



# MCT COMPASS

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## Amplification or Mitigation?

As milk production seasonally increases through the spring flush, there is typically downward pressure on dairy product markets. This year, the level and duration of high dairy product prices have caught many in the industry by surprise. At recent industry conferences, the talk ranged from “When will the cheese market fall?” to “How high will the market go?” It’s fairly easy to layout scenarios where either could occur.

Those who are bullish expect market amplification throughout summer. After all, they reason, if the market is approaching \$2.00/lb. for Cheddar in May (the peak production month), then \$2.50/lb. is a possibility by October (the peak demand month).

Clearly contributing to the

market’s strength is the decrease in American and Cheddar cheese production, lower American cheese stocks, and an increase in Cheddar cheese exports. American cheese production during the first two months of 2008 (adjusted for leap day) was down 0.6% (or 3.7 million pounds) vs. 2007. However, production of Cheddar cheese, which is part of the American cheese category and the only type of cheese traded at the Chicago Mercantile Exchange (CME), was down 3.2% or 16.5 million pounds (see chart on page 2).

The two biggest losers of Cheddar cheese production in 2008 were California and Idaho. During the first two months, California’s Cheddar cheese production fell 22.9 million pounds largely due to the closing of a

cheese plant there. Idaho’s production drop of 11.2 million pounds appears to be more related to a shift in production styles. Production gains in New Mexico, Texas, Minnesota, and Wisconsin offset about half the declines.

In addition to lower Cheddar production, exports are greater. Through February 2008, Cheddar cheese exports totaled 8.6 million pounds. Since September 2007, the United States has consistently exported between 3.9 million and 4.9 million pounds of Cheddar cheese each month. About 30% of the Cheddar cheese exports have gone to Mexico while exports in excess of 10% have gone to Europe, North Africa, and Oceania.

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## KEN’S CORNER



*by Ken Meyers  
President  
MCT Dairies Inc.*

There never seems to be a dull moment in our industry anymore.

Our historical experience regarding the seasonality in production and pricing is again being tested this year.

Our supply and demand curves contain more variables than ever before. U.S. energy policy, competition for acres, the euro, the U.S. dollar, domestic demand, export demand, supply elasticities and demand elasticities are key factors that contribute to our domestic pricing level.

Since January, the CME cheese price had traded in a range between \$1.65/lb. and \$2.09/lb. Given the number of variables that are being juggled, it’s likely that cheese prices will test both sides of that range over the next several months. **MCT**

## Lower stocks...

The CME cheese, butter, and nonfat dry milk markets have gradually moved higher over the past month. Export demand has been a key factor in supporting these markets. To date, the weakening economy in the U.S. has not had a significant impact on domestic dairy product demand. However, this could

MCT Forecast							
	Block*	Barrel*	Butter*	Whey**	NFDM**	Class III	Class IV
Apr	1.8826	1.8010	1.3905	0.2560	1.257	16.76	14.65
May	1.9500	1.9200	1.4400	0.2700	1.310	18.00	15.35
Jun	1.9400	1.9150	1.4950	0.3150	1.320	18.55	15.65
Jul	1.9650	1.9300	1.5100	0.3250	1.360	18.70	16.15
Aug	2.0000	1.9750	1.5250	0.3450	1.400	19.15	16.50
Aug	2.0200	1.9900	1.5500	0.3500	1.420	19.40	16.80

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

change the longer the weakness lingers and consumers face ever-

increasing food and energy costs. **MCT**

## Runaway prices?...

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Weaker production and greater exports have resulted in lower American cheese stocks. (Note: USDA does not publish a separate stock number for Cheddar cheese.) The industry started the year with a 32.2-million-pound deficit vs. the prior year. As of March 31, 2008, the deficit had grown to 42.9 million pounds (see chart at right).

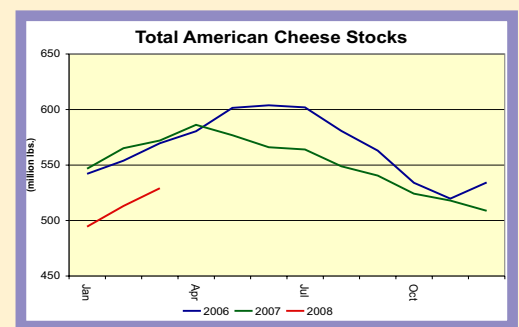
Given the above statistics, it appears this could be a year of runaway prices if there are any supply hiccups. But are the statistics from the first two months of the year indicative of the next 10 months? And are there mitigating

factors that are could cap rising dairy product prices?

Typically, higher prices spur additional production. Dairy producers have responded by culling fewer cows and increasing the U.S. dairy herd by 1.4%. California milk buyers have responded with supply management programs. So barring the reopening of a large cheese plant in California, it is unlikely that additional cheese production will come from the Golden State.

Some California dairy producers have responded to their new supply management programs by moving cows from California to Texas and New Mexico where capacity exists. In the Upper Midwest, the spring flush is just beginning. During the first two months of the year, Minnesota and Wisconsin increased Cheddar cheese production by 1.5 million pounds and that number is expected to grow during the next two months.

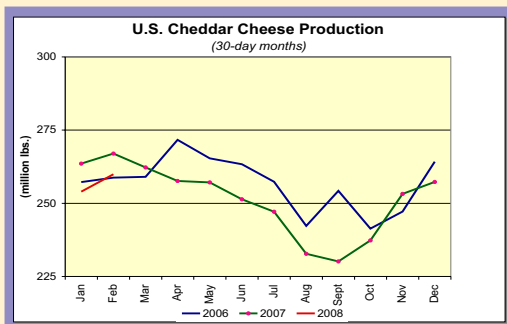
What if the export market



Source: MCT Dairies, Inc.

slows or becomes more variable? This is a distinct possibility if the European Union expands its milk production by 2% as allotted by the new quota, if the U.S. dollar strengthens vs. the euro and Oceania currencies, if freight forwarders can obtain containers on a timely basis, and if domestic cheese prices soar above \$2.00/lb., thus choking export demand.

In the short term, though, U.S. dairy product markets remain firm. However, by June the outlook becomes less certain. CME block cheese prices as low as \$1.60 or as high as \$2.10 are not out of the question, and that equates to a milk price swing of about \$5.00/cwt. **MCT**



Source: MCT Dairies, Inc.



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