



MCT COMPASS

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Slumbering Bear to Stir in 2006

World trade played a much larger role in U.S. dairy markets in 2004 and the first half of this year than it has in a long time. Not only did the U.S. dairy industry benefit from drought in New Zealand and Australia, which allowed large quantities of powder to move offshore without government subsidies, but a continued ban on live cattle from Canada also kept U.S. dairy farm expansion in check—that is until the past few months.

Large year-over-year gains in milk production, like those seen recently, are uncommon and usually portend large declines in dairy product prices, but demand has also been robust as evidenced by the recent Cold Storage report.

A strengthening U.S. economy has allowed the Federal Reserve to

increase interest rates eight times since June 2004 and consumer confidence has nearly recovered to levels seen prior to the NASDAQ stock market crash that began in 2001.

The producer-funded Cooperatives Working Together (CWT) program also played a key role in keeping prices strong. At a block cheese price of \$1.40/lb., CWT began to remove cheese from the market, which in effect usurped the government support price to become the new price floor.

To get a sense of where markets might go from here, *MCT Compass* compiled a consensus forecast from futures prices and the forecasts of six top dairy analysts: Bill Brooks, e-Dairy Inc.; Bob Cropp, University of Wisconsin; Wilson Gray, University of Idaho; Alan Levitt, Levitt Communications; Mary Ledman,

Keough Ledman & Associates; and Mark Stephenson, Cornell University.

The verdict from the group is weakening prices over the next five months with lower prices in 2006. On cheese, MCT's panel of experts expects the 40-lb. NASS block price to drop to just under \$1.43/lb. by December. The most bearish of the six analysts pegs the block price at \$1.35 by December, while the two bulls expect prices to hold, ending the year near \$1.47.

All of our experts expect the Class III price to drop below \$14.00/cwt. by year end, with the most optimistic forecast at \$13.50 by December and the most

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KEN'S CORNER



by Ken Meyers
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Today's teeter-totter markets continue to perplex even the best market watchers. June's Milk

Production report showed the largest year-over-year gain in almost two decades, which should have put prices into a tailspin. Days later, however, the Cold Storage report showed that

confident, dairy-loving consumers are supporting dairy markets just like they're pushing up real estate values — and for good reason. Continued weather problems in Oceania and Europe in 2006 could cut into butter and powder production just as feed-quality and availability problems threaten to derail the U.S. milk production recovery.

However, today's confident consumers could also start paying attention to the fed chief's comments about growing real estate speculation and "frothy" values as well to news reports about how spendthrift

Americans are not saving nearly enough. If consumers take those comments to heart in upcoming months, demand could suffer a temporary setback. While any demand dip will be brief, timing could be critical.

Whichever way consumer behavior and weather markets play out, everyone agrees that butter and cheese prices in 2006 will be lower than they are this year. Bear in mind, though, that while 2006 prices will be lower compared to 2005 values, they'll still look strong historically. **MCT**

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Sleepy bear...

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pessimistic at \$12.42. The consensus: \$13.17.

The range of predictions for Class IV prices by the end of the year is about as wide as that for Class III. The consensus December forecast calls for butter-powder milk to fall to 12.38/cwt., with the high forecast at \$12.80 (futures and one expert) and the low at \$11.89.

As a group, the economists expect NASS butter prices to drop to \$1.46 by December, with nonfat prices holding fairly steady at 92.93 cents. Of all the commodities, whey generated the most disagreement. One analyst sees whey prices steadily rising to 31.33 cents by December, while another expects prices to gradually drop to 22 cents.

Looking at 2006, the economists become more bearish. The panel's consensus for Class III prices next year is \$12.53/cwt., with an average cheese price of \$1.38. The Class IV prediction is lower at \$12.09, with 2006 butter prices averaging near \$1.43/lb. and powder prices slightly more than 91 cents per pound. Whey, again, causes the most disagreement, with price predictions ranging between 32.5 and 20.15 cents.

Admitting that anything could happen, the analysts couched their 2006 supply-side predictions. For instance, one says that price drops "will be worse and declines swifter" if the U.S. opens its border to Canadian replacements.

At the other end of the spectrum, another says that "a \$2.00/cwt. drop in the average milk price could prompt some retirements, or sell outs, especially if feed quality and availability is questionable." **MCT**

Consensus Forecast

	Cheese	Class III	Butter	Class IV	Whey*	SMP*
July	1.5162	14.36	1.5848	12.89	27.88	93.51
Aug	1.5075	14.19	1.5655	12.89	27.71	93.92
Sept	1.5143	14.22	1.5563	12.86	27.62	93.93
Oct	1.4906	13.93	1.5442	12.72	27.02	93.76
Nov	1.4564	13.50	1.5173	12.58	26.43	93.35
Dec	1.4274	13.17	1.4600	12.38	25.59	92.93
Avg	1.4893	14.00	1.5338	12.70	27.03	93.54
2006	1.3811	12.53	1.4334	12.09	24.75	91.58

* Whey and SMP in cents.

What the experts are saying

Bill Brooks For the first six months of this year, steady demand and a lack of substantial imports offset U.S. milk production. However, continued strong milk production for the second half of this year and the start of the production season in the Southern Hemisphere will overtake demand.

Bob Cropp I expect milk production next year to show a year-over-year increase of 1.7% to 1.8%. At the same time, commercial disappearance will increase by only 1.5%, and that points to lower milk prices in 2006. One uncertainty is the severe drought in Illinois and Wisconsin, which could raise corn, soybean, and hay prices, limiting milk production.

Wilson Gray If the heat this summer slows production enough, prices could be supported into the fall. However, with continued growth in dairy cow numbers, total production is likely to continue to increase well into 2006. Increased supply will start to dampen prices by year end.

Alan Levitt The new Southwest Cheese Co. plant in Clovis, N.M., could shift industry dynamics next year. UF milk that's now moving to Midwest plants will go into that plant, leaving Midwest plants short. Likewise, the Midwest will have to supply the Southeast during summer and fall because New Mexico-area milk will be used at Clovis, and Clovis will be turning out 100+ loads of American cheese per week.

Mary Ledman A key factor that will prevent a total market collapse, like we experienced in 2002, is the strength of the world market. Instead of selling surplus into government storage, the United States has become a key supplier of skim milk powder on the world market. The fact that skim milk powder is finding a commercial outlet mitigates what would be a burdensome supply of powder and buoys the market price.

Mark Stephenson We will begin to hear a lot more about the next Farm Bill in 2006. As WTO negotiations progress, the U.S. position will be more on the fringe of what's considered acceptable by other countries. Washington will also be feeling the need to address the largest deficit spending ever incurred. Agriculture, including dairy, will have to face its fair share of federal cuts.

