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MCT COMPASS

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Biofuels Ignite Costs

Last month, MCT Compass outlined several key factors that are influencing today's dairy markets and how several were not factors a decade ago. Some of these new factors, were recently highlighted in a report *The Role of Biofuels and Other Factors in Increasing Farm and Food Prices*, written by Dr. Keith Collins, former chief economist for USDA, and commiss-ioned by Kraft Foods Global, Inc. A copy of the report is available at: www.thebioenergysite.com/articles

The report indicates that many factors are contributing to higher farm-level and retail food prices, including: 1) strong global economic growth resulting in increasing demand for U.S. commodities; 2) the declining value of the dollar; 3) reduced stocks of both wheat and rice; 4) escalating energy prices that have increased farm production costs as well as food processing and distribution costs; 5) changing foreign agricultural policies that insulate countries from higher world market prices; 6) increased investment by commodity funds and other managed investments that likely have increased price volatility but are not likely to have sustained effects; 7) biofuels, primarily corn-based ethanol.

The report notes that biofuels have been a major factor in the rising cost of feed grain and livestock markets. For instance, corn used in ethanol is expected to rise from 2.1 billion bushels in 2006-07 to 4.0 billion in 2008-09. This increase in corn for ethanol production exceeds the entire expected increase in total corn use over this period, the report notes.

The increase in demand for corn from ethanol plants is rising faster than the growth in corn yields per acre, according to the report. As a result, corn will have to pull acreage from other crops to fill demand. The competition for acreage results in higher prices for all crops that compete directly or indirectly with corn.

Dr. Collins presents two key factors that have increased the price of ethanol. The first is high crude oil prices and correspondingly high gasoline prices. The second is federal biofuels policies that are encouraging continued ethanol production in light of record-high and steadily rising corn prices. A

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KEN'S CORNER

by Ken Meyers
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Several factors, such as high energy costs, general inflation, the weak dollar, low stocks and government policies are contributing to rising food prices. In some countries, such as India and Argentina, government policies are attempting to insulate consumers from higher prices.

In the United Sates, a well-intended energy policy has resulted in a host of unintended consequences that will eventually lead to higher food prices for the next several years. The food vs. fuel debate is fairly new and likely will heat up in this political year.

USDA has 34 million acres enrolled in a conservation reserve program. Some speculate that restrictions will be lifted to allow some of these acres to come back into production early—but not without a fight from environmental groups interested in conservation and sport/game lobbies, both of which favor the program. MCT

Cheese uncertainty...

MCT Forecast	Block*	Barrel*	Butter*	Whey**	NFDM**	Class III	Class IV
Jun	2.0350	2.0580	1.5000	0.2750	1.355	20.25	16.00
Jul	1.9800	1.9725	1.5800	0.2600	1.395	18.50	16.75
Aug	2.1200	2.1000	1.6000	0.2700	1.435	19.35	17.20
Sep	2.2000	2.1750	1.6000	0.2750	1.450	20.50	17.30
Oct	2.2000	2.1750	1.5300	0.2850	1.450	20.80	17.20
Nov	2.0700	2.0450	1.5300	0.2950	1.435	20.80	16.90

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

CME block and barrel cheese prices have fallen from their recent highs, but upside price risk awaits in July and August. The June Class III price is forecast near $20.25/cwt., which will put a damper on cheese production during the second half of June due to the unfavorable milk cost/cash cheese price relationship. Butter prices are strengthening as market participants try to gauge whether June 1 butter stocks of 263 million pounds are enough to carry both the domestic and export markets through year end. **MCT**

The ethanol advantage..

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tariff on ethanol imports into the United States limits U.S. access to foreign supplies. A tax credit enables ethanol plants to pay the equivalent of up to $1.43 more per bushel that other buyers can pay for corn. And the Renewable Fuel Standard mandates steady, annual increases in ethanol demand. These requirements must be met regardless of the price of oil, ethanol, or corn.

According to the report, the Renewable Fuel Standard is likely to be an increasingly important factor in determining the direction that ethanol and corn prices take over the next several years. “Nearly all of the increase in total use of corn over the past two years has been due to the use of corn by ethanol plants, thus most of the corn price increase has likely been due to ethanol,” the report states. Depending on the analysis and methodology, research suggests that expected increase in corn demand due to ethanol between 2006-07 and 2008-09 could be accounting for as much as 25 to 60 percent of the corn price increase during this period.

Impact on the dairy sector

Record-high and rising corn prices have a domino affect on the rest of the feed grain and oilseed sectors that compete for acreage. The rising costs of all feedstuffs translate into increasing costs of production for dairy and livestock producers. Moreover, those higher costs are likely to linger for 2 to 3 years due to the growth cycles in animal agriculture.

Currently, the dairy industry appears to be immune to rising feed costs as the dairy herd continues to expand. However, many dairy producers either produced corn for less than $4.00/bushel in 2007 or contracted for their 2008 corn at less than $5.00/bushel. Looking into 2009, dairy producers who grow their own feeds will have a comparative advantage over those who purchase the majority of their feeds. Likewise, dairy producers in the traditional milk producing regions of the Upper Midwest and Northeast are likely to have a cost advantage verses their western counterparts that generally purchase a greater percentage of their feedstuffs. Corn prices for 2009 are north of $7.00/bushel, which translates into an increase of about $1.00/cwt. in the cost of production. (For every $1.00 increase in the corn price, the cost of producing milk increases about 50 cents per hundredweight.)

It is important to note that dairy product prices soared in 2007 largely due to increased global demand and a decrease in global dairy supplies. In other words, dairy producers saw their milk checks rise more quickly than their feed costs in 2007, which put them in a strong financial position in 2008. Looking forward, that could change if export and domestic sales slow due to the high prices. **MCT**

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