



MCT COMPASS

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Is Powder Really Drying Up?

Even prior to the triple-digit heat wave hitting the West, nonfat dry milk powder production was on the decline. According to USDA's latest Dairy Products production report, the combined production of nonfat dry milk and skim milk powder totaled 138.9 million pounds in June. That was 4.6% lower than the prior month and 7.4%, or 11.0 million pounds, less than June 2005. Those 11.0 million pounds of powder translate into about 275 loads.

The vast majority of that decline occurred outside California, though, with production in the South Central and East North Central regions down 4.5 million and 2.1 million pounds, respectively. Production in the Atlantic region declined by 1.9 million pounds. Some of the decline

is due to seasonally lower milk production and some can be attributed to a switch from powder production to cheese production. Still, these regions are not the dominant powder producers.

The Western region produces 75% of the nation's nonfat dry milk. California alone accounts for nearly 50%. During June 2006, California's production of nonfat dry milk actually increased 10.3%, or by 4.9 million pounds vs. June 2005. However, output in both July and August is expected to dip below prior-year levels due to a heat-induced reduction in milk supplies. Then beginning in September through the end of this year, nonfat dry milk production is, once again, expected to post year-over-year gains.

The prolonged 2006 spring flush, which seemed to start in March and continue through June, resulted in a

3.5% gain in U.S. milk production for the first half of the year. Much of the surplus output went into nonfat dry milk production and ultimately resulted in USDA purchasing almost 64.0 million pounds of nonfat dry milk powder under the price support program. Now that nonfat dry milk prices have jumped about a dime in August, some of those sellers are wishing they had that powder back to sell on the open market. Nonfat dry milk futures indicate that prices are expected to continue to rise through year-end. However, some question whether this quick market gain is supported by market fundamentals or whether it is just an overreaction to a blip in market conditions.

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KEN'S CORNER



*by Ken Meyers
President
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It's my perception that USDA could be underestimating 2006 exports of nonfat

dry milk/skim milk powder as we anticipate a greater percentage of exports weighted toward the second half of the year. A 50,000 metric ton blip in either supply or demand

could change the outlook for powder prices. In addition, the industry needs to remember that as an increasing share of U.S. powder enters the global marketplace, monetary policy and exchange rate fluctuations can play havoc with both world and domestic powder prices.

One has to wonder whether USDA will alleviate some of this actual or perceived tightness by releasing government stocks. To

date, USDA has been quiet on this subject. We do know that about 34 million pounds has been targeted for world food aid. It is very possible that USDA could use the remaining stocks for domestic programs. Only time will tell what USDA does but we don't expect stocks to accumulate as they did during the last dairy expansion in 2002. **MCT**

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Milk Slowdown

Milk and dairy product markets are strengthening as a result of a decrease in the rate of milk production growth and rising seasonal demand. USDA estimates Q2 2006 milk production at just 2.3% greater than last year. This pales in comparison to the 5.1% gain during Q1 2006 vs. the prior year. Despite the recent market gains, both the cheese and butter markets are lower than their 5-year averages, but are

MCT Forecast					
	Block*	Barrel*	Class III	Butter*	Class IV
Aug	1.2353	1.2204	11.07	1.3036	10.85
Sep	1.3550	1.3300	12.40	1.3750	11.70
Oct	1.3750	1.3500	13.05	1.3500	11.50
Nov	1.3750	1.3500	13.00	1.3500	11.50
Dec	1.3650	1.3400	12.85	1.3200	11.40
Jan	1.3450	1.3200	12.65	1.3000	11.30

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

from 10 to 15 cents per pound higher than the first half of 2006. Cheese and

butter prices are expected to rise modestly through year end. **MCT**

Not just a U.S. market ...

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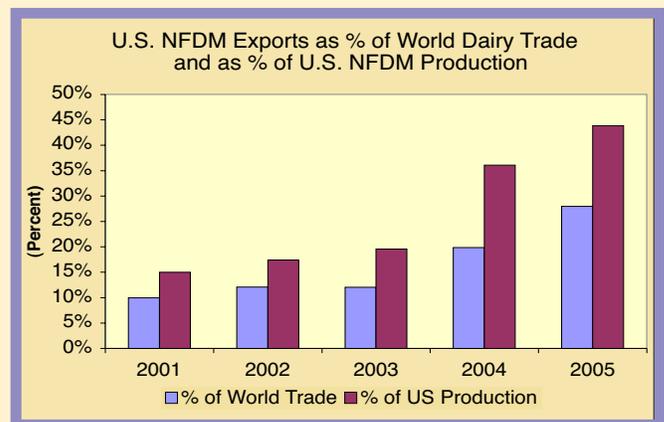
Since 2001, nonfat dry milk/skim milk powder exports have grown as a percent of domestic production and as a percent of the world market. The chart below illustrates that in 2001 nonfat dry milk exports accounted for just 15% of domestic production and 10% of world trade. By 2005, nonfat dry milk exports represented almost 45% of domestic production and 28% of world trade. The large increase in U.S. exports has been partly due to favorable exchange rates and tight world supplies.

Currently, none of the other key global sources of skim milk powder are flush with product, but supplies are expected to increase in several key markets, including Oceania and the United States. Production in Oceania is forecast at 465,000 metric tons this year, a 34,000 metric ton increase and a nearly 8% rise. Production in the United States is expected to hit 790,000 metric tons, a 50,000-metric-ton, or nearly

7%, increase. Supplies in the European Union are forecast to fall by 34,000 metric tons, or 3%, this year. Overall, in the selected countries monitored by USDA's Foreign Agricultural Service, however, nonfat dry milk and skim milk powder supplies are expected to increase by 82,000 metric tons, or 2.4%.

From a fundamental standpoint, a few unanswered questions remain as to why U.S. nonfat dry milk prices are rising. According to USDA's Foreign Agricultural Service, U.S. exports of 145,000 metric tons of nonfat dry milk for the first half of the year were down 13% from the comparable period a year ago. Production of nonfat dry milk during that same period was up 11.9%. Moreover, according to FAS 2006 exports are forecast to be 50,000 metric tons less this year, compared to 2005 exports. At the same time, U.S. production

of nonfat dry milk is forecast to be 50,000 metric tons, or nearly 7%, higher than last year. Year to date, the Commodity Credit Corp. has purchased 64 million pounds (or 29,030 metric tons) of nonfat dry milk under the price support program. Last year, CCC did not purchase nonfat dry milk. And as noted above, global supplies of nonfat and skim milk powders are expected to increase this year according to the Foreign Agricultural Service. This begs to question the long term viability of higher nonfat dry milk prices. **MCT**



Source: USDA Foreign Agriculture Service.



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