



MCT COMPASS

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Modest Recovery Ahead

Milk production gains rose to a feverish pitch in the second half of last year and the first half of 2006, driven by milk production per cow and cow numbers that have trended well above average. Exceptionally high milk prices in 2004 and 2005 enticed producers to begin expanding their herds in May 2004 and they haven't stopped yet. Cow numbers from May 2004 through June 2006 have risen 1.8%, a 165,000-head gain. Growth in per cow milk output, although starting to slow, has also been strong, rising to a peak of 1,757 lbs. last month.

Demand for dairy products during this period has been pleasantly strong but not strong enough. Since January of this year, milk production has outpaced demand and, for the most

part, stocks have been steadily building. For months, the industry has been saddled with ample-to-burdensome stocks along with weak to lower dairy product prices. Many cheese buyers, particularly buyers of process cheese, put product into storage when prices were low.

For the remainder of this year and into next, cow numbers will be the benchmark that analysts watch. Until producers start culling their herds, heavy supplies of milk and dairy products are expected to prevent prices from spiking. Factors other than soft milk prices that might entice producers to cull their herds are: hot weather that knocks some cows into the low-producing group; low-quality or not enough feed in some areas; and high feed costs for those who purchase feed.

To get a sense of where markets

might go from here, *MCT Compass*, once again, collected forecasts from a handful of top dairy analysts: Bill Brooks, e-Dairy Inc.; Bob Cropp, University of Wisconsin; Wilson Gray, University of Idaho; Mary Ledman, Keough Ledman Associates; Alan Levitt, Levitt Communications; and Mark Stephenson, Cornell University. Their forecasts were then added to the futures market prices when applicable and merged into a consensus forecast.

The consensus? A milk price recovery is in store, but it will be slow to arrive. The group's average Class III price for the remainder of 2006 is only \$11.63. Looking ahead to next year, the

Continued on page 2

KEN'S CORNER



*by Ken Meyers
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You've heard it before and you'll hear it again: you can't believe everything you read. Dairy

economists and milk price forecasters have a tough gig. Not only do they need to predict human behavior, but they also need to make certain assumptions about the U.S. economy, the

weather, world trade conditions, a changing health environment as it relates to food, politics, the business environment, and government regulations in order to develop a forecast. They can't be right on all fronts.

Long-range forecasting is a dirty job, but someone has to do it. We took a look back to see how well our experts have done over the past three years and the answer is about as well as can be expected. On their short-term forecasts, they were much closer as one might anticipate.

So what does this tell us? It tells us

to use the 2007 consensus forecast as a starting point and as a planning tool, but to be ready for unexpected market shocks. Some recent shocks that have blindsided our analysts over the past few years, have been the closing of the Canadian Border for importing Canadian heifers and cows into the United States and the rationing of rBST. In recent years, we've also seen market-altering programs, like CWT and MILC, implemented. So expect a slow recovery but be ready for the unexpected. **MCT**

Prices to inch higher...

Continued from page 1

group sees some recovery occurring, with a consensus Class III forecast of \$12.58. The most bearish of the six analysts expects Class III prices to be at \$11.07 by December and the most bullish sees a Class III price of \$12.12 by year-end. Looking ahead to next year, the group is divided, with the most price pessimistic predicting an average Class III price of \$11.80 and the most optimistic expecting a yearly average price of \$14.05, a range of \$2.25/cwt.

Our panel of experts expects Class IV prices to remain relatively low throughout the remainder of this year and next. Their average forecast places the July through December Class IV price at \$10.76 and the 2007 price at \$11.39. The range in their average 2007 forecasts is much more narrow than their Class III forecasts, from \$10.35 to \$11.25, less than \$1/cwt. difference.

Butter and cheese prices are also expected to recover into 2007, with the consensus second-half 2006 forecast calling for an average butter price of more than \$1.28 and an average NASS 40-lb. block cheese price of \$1.32. Individual 2007 forecasts range between \$1.275 and \$1.48 on cheese and \$1.185 and \$1.27 on butter.

When looking at the consensus forecast, whey prices are expected to remain stable well into 2007. Both second-half 2006 and 2007 averages fall in the 27-cent range. However, when looking at individual forecasts, our experts' 2007 average whey forecasts range between 26 cents and 30 cents per pound. **MCT**

Consensus Forecast

	Cheese	Class III	Butter	Class IV	Whey*	SMP*
July	1.1869	11.03	1.1375	10.31	27.74	82.34
Aug	1.2150	11.42	1.1657	10.52	27.75	82.40
Sept	1.2704	11.96	1.2168	10.75	27.89	82.92
Oct	1.2751	12.07	1.2444	10.94	27.65	82.96
Nov	1.2610	11.90	1.2483	10.97	27.20	82.82
Dec	1.2400	11.71	1.2246	10.87	27.09	83.56
Avg	1.2401	11.63	1.2125	10.76	27.93	82.93
2006	1.3201	12.58	1.2877	11.39	27.11	84.51

* Whey and SMP in cents.

What the experts are saying

Bill Brooks: Producers will continue to be squeezed by low milk prices and higher input costs into 2007. Feed costs have been creeping higher and could really jump if moisture is not received in the western Corn Belt. That said, producers are expected to continue to add cows through the end of the year.

Bob Cropp: Our current \$9.90/cwt. support program does not score well under WTO "amber box" regulations. Because of this, I do not expect any increase in support levels in the 2007 Farm Bill. With the large federal deficit and the MILC program expiring Aug. 31, 2007, increased spending for dairy programs is not likely.

Wilson Gray: If inflation fears, climbing fuel costs, or a yet unknown shock to the economy slows spending, dairy stocks could build quickly and prices could become more depressed. Home refinancing has driven much of the growth in consumer spending. Slowing increases, a flattening, or declining house values could have a longer-term negative effect on purchasing.

Mary Ledman: Despite lower milk prices, the pain has not been great enough to cause a contraction in cow numbers and hence milk supply. Strong milk prices in 2004 and 2005 have left dairy producers in a good financial position to weather current low prices. Without a major correction, low prices will continue into 2007.

Alan Levitt: CWT did its job too well; If you give producers \$16 milk for two straight years, they'll produce considerably more milk than anyone can consume. Now we're dealing with the backlash of encouraging more milk than the market can bear. CWT export volumes have proven inconsequential in terms of clearing the market of surplus.

Mark Stephenson: Butter inventories are creeping up. This will keep downward pressure on milk prices as traders begin to realize we need to move butterfat. We have already seen some farm reaction to lower milk prices in the form of weak growth in milk per cow. And while expansions have continued to fill barns, growth in cow numbers will slow and perhaps retreat as we continue to face low milk prices.

