



MCT COMPASS

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From Demand to Supply

Total cheese production through the third quarter of 2006 is up 3.5%, driven by a 3.9% increase in Mozzarella cheese production and a 3.7% increase in American cheese production. In September 2006, American cheese production posted a phenomenal 7.7% gain in production, compared with the prior year.

About the only statistic more spectacular than the September American cheese production figure was the level of commercial stocks of American cheese as of September 30, 2006: down 4.2% from the prior month and 1.2% lower than last year. In other words, despite a significant increase in production, stocks decreased. And as the industry digested the production and stocks

reports, the Chicago Mercantile Exchange (CME) spot block cheese price posted its largest monthly price increase this year of more than a dime, from \$1.235 per pound to \$1.375 per pound.

Intermixed with the stocks data was a special note indicating that USDA has implemented mandatory reporting for dairy products included in the Cold Storage report. As a result, additional data have been collected that were not previously reported. Since USDA does not have comparable data for 2005, it is publishing a separate table with the expanded survey results. According to the expanded survey, American cheese stocks totaled 546.1 million pounds as of October 31, 2006, down 23.1 million pounds or 4.1%.

Supporting the strong increases in

commercial disappearance are lower consumer prices. According to the Bureau of Labor Statistics, consumers have enjoyed lower-priced butter, cheese, and fluid milk during 2006. Through October 2006, the butter CPI has averaged 7.5% less than last year while the CPIs for cheese and fluid milk have averaged 1.1% and 0.9% less than a year ago, respectively.

Assuming that 30% of the U.S. milk production is utilized in fluid milk products, a 1.0% increase in commercial disappearance means U.S. milk production would have to increase 0.3% to fill the 1.0% gain in demand from the fluid market. Likewise, the 2.7%

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KEN'S CORNER



*by Ken Meyers
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The 2002 Farm Bill included a provision for mandatory reporting of the production, stocks, and prices of dairy commodities (American cheese, butter, nonfat dry milk, and whey) used in the milk pricing formulae. Mandatory reporting of dairy product prices and production

was mandated a few years ago. One reason for the delay in implementing mandatory reporting of stocks is that public warehouses, not dairy product manufacturers without storage facilities, are surveyed for the report. As a result of the mandatory reporting, the industry will get better data — albeit in the near term, only month-to-month comparisons will be comparable as USDA builds its database.

Current strong domestic and global dairy product demand is setting the

stage for higher prices in 2007. One needs to be cognizant that while lower product prices during the first three quarters of 2006 spurred domestic demand, they also have contributed to the slowdown in milk production growth as producers begin to respond to higher input costs. As producers and consumers respond to their respective price elasticities, the dairy sector will adjust to a new supply-demand equilibrium in 2007. **MCT**

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The Power of Protein

Protein markets remain strong especially compared to butterfat. Whey and lactose are posting new highs, both have surpassed 40 cents per pound and are now marching toward 50 cents. High nonfat dry milk prices are keeping additional solids from entering the cheese vat and ultimately reducing whey and/or lactose production. Cheese prices are expected to

MCT Forecast					
	Block*	Barrel*	Class III	Butter*	Class IV
Nov	1.3758	1.3824	12.89	1.2915	12.16
Dec	1.3300	1.3300	13.70	1.2750	12.75
Jan	1.3025	1.2975	13.15	1.2550	13.10
Feb	1.2900	1.2700	12.70	1.2500	12.95
Mar	1.2700	1.2500	12.55	1.2850	12.85
Apr	1.2700	1.2500	12.35	1.3000	12.75

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

remain above \$1.30 through year-end. Butter is expected to languish

until new crop (produced after Dec. 1) makes it to market. **MCT**

Surprising strength ...

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increase in commercial disappearance of cheese would command a 1.2% increase in milk production based upon an estimated cheese milk utilization of 45%.

If commercial disappearance of dairy products continues at this rate, U.S. milk production would have to increase by at least 1.5% annually just to meet the "milk demand" from the fluid milk and cheese markets. Historically, U.S. milk production has grown at an annual average growth rate of 1.3%. Thus, stable demand would leave the industry

with a 0.2% shortfall in milk production.

This year, demand surprised many by being strong enough to absorb monthly milk production increases between 1.2 and 5.3 percent. Not only was demand for fluid products stronger than it had been in many years, but cheese demand was better than expected, and nonfat dry milk flew out of warehouses for foreign markets. Nonfat dry milk has become so pricey, in fact, that many cheese makers have eliminated it from their cheese vats.

The market appears to be in a transition. The consumer spending machine is showing some signs of cracking, although early indications from retailers are that the holiday season will be, at the very least, decent. Yet consumer confidence is slipping as consumers watch "For Sale" signs in their neighborhoods go virtually unnoticed by potential buyers who are waiting patiently on the sidelines for better and better deals.

Meanwhile, back on the farm, dairy producers across the country are looking at having to compete for corn with a growing number of ethanol plants and that means only one thing: higher input costs. With input costs soaring, a lower rate of growth in milk supply could overtake demand as the prominent part of the supply-demand equation sometime next year. While domestic demand could weaken a bit, strong global demand is expected to soak up any excess. **MCT**

CPI % Change YTD vs. 2005

Disappearance % Change YTD vs. 2005

Butter	-7.5%	+1.4%
Total Cheese	-1.1%	+2.7%
American Cheese	NA*	+5.3%
Other Cheese	NA*	+1.0%
Fluid Milk	-0.9%	+1.0%

Source: MCT Dairies. * Information not available.



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