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MCT COMPASS

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Converging Domestic & Global Markets

Predicting milk and dairy product markets is never easy. USDA indicates that cheese traders are sharply divided on their short-term price expectations since the CME block price took a 34.5-cent nosedive to $1.815/lb. within a 7-day trading period during mid-September. The block market recovered to $1.85 but with an unsustainable inverted block/barrel price spread of 4.75 cents. A week later, the market corrected to a more manageable block-barrel price relationship of $1.90 for blocks and $1.85 for barrels.

If block and barrel cheese prices approach $1.80/lb. while the nonfat dry milk market (NFDM) remains near $2.00/lb., the difference in the value of milk used to manufacture NFDM and butter vs. the value of milk used to manufacture cheese will exceed $3.00/cwt., the largest price difference since 2000.

According to the American Dairy Products Institute, 552.5 million pounds of NFDM was used in hard cheese production during 2006. That is equal to 45% of total NFDM production in 2006. It is likely that 2007's usage of NFDM in cheese production will be less.

The economics of vat fortification do not work if NFDM costs $2.00/lb. and the cheese sales price is $1.80/lb. The disincentive to use nonfat dry milk in cheese making is evident in Minnesota and Wisconsin. Total cheese production in the two states is down almost 40 million pounds (-2.2%) through July 2007, despite milk production being up more than 3.0%.

Another key outlet for U.S. NFDM and skim milk powder (SMP) is the export market. In 2006, combined NFDM/SMP production totaled 1.5 billion pounds, with 42% being exported. For the January through July period this year, U.S. NFDM/SMP exports fell by 15%, compared to year-earlier levels, due to higher prices and lower production, which was 9.7% lower than the same period a year ago.

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KEN'S CORNER

by Ken Meyers
President
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There appear to be tug o' wars occurring across the dairy product complex. It all boils down to milk and dairy products moving to their highest valued markets. Domestically that may translate into more milk moving into NFDM production, and globally that could mean more U.S. sourced product moving into world markets.

As the United States has embraced its role as a key supplier of SMP to the world, we now have the opportunity to do the same for our butter and cheese industries. Growing world demand, supply issues in other regions, and the lower value of the U.S. dollar have provided us this opportunity.

As a company that is in the exporting business, we are puzzled and concerned that U.S. dairy product manufactures are forgoing business opportunities. It is time to seize the day! MCT

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U.S. Prices Lag...

The global markets for SMP, Cheddar cheese and butter are firm. Current Oceania prices range from $2.10 to $2.35/lb. for SMP and Cheddar. Their butter price ranges from $1.52 to $1.82/lb. The CME Cheddar block and barrel prices are in the $1.80's while the butter price is hovering near $1.30/lb. It is our opinion that both the world and domestic markets will converge at higher price levels than we have experienced before and for the foreseeable future. MCT

MCT Forecast

	Block*	Barrel*	Butter*	Whey**	NFDM**	Class III	Class IV
Sep	1.9929	1.9901	1.3783	0.4777	2.050	20.05	21.61
Oct	1.9150	1.8850	1.3800	0.4225	1.975	18.80	20.80
Nov	1.8500	1.8200	1.3950	0.4400	1.928	18.50	20.50
Dec	1.8350	1.8050	1.3850	0.4525	1.852	18.25	19.85
Jan	1.8300	1.8000	1.3700	0.4300	1.819	17.80	19.50
Feb	1.7750	1.7450	1.4000	0.4400	1.775	17.25	19.20

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

Looking Toward 2008...

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The 2008 outlook is for a continuation of strong milk and dairy product prices, albeit perhaps not as high as 2007's peak levels. Some market watchers are concerned about cheese production capacity. A large California cheese plant, utilizing 5.0 million pounds of milk a day will be idled by Jan. 1, 2008. That milk is expected to flow into a new NFDM operation in Central California. In other words, the cheese capacity is being replaced by NFDM/SMP capacity.

Additional cheese capacity will be coming on line yet this year with a new cheese plant in the Texas panhandle. While this plant is not expected to run 5.0 million pounds of milk per day, it is likely that, in tandem with a large plant in New Mexico, it could make up the capacity lost in California if there is enough milk in the region to feed both plants and if whey prices are not a deterrent to cheese production next year.

Within the Upper Midwest, milk production is expected to continue to increase to the point of stressing current capacity. Moreover, if the economics of vat fortification improve, there will be additional cheese produced in this region.

Once again the relationship between the value of milk used in butter/powder production and the value of milk used to manufacturer cheese/whey is expected to play an important role in dairy product production in 2008. If NFDM prices are significantly higher than cheese prices, then cheese production will not surpass customers' orders. If nonfat dry milk and cheese prices converge, then cheese production is not expected to be hampered.

Global NFDM/SMP and cheese markets will likely help determine the level of U.S. dairy product prices in 2008. On the global side of the equation, current Oceania SMP and Cheddar prices are reported at $4,700 to $5,200/metric ton ($2.10 to $2.35/lb). Market commentary suggests that much of New Zealand's production is already committed through the first half of 2008.

In addition to our NFDM exports, there are reports of Oceania customers sourcing Cheddar and Mozzarella cheese as well as butter from the United States. With the world market prices, in some cases, significantly higher than U.S. domestic prices, it may be only a matter of time before U.S. prices converge with global prices. MCT

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