rising butterfat prices. High butterfat prices place Cheddar cheese at a competitive disadvantage relative to Mozzarella which is lower in butterfat and higher in moisture.

The decline in Cheddar cheese production ultimately results in fewer loads of Cheddar block and barrel cheese available to trade at the CME. This is particularly true in the summer months when cheese yields are seasonally low and the supply of cheese less than 30 days of age is limited. As a result, the CME block and barrel cheese prices tend to be more volatile during this period.

But why has Cheddar cheese production fallen off while other varieties of cheese have increased their market share? The simple answer is consumer demand. According to USDA, the per capita consumption of Mozzarella cheese has increased from 1.2 lbs. per person in 1970 to nearly 10 lbs. per person in 2002. During the same period per capita consumption of Cheddar cheese increased from 5.8 lbs. per person to 9.7 lbs. If the past three decades are any

indication of the future, one could expect a continual increase in production of non-traditional American-style cheeses, such as Hispanic cheese. Since 1999, Hispanic cheese production has increased from 86.5 million lbs. to 125.8 million lbs. in 2003.

As Cheddar cheese production accounts for a smaller share of total U.S. cheese production, perhaps it will also play a lesser role in establishing cheese and milk prices for the industry. **MCT**

