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Sustained Demand Revival?

The global dairy markets came tumbling down in mid-2008 as producers worldwide increased milk production to take advantage of the hefty milk prices of 2007 and early 2008. By mid-2008, consumers and end users had started to view dairy products as pricey and were cutting back on use. Then the global economy crashed and demand weakened further. For the next 12 months, dairy producers worldwide grappled with the decline in global dairy product demand and depressed milk prices, which have led to reduced milk production.

The combination of lower-than-anticipated milk production this summer and fall, particularly in New Zealand, and a modest resurgence in dairy demand, especially from Asia, has reignited the global markets. But whether this heated market is a slow, sustainable flame, or an easily extinguished flash in the pan is still uncertain. Rapidly rising global prices and international demand for whole milk powder and butterfat appears to be the result of pipeline refilling. However, the longer prices hold, the more convinced buyers are becoming that global markets are again establishing a new price level.

The U.S. dairy sector's participation in global markets is tied to the rise and fall of milk production in Oceania and to demand in Asia, particularly China. While not as large a milk producer as the United States, Oceania is a more formidable player on international markets. New Zealand's annual milk production equates to about 30% of U.S. milk production, while Australia produces about 7% of what the United States produces. New Zealand's total milk production represents less than 5% of total global milk production, but the country accounts for 38% of global trade in whole milk powder, 26% of global skim milk powder trade, and 42% of butter trade.

According to USDA's *Dairy Market News*, midpoint Oceania dairy product prices as of Nov. 25 were as follows: whole milk powder, $3,550; skim milk powder, $3,400; butter, $3,750; and Cheddar cheese, $4,350. The "hottest" commodities in today's market are whole milk powder and butterfat. The United States, however, is not a major player in whole milk powder production, so it's unlikely that U.S. dairy

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KEN'S CORNER

by Ken Meyers
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Global dairy markets certainly have taken a turn over the past few months. On Nov. 5 the European Union eliminated its subsides on whole milk and skim milk powders. Two weeks later on Nov. 19, it eliminated them on butter and anhydrous butterfat. This illustrates just how much the market outlook has changed.

Product positioning has also changed. Historically, cheese prices have been the leader in determining U.S. milk prices. Two years ago, skim milk powder prices came on strong due to world demand. Suddenly, skim milk prices were pulling the prices of other U.S. dairy products higher. Today, whole milk powder and butterfat are leading the way due to strong demand from Asia for these products.

Dairy product prices will likely remain firm or strengthen further over the next three to six months — unless demand from Asia, particularly China, dries up. And cheese prices, while continuing to lag whole milk powder prices, will hop on board for the ride. MCT

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Will West Recover?

Holiday buying and pipeline refilling will continue into 2010, and that will keep a floor under prices. Soon U.S. producers will receive milk checks near breakeven. How long it takes them to ramp up production to meet demand for product on world markets is unknown. If production comes back quickly, further price increases will be tempered. If recovery is delayed, world prices could steadily march higher—assuming demand remains buoyant. MCT

MCT Forecast

	Block*	Barrel*	Butter*	Whey**	NFDM**	Class III	Class IV
Nov	1.5788	1.4830	1.5008	0.3480	1.112	14.10	13.30
Dec	1.6600	1.5900	1.5250	0.3600	1.225	15.00	14.80
Jan	1.6200	1.5450	1.5350	0.3550	1.200	15.40	14.60
Feb	1.5250	1.4750	1.5500	0.3380	1.115	14.50	13.90
Mar	1.4800	1.4400	1.5750	0.3300	1.050	13.85	13.45
Apr	1.4800	1.4500	1.5650	0.3325	1.050	13.85	13.25

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

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producers will benefit directly from the higher global whole milk powder prices. However, indirectly, U.S. producers and exporters could be major beneficiaries. For example, as New Zealand services customers with whole milk powder, less of the nation's milk will be manufactured into butter/AMF, skim milk powder, and cheese. Thus, the United States could be called upon to fill skim milk powder orders. This would not be the first time Oceania has come knocking on the doors of U.S. manufacturers to fill in during a shortage. Whether the United States can participate in world markets will also depend on its ability and willingness to produce for the world market.

And timing is everything. The exceptionally low milk prices of 2009 took a dramatic toll on milk production in the key nonfat dry milk producing states of California, Washington, Idaho, and Arizona. Thus, it's unlikely that the United States will be able to fill a significant quantity of the current demand for skim milk powder. Early next year if the global market is still wanting, the United States could be in a better position to respond. By mid-January, U.S. producers will have pocketed at least two months of milk checks that are $2.00 to $3.00/cwt. higher than their previous milk checks, which could boost output.

But there are costs associated with playing in the global market. It costs about a dime per pound to get the product to the export market. Costs include transportation, document fees, grading fees, credit insurance, and brokerage fees. So a $3,400/ton (or $1.54/lb.) Oceania price equates to a U.S. price of about $1.44/lb.

A $3,750/ton (or $1.70/lb.) price for 82% unsalted butter translates into a raw material price for 80% salted butter of near $1.40/lb. The difference takes into account the fat content as well as export transaction costs. In addition, U.S. butter makers often demand a larger premium than one would expect, which reflects their resistance to make product for the world market.

The story is similar for Cheddar cheese for export, which is not the same as Cheddar cheese traded at the Chicago Mercantile Exchange (CME). CME specs call for block Cheddar cheese not less than 36.5% moisture and not greater than 39% moisture. Oceania Cheddar cheese for export contains between 35% and 36% moisture. The moisture premium is 5 to 7.5 cents per pound. Deduct that and the costs to prepare and get the product to the export docks, and U.S. Cheddar becomes competitive near $1.65/lb, based on a $4,350/ton (or $1.97/lb.) Oceania price.

In some cases, an overheated market just serves to ration demand. If this season's price run-up is mostly the result of pipeline refilling, prices should cool off relatively soon, but if they are the reflection of a more sustained demand revival, they likely will remain high well into 2010. MCT

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