



MCT COMPASS

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Connecting the Dots

Since the beginning of the year, we've watched the Chicago Mercantile Exchange (CME) cash Cheddar market rise 20¢, fall 30¢, only to rebound 20¢. That translates into a nearly 20% price variation, and we're not even into the second quarter.

The release of USDA's *Milk Production* report in mid-February stymied the bulls. The reported 1.3% increase in milk production for the selected 23 states, which produce 91% of the nation's milk supply, was above the historical growth rate of 1.2%.

Granted this increase came on top of a 0.9% decline in milk production during January 2004. In other words, January output would

only have increased by 0.4% had January 2004 kept pace with 2003. During that same two-year period, U.S. population grew by 5.7 million people, almost 2%. So while milk production growth is trending higher, it has not kept up with population growth.

A week after the milk production report, USDA released its monthly *Cold Storage* report. While the industry expected fewer pounds of cheese in storage compared with the previous year, market watchers were not prepared to see a number as low as what USDA published.

With commercial stocks of American cheese at 480.6 million pounds, there's 5.5%, or 27.9 million pounds, less cheese in storage than

there was at the end of January 2004. Keep in mind, though, that the American cheese reported is product that is expected to be stored for more than 30 days.

One could make a case for not stockpiling cheese in January 2005, while at the same time arguing that January 2004 was a good time to put cheese into inventory. If we flash back to January 2004, the industry was coping with the discovery of a BSE-positive cow in Washington state. This subsequently led to the closing

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KEN'S CORNER



*by Ken Meyers
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The roller coaster has left the gate and it's hard to tell if we're on top of the coaster, climbing higher, or heading lower. Managing through production and price volatility will once again be a

key issue for all segments of the dairy industry in 2005. Perhaps it's time to consider how much of this volatility is market induced or a byproduct of regulated milk pricing. After all, the Class III (cheese milk) price was \$14.14 in January when the CME block price was

near \$1.62 per lb. A month later, cheemakers' milk costs are higher but their selling price is lower. More timely market signals to both the producing and manufacturing sectors would likely reduce some of the production and price volatility. **MCT**

Repeat of 2004?

If the market was able to justify last year's butter prices, it's hard to imagine why the market won't support a similar pricing level in 2005. Inventories are even lower than last year. The world market is strong with limited supply available for the U.S. market. And the low US\$ does not make the United States an attractive import market. **MCT**

| MCT Forecast | | | | | |
|--------------|--------|---------|-----------|---------|----------|
| | Block* | Barrel* | Class III | Butter* | Class IV |
| Feb | 1.4901 | 1.4439 | 14.64 | 1.6273 | 12.75 |
| Mar | 1.6400 | 1.6000 | 14.50 | 1.6850 | 12.83 |
| Apr | 1.5850 | 1.5600 | 15.00 | 1.7000 | 12.80 |
| May | 1.5000 | 1.4750 | 14.30 | 1.6850 | 12.75 |
| Jun | 1.5500 | 1.5250 | 14.15 | 1.6000 | 12.45 |
| Jul | 1.6000 | 1.5750 | 14.60 | 1.6500 | 12.65 |

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

Diverging tea leaves...

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of the Canadian border coupled with a reduction in the supply of the growth hormone bST. In other words, the industry was preparing for fewer cows and less milk per cow. Inventory building was driven by the expectation that there would be less milk and cheese produced during upcoming months.

Fast forwarding to January 2005, the industry was expecting an ever-increasing milk supply driven by more cows and rebounding milk production per cow. But clearly not everyone was reading the tea leaves in the same direction: the CME block Cheddar cheese price rallied from \$1.485 at the beginning of the month to \$1.755 per pound by the end of the month. Given the dramatic rise in cheese prices during the month, it's not surprising that some end users backed-

off putting cheese in storage.

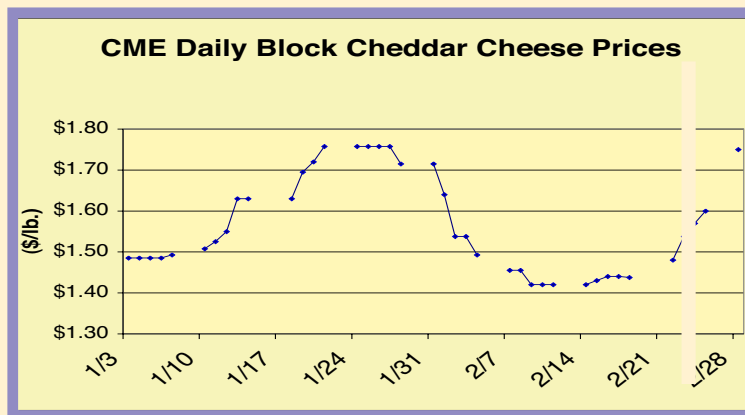
On the surface, January appears to have been a profitable month to make cheese. The CME block market averaged \$1.62 per pound while the Class III price was \$14.14 per hundredweight. Just the opposite is true in February; the Class III price is expected to be near \$14.64, or 50¢ higher, while the CME block price averaged less than \$1.50 per pound, 13¢ per pound less than in January. Higher milk costs in tandem with

lower cheese prices are typically not the recipe for greater cheese output.

If cheese manufacturers produced just enough to cover orders in February, it's likely that there is not going to be much extra cheese laid away during February either. That leads us to March and what's ahead.

The tea leaves of one segment of the market point to a scenario in which both milk and cheese

production come on strong during second quarter, while another segment is interpreting the leaves to mean that January's low stocks are a sign of robust commercial disappearance. This segment also believes that demand will continue to outpace supply. We'll soon see who's right. **MCT**



CME block Cheddar prices have recently fell from peak levels.

Source: MCT Dairies.

