



MCT COMPASS

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A Demand Market

Every so often the stars align in such a way that the dairy markets are poised for unusual strength. This was the case in the U.S. domestic market in 2004. The large dairy herd sell off during 2003 that followed exceptionally low milk prices during 2002 and the first half of 2003, in tandem with the closing of the Canadian border and the rationing of bST, fed a bull market.

The Supply Side

Seldom do two bull years occur back to back. Most thought 2005 would be different than 2004 since high price years are typically followed by low price years. While 2005 could still produce a bear

market, so far the bearish factors of more cows, more bST and cheaper feed have not combined to create a significant increase in milk production.

Historically, the industry has counted on an annual average 2.0% increase in milk per cow to offset the typical 1.0% decline in the dairy herd. That leaves a net increase in total milk production of a little more than 1.0%, which narrowly outstrips the 0.8% average population growth.

For the past two years, however, the growth in U.S. milk production hasn't kept pace with population growth. Milk production was up just 0.15% during 2003 follow by a meager 0.1% increase in 2004. In other words, the U.S. population has

grown by about 1.6% over the past two years while U.S. milk production has increased by just 0.25%.

Moreover, lackluster milk production growth has not been contained to the United States. Production reports from both Europe and Oceania indicate that milk output is trailing prior-year production in both regions. The majority of manufactured dairy product stocks in Oceania are fully committed.

Meanwhile, European stocks of nonfat dry milk are available and modestly more price competitive than in recent

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KEN'S CORNER



*by Ken Meyers
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Historically, the dairy industry, both domestically and globally, has operated in a supply market.

That is, government programs and policy have generated adequate supplies. But how do we manage

for a demand economy? A global economy? Is this a short-run situation, or part of a longer-term trend?

A variety of forces have now aligned to create a demand economy: foreign currency movements, weather impact on global production, and greater global demand, particularly from China. So far the United States has stepped up to the plate and

supplied the global skim powder market with more than one-third of our domestic production.

The United States played a greater role in world dairy markets in 2004, while domestic dairy producers received the highest annual all-milk price in history. Clearly, the two events are not mutually exclusive. **MCT**

Seller's Market

The dairy product markets are nervously awaiting some clear direction. And while a correction in the cheese market is expected, it is not likely to be as great as some in the industry anticipate. Until year-over-year monthly milk production increases exceed

2.0%, it clearly is going to remain a seller's market. **MCT**

MCT Forecast					
	Block*	Barrel*	Class III	Butter*	Class IV
Jan	1.6269	1.5796	14.20	1.5757	12.55
Feb	1.6550	1.6300	15.95	1.6850	12.85
Mar	1.6050	1.5800	15.30	1.7375	13.10
Apr	1.5850	1.5600	15.00	1.6850	12.95
May	1.5000	1.4750	14.50	1.5550	12.30
Jun	1.5500	1.5250	14.25	1.6100	12.55

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

Supply side gives way...

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weeks. The EU Dairy Management Committee recently increased the export refund of 10 Euros to 280 Euros per metric ton (or 9.8 cents per pound), and the U.S. dollar continues to be weak compared to other world currencies.

The Demand Side

USDA reports positive growth in commercial disappearance of butter, cheese and nonfat dry milk powder during the first three quarters of 2004. Only fluid milk sales were reported lower, down 1.6%. In total, sales of milk in all products increased 0.2%.

However, November's data indicates that sales of milk used in all products were substantially higher than the prior year, up 2.9%. And a glance at the year-ending stocks of butter, nonfat dry milk and cheese indicates robust sales through year end.

The commodity that experienced the greatest increase in commercial demand during the

year was nonfat dry milk. Through October, sales were up almost 45%. The combination of food aid, DEIP and commercial exports have resulted in more than 430 million pounds of nonfat dry milk being exported through December. That's equal to about one-third of domestic production.

The last time the United States was such an active exporter was in 1989. Just like now, milk production that year was lower in the three major milk production regions: the United States, Europe and Oceania. Production in the United States and Oceania was lower than expected due to weather related problems. And European production and stocks declined after the implementation of output-restricting milk quotas.

The combination of global demand and lower milk production shot domestic nonfat dry milk prices past \$1.70 per pound in November 1989. At the time, the support price for nonfat dry milk was only 70 cents per pound. In some cases, domestic powder manufacturers

committed to export sales early in the year expecting an ample milk supply. But when milk production declined by 0.8%, they and other end users were caught short, causing domestic prices to soar.

The current demand for nonfat dry milk on the export market could very well be more than a passing fad. Oceania has made clear commitments to produce a greater percentage of whole milk powder and cheese rather than nonfat dry milk and butter. In Europe, the expanding European Union is internalizing demand for dairy products that were once exported on the world market.

As a result, the price of nonfat dry milk will more likely be a function of global demand rather than the U.S. domestic support price. The marketing arrangement between Fonterra and Dairy America provides a strong global customer base for U.S.-sourced skim milk powder since Fonterra is naturally short of nonfat dry milk. **MCT**

