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MCT COMPASS

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Obesity Not a Problem in Ag Markets

Editor's note: Last month's Compass discussed the challenges of our thin cash cheese market. This issue focuses on other agricultural commodities and how their markets work.

The cash cheese market is not the only member of the thin market club. Economists describe thin markets as those that have too few players and too little trading volume. In fact, markets for several agricultural commodities from eggs to bacon fit the bill of a thin market.

The egg and dairy products markets probably have more in common than most agricultural commodities. The egg market, for example, is segmented into a fresh, graded and sized product for retail, while other eggs (known as breaking stock) are sold to manufacturing facilities that further process eggs into liquid, frozen and dried products. And, like dairy markets, a higher price is typically paid for fresh, graded product. Although the egg market does not have a Federal Order program that assigns a different value to the egg based upon its end usage, the market itself makes price distinctions.

In 1970, the egg industry found itself at a crossroads when both the Chicago Board of Trade and the Chicago Mercantile Exchange discontinued cash egg trading. In 1971, the industry, driven by producer interests, established the Egg Clearinghouse Inc. (ECI) in New Hampshire, primarily as a price discovery mechanism. Today, ECI trades at least six different types of eggs as well as liquid and frozen eggs. Trading occurs daily from 8:00 a.m. to 5:00 p.m.

ECI electronically posts blind bids and offers to their Web site but actual trades are aided by phone confirmations. ECI trades about 5% to 8% of the egg market. These prices are then reported by Urner Barry, an independent industry news source, which then sets the price for more than 90% of the nation's egg production.

Currently, no futures market exists for the egg industry but forward contracting and contracts based upon feed costs are increasing.

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KEN'S CORNER

by Ken Meyers
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Thin markets are prevalent in the agricultural arena. One can argue that these markets were thin 30 years ago and now they are getting down right anorexic. Still there seems to be little appetite for change. Despite few players in the cash cheese market, those players who participate daily represent a large majority of the producers and marketers of American Cheese. In the long run, no one player is bigger than any market. Therefore, if the market does not reflect current supply and demand conditions, it will adjust in short order.

The unfortunate situation in the dairy industry is that the milk price received by dairy producers in the current month actually reflects supply and demand conditions for cheese and butter from the previous month. Thus, the lack of timely price signals and market clarity unnecessarily add to the price volatility in the dairy industry. MCT

Higher Retail Prices

MCT Forecast					
	Block*	Barrel*	Class III	Butter*	Class IV
Nov	1.6960	1.6534	14.95	1.9240	13.35
Dec	1.7200	1.6750	16.90	1.8270	13.85
Jan	1.4400	1.4125	14.50	1.4075	11.70
Feb	1.4000	1.3700	12.90	1.4700	11.60
Mar	1.3750	1.3450	12.75	1.4750	11.65
Apr	1.3500	1.3200	12.50	1.3800	11.40

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

Exceptional demand has propelled dairy product prices to new seasonal highs. This near-term bullishness is likely to translate into mid-to- longer-term bearishness. Over the next couple of weeks, milk from the Southeast is expected to back up into more northern processing plants. Consumers are likely to face higher milk prices in January as the fluid milk price to producers increases about 20 cents per gallon. Net-net, higher milk prices drive producers to increase supply while causing consumers to reduce their demand. MCT

No packer fat...

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In the livestock industry, there has been increasing concern in the livestock sector over the level of concentration and the amount of price discovery information available to all participants. Congress passed the Livestock Mandatory Reporting Act of 1999; but it wasn't implemented until April 2001. The Act aimed to provide information that could be readily understood by producers, packers and other market participants, including price information, contracting for purchase, and supply and demand conditions for livestock, livestock production and livestock products.

USDA's Agricultural Marketing Service (AMS) publishes daily and weekly summary reports for swine, beef and lamb. The livestock sector does not have a national market but is dominated by regional markets.

There are five regional direct-slaughter markets for live cattle: Texas/Oklahoma; Kansas; Nebraska; Colorado; and Iowa/Minnesota. AMS publishes daily market updates in the morning as well as in the afternoon.

The cash markets for live cattle include: regional packing plants, forward contracts and local livestock auctions. For example, a large feedlot may commit 5,000 head to one of the four large packinghouses. The price received by the feedlot may be based upon the average price reported by USDA's *Market News* on the day of delivery, or off the nearby live cattle futures contract.

A valid concern in the livestock sector is the reliability of the cash market as a greater percentage of livestock are sold through other pricing arrangements. According to the U.S. Hog Marketing Contract Study published by the University of Missouri, 43.4% of U.S. hogs were sold on the cash spot market in 1997. By January 2004, that figure had dropped to 11.6%.

The study also indicates that when the percentage of spot sales is added to the percentage of hogs purchased on a swine-pork market pricing formula, the price of at least 53% of the hogs in the United States was directly related to the spot market. Nevertheless, the study shows that the continued decline in the spot market for hogs increases the urgency for the industry to find another form of price discovery for most of the contracts. This is particularly true since the hog futures contract is not deliverable and settles against an increasingly thin cash hog market.

As early as the mid-1970s, agricultural economists suggested the use of electronic markets as an alternative to thinly traded cash markets. One study notes that problems occur when many want to use open-market prices as the basis upon which to establish product values, but few are using the open market for buying and selling.

This is clearly the case in U.S. hog and cheese markets. Virtually all 8.6 billion pounds of cheese produced in the United States is priced off the cash cheddar cheese price while less than 1% of cheddar cheese production is traded on the cash market.

The dairy industry introduced Dairy.com in 2002 as an electronic trading platform for milk and dairy products. To date, however, Dairy.com has been primarily used to trade cream. MCT

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