



MCT COMPASS

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Baby Steps toward Demand Recovery

The world we live in today may resemble the world we lived in a year ago, but a lot has changed. Mostly, consumers worldwide have hunkered down and are still waiting for the next shoe to drop. Barring another unexpected shock to the global financial system, it appears that at least some world economies, and thus hopefully dairy demand, have bottomed out, but recovery could be protracted.

In last month's *Compass*, we discussed global milk supply and what it means for dairy product prices moving forward. In this month's *Compass*, we take a look at demand.

By way of review, a number of factors collided in 2008 that stripped consumers of their overall confidence and reduced global dairy

demand. First, a long stretch of exceedingly high international dairy prices that resulted from a world shortage of dairy products, particularly skim milk powder, cut into dairy demand as food manufacturers and food service providers looked for less expensive substitutions. Then, just when demand was beginning to respond negatively to price, a worldwide financial crisis sent economies plunging, causing further softness in dairy product demand.

To make matters worse, during the summer and fall of last year, melamine-tainted milk products made with Chinese milk, particularly infant formulas and milk powders, sent demand in China tumbling. The food-safety scandal also led to widespread bans on Chinese dairy products. Zhang Gang, chief engineer of China's

General Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ) said last week that the breach in food safety cost China at least 100 billion yuan (\$14.6 billion U.S.) in lost sales, both domestic and export. It also seriously damaged the reputation of China's dairy products, and in some consumers' minds, dairy products in general.

As the world market turned upside down and dairy product stocks started to build to burdensome levels, countries responded. The European Union reinstated its export subsidies on dairy products in January 2009, and the United States recently announced allocations under its Dairy Export Incentive Program (DEIP) for the July 2008 through

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KEN'S CORNER



*by Ken Meyers
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I can say with certainty that this is the most challenging and volatile market

we've ever experienced. With cheese prices languishing near support, it's hard to think about volatility, but it wasn't all that long ago that consumers were

living the high life, companies' stock valuations were soaring, and homeowners were using their homes as ATM machines.

Not today. Consumers have gone into hiding, blue chip stocks are selling for what appear to be unbelievably low prices, and many homeowners are upside down in their mortgages. As a nation, and a world, we've basically done an about face in about a year's time.

Some might call consumers' response to the economic downturn an overreaction. Others call it long

overdue. Whatever label one wants to slap on it, we should all be relieved that the worst appears to be behind us and we should be happy that we are in the cheese business and not the auto industry.

Still, the days of conspicuous consumption have come to an end. Americans are returning to a more frugal society like the one that baby boomers were raised in. Therefore, our response to the current economic downturn represents a longer-term change in consumer behavior. **MCT**

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Cheese not moving...

Most of the dairy product markets from dry whey to butter are moving incrementally off their lows. The cheese market appears to be the only exception. Stocks of American cheese are about 8% higher than last year while butter stocks are 3.5% lower. A rally in the cheese market is unlikely until there is a

MCT Forecast							
	Block*	Barrel*	Butter*	Whey**	NFDM**	Class III	Class IV
May	1.1385	1.0750	1.2526	0.2325	0.830	9.85	10.10
Jun	1.1975	1.1725	1.2925	0.2500	0.845	10.10	10.45
Jul	1.2550	1.2300	1.3450	0.2600	0.858	10.90	10.75
Aug	1.3200	1.2950	1.3800	0.2700	0.865	11.55	11.00
Sep	1.3700	1.3450	1.4250	0.2775	0.880	12.15	11.35
Oct	1.4300	1.4050	1.4450	0.2825	0.900	12.75	11.60

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

significant reduction in the dairy herd and a subsequent decrease in

milk output, thus cheese production and stocks. **MCT**

Renewed subsidies..

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June 2009 period. DEIP financially facilitates the export of up to 68,201 metric tons of nonfat dry milk; 21,097 metric tons of butterfat; 3,030 metric tons of various cheeses; and 34 metric tons of other dairy products. It is uncertain just how much product will be exported through DEIP during the next several months. USDA will receive bids for the allocations from June 1 through June 30, 2009. Deliveries are likely to continue through year-end.

After having come to a near standstill late last year, dairy products have started to move again on world markets. New Zealand reports that the sharp decline in New Zealand dairy product prices started to pull buyers back into the market by the end of January 2009, and that its stocks of dairy products peaked in February and March. Reports out of New Zealand also indicate that the country's 2008-09 inventories are basically in balance. New Zealand's exports of butter and cheese for the June 2008 through March 2009 period are running below year-ago levels, but exports of skim and whole milk

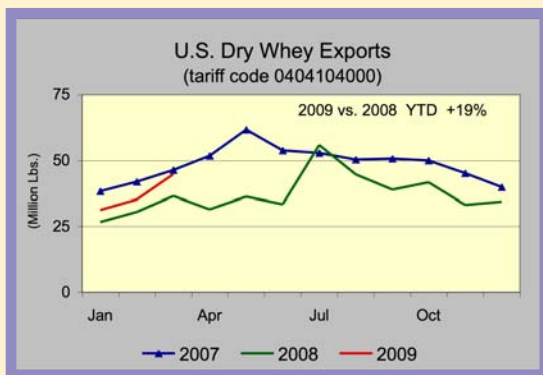
programs in Western Europe have removed about 70,000 metric tons of butter and 140,000 metric tons of skim milk powder from the market.

The U.S. government has also been busy removing nonfat dry milk. As of mid-May, USDA's Commodity Credit Corp. had bought 236 million pounds, or 11,800 tons, of nonfat dry milk. First-quarter U.S. exports of butter, cheese, and nonfat dry milk are still down substantially from first-quarter 2008. The one bright spot in U.S. exports appears to be whey. Exports of dry whey increased 19% in first quarter 2009, vs. the previous year.

For the global dairy market to return to a supply/demand balance and for prices to stage a sustainable rebound, economies need to recover and dairy demand needs to continue to pick up worldwide. Meanwhile, until there is a significant demand rebound, global milk supply needs to adjust. Look for reductions in the dairy herds in the United States, Europe, and Oceania to signal a change on the supply side. **MCT**

powder are running ahead. New Zealand's strong whole milk powder exports are in part due to increased exports to China following the melamine scandal.

The newly reinstated export subsidies in Europe along with its government intervention program are helping clear dairy product surpluses there. Government



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