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MCT COMPASS

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Cheese Demand Caught in Perfect Storm

Global dairy marketers gathered in Paris in October to see the latest and greatest food innovations and to rehash the markets. It appears that the record-high global dairy product prices in 2007-08 will be followed by a return to historical lows at least for the powder markets. Cheese and butter markets remain unsettled.

The two key factors that propelled world dairy product prices to record highs last year included increased demand from the growing global middle class and tight dairy product supplies. It took at least six months to pass record-high prices on to the world's rising middle class, but once elasticity hit, the sector responded by reducing demand. At the same time, dairy producers from around the globe—Oceania, South America, Europe, and the United States—responded to record-high prices by increasing milk production. The slowdown in global demand, rising global milk production, and the global credit crunch have all contributed to accelerate decreases in global dairy product prices. And demand does not show signs of improving, at least not yet.

Just like in world markets, higher cheese prices have collided with a weak economy in the United States to provide a double hit on U.S. cheese demand. This week, the Conference Board announced consumer confidence at 38, the lowest level since the Board began tracking the index in 1967. That's right. Consumer confidence is now lower than it was following the September 11 terrorist attacks and the implosion of the dotcom bubble. Those events also coincided with a time of contracting U.S. economic growth, but not the near record-high milk prices that ushered in 2008.

While the outcome of the current economic crisis is uncertain, it is highly improbable that it will be a time of robust dairy demand growth. On Tuesday, McDonald's Corp. announced that it was considering replacing its hallmark dollar menu product, the double cheeseburger, with a new burger called the McDouble, a double

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KEN'S CORNER

by Ken Meyers
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The dairy trade is a tough business to be in at this time. The global market has seen a shift from whole milk powder production globally to skim milk powder and butter and cheese production. Dairy product offerings from countries that have not been active exporters over the past few years are reappearing on the market.

The economic meltdown around the world is also affecting global trade. From fluctuating exchange rates to the lack of export credit insurance, it's just tougher to get deals done.

The domestic markets are unsettled and will be under price pressure from both domestic and imported supplies.

This will translate into a slowdown in growth opportunities for the U.S. dairy sector for a few months, maybe longer. However, once supply reaches a more typical balance, the industry can expect a return to a more normalized domestic and export trade. It may not be as robust as 2007-08, but there will still be opportunities for the U.S dairy industry. MCT

Powder surplus

MCT Forecast							
	Block*	Barrel*	Butter*	Whey**	NFDM**	Class III	Class IV
Oct	1.7963	1.8025	1.7320	0.1945	0.999	17.06	13.62
Nov	1.6300	1.6100	1.5990	0.1928	0.895	15.15	12.45
Dec	1.5800	1.5550	1.5000	0.2035	0.889	14.20	11.70
Jan	1.5800	1.5550	1.4400	0.2135	0.858	14.00	11.35
Feb	1.5300	1.5100	1.4050	0.2161	0.860	13.80	11.15
Mar	1.4850	1.4650	1.4545	0.2289	0.895	13.25	11.55

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

Over the next 90 days, dairy markets are expected to remain weak and unsettled. Interest rate volatility, the cost of credit insurance for exports, and ample competing supplies are dampening U.S. exports. During October, more than 30 million pounds of nonfat dry milk was cleared to the government at 80 cents per pound. Sales to the government are expected through year-end and will continue to put downward price pressure on the cheese market. **MCT**

Slicing cheese...

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cheeseburger with one slice of cheese instead of two. Removing a slice of cheese would allow the company to keep the price of the meal at $1.00. McDonald's cited soaring commodity costs as the reason behind the possible change. Meanwhile, the cost of a double cheeseburger with two slices of cheese will increase to $1.19 if the switch is made.

By no means is McDonald's the only restaurant considering a change in its menu. Buyers at foodservice companies, food manufacturers, and restaurants have faced a long stretch of unexpectedly high commodity prices, including cheese prices. The impact of that has been showing up in USDA's commercial disappearance numbers. The latest numbers, released this week, show that total cheese demand has been running below year-earlier levels for several months. For the January through August period, year-to-date total cheese use was 0.7% lower than in 2007.

The unsettling part of this equation is that the current recession, which some analysts think could be deeper and longer than the last few recessions, has not been factored into any demand hit. If consumers start eating out less frequently or trading down at restaurants, then McDonald's potential decision to remove a cheese slice from its dollar double burger becomes more ominous.

In the not too distant future, however, slower global milk production is expected to bring world dairy markets back into some semblance of equilibrium. (Slowing demand could push the equilibrium date out further.) Reports out of Oceania caution that earlier predictions of robust milk production growth in the region are likely to be tempered by poor pasture conditions in New Zealand and continued drought conditions in Australia. Likewise, EU and U.S. dairy producers face high feed costs by historical measures and profit margins are slim. As a result, U.S. dairy producers have increased culling. From July through September 2008, U.S. dairy farmers culled 659,000 head, up 67,000 head from last year, an 11% increase. A new herd retirement by Cooperatives Working Together (CWT) will further reduce the herd, and the credit crunch is expected to slow expansions.

So what does all this mean? A perfect storm has hit. Dairy producers after months of high input costs are starting to tighten their belts. That should stem the drop in dairy product prices, but at a time when consumers worldwide need price relief and dairy demand needs a boost. **MCT**

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