



MCT COMPASS

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How Low Will We Go?

The supply side

After more than a year of higher than historical average prices, the tide appears to be changing. Milk production is rising at an increasing rate and the dairy herd is growing despite the culling of 53,000 cows in late 2004 and early 2005 by the Cooperatives Working Together (CWT) program.

In January, USDA estimated the number of milk cow replacements expected to calve this year at 2.8 million head. That is 69,000 head greater than last year. It appears that some of the animals entered the herd in March as the U.S. dairy herd expanded by 28,000 head to 9,010,000.

In addition, dairy cow slaughter numbers trail year-ago levels by 40,000 head. Dairy producers have had little incentive to cull their herds despite strong cull cow prices. Several key factors have been influencing the cull rate. First, milk prices are high. Second, the milk feed-price ratio is favorable, and third, the cost of replacement heifers is also strong. Despite receiving \$800 a head for a cull cow, the replacement cost is over \$2,000 per head.

The demand side

Commercial disappearance of cheese and butter was positive in 2004 despite exceptionally strong wholesale prices. Commercial disappearance of American cheese

increased 2.4% while the Other Cheese category posted a 2.9% gain. Butter followed with a 1% increase, and strong sales continued into February 2005.

However, the more-than-ample butter and cheese stocks reported by USDA as of March 31 indicate that either butter and cheese production were exceptionally strong during March (figures to be released May 5) or domestic demand has softened.

On the Chicago Mercantile Exchange (CME), cash butter and cheese are trading at or below trading lows for the year.

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KEN'S CORNER



*by Ken Meyers
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The industry is facing its first flush in three years. It's hard to say whether the

growing milk supply is due to expansions at the farm level or whether supply is

just catching up from two years of lackluster growth.

Despite the onslaught of production, global demand is soaking up skim milk powder. The combination of the Dairy Export Incentive Program and the Cooperatives Working Together program will also help clear additional product.

At this point, though, it is still unclear whether the strong economy of 2004 is continuing through 2005. Recent data would suggest an economic slowdown, but the crystal ball for the remainder of the year is still pretty cloudy. **MCT**

Low only temporary

Look for softening as the spring flush carries through May. Our bet is that the CWT program with the help of a weak dollar and a strong global market will be successful in buoying the CME cheese market. Sure, cheese may trade near \$1.40 per pound, but don't expect it to stay low too long. The strong milk production

gains vs. the prior year will taper off by mid-year as the dairy herd

rebuilt to last year's mid-year herd level. MCT

MCT Forecast					
	Block*	Barrel*	Class III	Butter*	Class IV
Apr	1.5413	1.4800	14.61	1.4933	12.61
May	1.4550	1.4300	13.70	1.4500	12.30
Jun	1.5150	1.4900	13.70	1.5400	12.70
Jul	1.6000	1.5750	14.65	1.5900	12.90
Aug	1.6350	1.6100	15.20	1.6100	13.00
Sep	1.6750	1.6500	15.60	1.6450	13.15

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

Spring flush to test prices...

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CME cash butter is trading at its lowest price level since August 2004. Barrel cheese is at par with its previous low posted in mid-February 2005, while block cheese prices are still a few cents above their mid-February low of \$1.42 per pound.

The CWT effect

With CME cheese prices trading precariously close to \$1.40 per pound, many are wondering if CWT, the self-funded supply management program, can make an impact in the face of rising milk production.

Since the program's inception in July 2003, milk production and hence dairy product production grew at far less than the 1.0% annual increase in milk production. In fact, milk production growth during 2003 and 2004 was limited to just 0.2% annually.

The current spring flush is likely to test the CWT export assistance prices for cheese and perhaps butter. CWT operates the export assistance program during periods when the CME cheese price is \$1.40 per pound or lower, or \$1.30 per pound or lower for butter.

CWT does not take ownership of any product; It just provides export assistance similar to the USDA's Dairy Export Incentive Program (DEIP). The assistance is the difference between the U.S. domestic price and the world market price. The current Cheddar cheese price out of Oceania averages about \$1.26 per pound plus transportation. Being generous, CWT assistance would most likely not exceed 20¢ per pound.

CWT set a 2004-05 goal of removing 20 million pounds of cheese and 7 million pounds of butter. For all of 2004, CWT provided export assistance for

approximately 7.9 million pounds of cheese. Assuming a 20¢ per pound level of assistance, CWT would need \$2.4 million to support 12.1 million pounds of cheese exports prior to June 30, 2005, to meet its 2004-05 goal of removing 20 million pounds of cheese from the domestic market. According to a recent news release, the program has more than \$10 million available for dairy exports.

Although the CWT program will not accept bids for export sales to Mexico, Caribbean nations, or Central America in an effort to reduce the possibility of product reentering the U.S. market, the United States is in a good position to land non-subsidized sales of cheese into Mexico due to the more favorable terms for U.S. imports. The United States faces zero tariffs on its cheese into Mexico while New Zealand and others are hit with a 20% tariff. MCT

