



MCT COMPASS

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No Bull! No Bear!

No doubt, first-half 2004 has been an unprecedented period for dairy markets. A ban on imports of live Canadian cattle has hobbled dairy farm expansions. Monsanto cut back Posilac (rBST) shipments and that put a lid on large increases in per cow milk production. The new CWT program, designed to stabilize farm milk prices, took cows out of the system and is once again moving stocks overseas. In response to these and other events, wholesale cheese and butter prices soared to unparalleled heights.

In the past, record-high price years have been typically followed by market crashes, but cheese and butter prices do not appear poised to fall close to support. Too many uncertainties remain. Will the United

States open its border to live Canadian cattle? If it does, dairy producers across the country are positioned and eager to expand their herds. Word on the street is that many producers have caught up on back payments. Despite a tight replacement market, milk cow numbers from May to June grew sharply.

The demand side is just as volatile. Consumers typically respond to higher-than-normal dairy product prices by cutting use. Sticker-shock prices on butter and drinking milk are reflected in a steep drop in demand for fluid milk in May and rising butter stocks.

Yet astute use of risk management tools has given some dairy processors a competitive edge this year. Companies with hedged positions have held prices steady to grab an extra share of the market. The concern going forward is whether retailers will reduce their

prices as quickly as wholesale prices decline and will it be in time to entice consumers back to the dairy case.

To get a sense of where markets might go from here, *MCT Compass* collected forecasts from a handful of top dairy analysts: Bill Brooks, e-Dairy Inc.; Wilson Gray, University of Idaho; Alan Levitt, Levitt Communications; Mary Ledman, Keough Ledman Associates Inc.; and Mark Stephenson, Cornell University.

The consensus? Lower prices. This group's average Class III price for 2005 of \$12.29/cwt. is even lower than the average Class III price of \$12.57 reflected in the Chicago Mercantile's futures market for July 22. For the

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KEN'S CORNER



*by Ken Meyers
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After a year of record-high milk, cheese, and butter prices, five of the nation's top dairy analysts are predicting that 2005 will be a much tamer year. If trade negotiators

open the U.S. border to live Canadian cattle, however, the dairy producers who are itching to expand will move forward and milk will begin to flow more freely soon after replacements arrive. On the supply side, whether retailers reduce prices to match falling wholesale prices in

a timely enough fashion to head off further hits in dairy product demand will play as big a role as trade policy in setting next year's price stage. Bottomline: plan for more middle-of-the-road milk and dairy product prices, but be ready for continued price volatility. **MCT**

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remainder of this year, the consensus Class III price forecast is \$13.96, with a September peak of \$14.94.

The most bearish analyst expects Class III prices to drop to \$11.89 by December and the most bullish sees a Class III price of \$13.07 by year end. The analysts are closer on their 2005 average Class III predictions, which range between \$12.15 and \$12.55.

Our panel of experts expects Class IV prices to be substantially lower next year at \$11.50/cwt. The high forecast of \$12.35 is \$1.85 higher than the low prediction of \$10.50. One expert went so far as to predict that nonfat dry milk prices would be the most volatile of all: "Given strong world markets for dairy proteins, nonfat dry milk powder could have the greatest price volatility in 2005. Government stocks are half of what they were last year and the amount of powder less than 1-year-old is even lower." Consensus for second half 2004 Class IV prices: \$12.57.

Butter and whey prices are also headed lower, but are far from collapsing. For NASS butter prices, the analysts expect a steady decline through December, with year-end prices near \$1.43/lb. and a second half average of \$1.64. The high estimate for butter calls for a \$1.49 in December and a 2005 average of \$1.49. The low calls for slightly less than \$1.40 in December and a 2005 average of \$1.25.

Whey prices will also weaken, hitting 22.19 cents per pound by December. For 2005, the panel expects whey prices to average near 19.47 cents per pound. **MCT**

Consensus Forecast

	Cheese	Class III	Butter	Class IV	Whey*	SMP*
July	1.5808	14.75	1.7782	13.31	22.48	84.85
Aug	1.5087	14.07	1.6791	12.83	23.03	83.85
Sept	1.5585	14.94	1.7270	12.87	22.24	83.35
Oct	1.5171	14.29	1.6815	12.68	21.64	82.82
Nov	1.4339	13.10	1.5345	12.06	20.94	81.95
Dec	1.3791	12.62	1.4302	11.68	20.43	81.66
Avg	1.4963	13.96	1.6384	12.57	22.19	83.08
2005	1.3698	12.29	1.3842	11.50	19.47	81.13

* Whey and SMP in cents.

What the experts are saying

Bill Brooks The second half of 2004 could be driven by fear and greed just like the first half of the year. If that does not happen, the determining market factor will be consumer response to the extremely high prices of first half 2004. If consumers react as they have in the past, we'll see a marked increase in product supplies.

Wilson Gray Three key factors will influence prices over the next 12 months, demand, milk production, and stocks. On the production side, we will likely see a steadily increasing milk supply. Commercial disappearance is more uncertain. Much will depend on the state of the economy, consumer attitudes about job security, income growth, and retail price levels. Increases in inventory would be negative, as would bad economic news. Good economic news and slower growth or reductions in inventory would be positive.

Alan Levitt Supplies will be sufficient next year to prevent the "panic-mode" buying we saw in 2004 that enabled record-high pricing in cheese and milk. Buyers will not have a "fear of shortages" that characterized the dairy markets of 2004. However, the presence of CWT will prevent markets from dropping to support. The biggest factor affecting the dairy markets over the next year will be the CWT program. Left to its own devices, the market would swing very decisively into excess by December, and we'd be back at support by Christmas, maybe sooner.

Mary Ledman Whether or not the CWT program implements a cow-kill program during the second half of 2004 is the key factor that will drive milk and dairy product prices in 2005. However, if it is implemented, then one has to question whether CWT is a price stabilization program or a price enhancement program. Looking at demand, the greatest percentage decline will come from the fluid and butter sectors. Consumers saw substantial retail sticker shock in milk and butter, but less so from other dairy products like yogurt, cheese and ice cream.

Mark Stephenson The key factors affecting dairy markets over the next year will be soft demand resulting from high product prices and producer challenges. Adequate inventories of dairy products will tend to push prices down, but tightness in replacement animals and poorer-quality forages will tend to push prices up. I think 2005 could be a fairly normal year for prices. A big story in 2005 would be the reopening of the Canadian border to live animal trade.

