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MCT COMPASS

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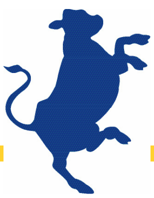
Higher Prices Here to Stay

The United States dairy market has truly become a world market. World demand for high-protein foods—particularly dairy and meat—has sent Class III prices to near record-high levels once again. However, July 2011 is about as precarious as July 2008 was when the Class III price hit an all-time high of $21.38. That was right before world economies began crumbling and demand tanked for nearly all commodities, particularly agricultural commodities. Analysts are more optimistic today than they were four years ago, but cautions remain.



July 2011 is about as precarious as July 2008 was when the Class III price hit an all-time high of $21.38.

"I'm nervous about current domestic inventory levels and these relatively high prices," says one leading dairy economist. "I hope that we won't see much consumer push back, but at these prices, domestic and export demand could be fragile. That would be especially true if the world dips back into recession led by problems in the Europe."

To get a sense of where markets might go from here, *MCT Compass* once again collected midyear forecasts from six of the nation's top dairy analysts: Bill Brooks, e-Dairy; Bob Cropp, University of Wisconsin; Wilson Gray, University of Idaho; Mary Ledman, Keough Ledman Associates; Al Levitt, Levitt Communications; and Mark Stephenson, University of Wisconsin. We then added their forecasts to futures settlement prices for July 22 to create a consensus forecast.

All of the experts agree that dairy prices have moved to a new and permanent higher level, supported by underlying feed and fuel prices. Higher milk prices will prevail even with a lackluster economy, the group agrees. "I think the country will slowly crawl out of this downturn. The new 'normal' is likely to be a more subdued economy. Historically, the United States has grown its way out of recessions with new investments and great enthusiasm," says one panel member. "This time I think government will have to reduce expenditures to come more into line with realistic expectations of growth."

Yet despite pessimism hanging over the domestic economy, our panel's average Class III price for the second-half 2011 is $19.03. And while the group expects the 2012 Class III average to be substantially lower at $16.98, that's

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Ken's Corner

by Ken Meyers
President , MCT Dairies Inc.

This summer's near record-high milk prices are primarily the result of two factors: world dairy demand and high feed costs.

U.S. 2011 exports on a total solids basis through May equated to 13% of U.S. milk output—a phenomenal number.

During the past decade, the United States has gone from exporting 10% of its annual nonfat dry milk production to selling about 50% of production overseas. More recently, cheese and butterfat exports have grown to 5% and 10% of production. Thus, everyone agrees U.S. dairy exports have played a substantial role in U.S. milk prices.

Feed costs have also helped buoy world and U.S. milk prices. With cottonseed prices near $400/ton, dairy-quality alfalfa scarce, corn nearing $7.00/bu. and soybeans close to $14.00/bu., U.S. producers will need milk prices well above historical averages.

According to USDA's baseline outlook, feed prices are expected to remain high—but below their recent peaks—through the end of this decade as world demand for meat and dairy products soars and biofuel demand holds steady at a minimum.

The biggest wildcard is whether producers in the Southern Hemisphere expand production significantly to meet world demand. If they do, U.S. dairy exports could taper off somewhat, but they won't evaporate. **MCT**

…up, up, and away

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still much higher than the historical average. The most bullish of the analysts expects next year's average Class III price to hit $18.44, while the most bearish anticipates an average of $16.35, about 30 cents below where futures settled July 22. Individual forecasts for the average NASS cheese price for second-half 2011 range between $1.83 and $2.00.

Our experts are just as bullish on Class IV prices. The consensus forecast for the 2011 second-half average Class IV price of $19.68 is only 30 cents lower than the Class III forecast. The group expects 2011 second-half nonfat dry milk prices to average near $1.52 and butter to average near $2.03.

One big wildcard is what happens in Europe. "The EU can probably handle the banking crises of Ireland, Greece, Spain, and Portugal, but if larger economies like Italy begin to falter, the strong economies such as Germany are unlikely to be willing or able to continue bailouts," says another leading expert. A badly faltering EU economy could spill over into other economies and dairy demand could take a hit like it did in 2009. **MCT**

Consensus Forecast

	Cheese	Class III	Butter	Class IV	Whey*	NFDM
July	2.1117	21.30	2.0400	20.81	55.00	1.64
Aug	2.1034	21.37	2.0429	20.28	55.80	1.58
Sept	2.0234	20.44	2.0573	19.86	54.13	1.52
Oct	1.9209	19.34	2.0777	19.53	51.93	1.49
Nov	1.8571	18.58	2.0541	19.14	50.24	1.45
Dec	1.8113	17.95	1.9302	18.45	47.68	1.43
Avg	1.9713	19.81	2.0337	19.68	52.46	1.52
2012	1.7491	16.98	1.8059	17.29	43.56	1.36

* Whey in cents

What the experts say...

Bill Brooks: The United States has not become a supplier of choice on world dairy markets. The ability of the United States to remain a large player in the export market will be dependent on lower-cost producers showing little to no gain in milk production.

Bob Cropp: China, all of Southeast Asia, and many other developing countries have policies to improve nutritional levels, and dairy products and milk proteins are a part of that. Therefore, world demand will likely grow 2% or more per year, challenging world milk production to increase at this same rate.

Wilson Gray: For the 2011-20 period, Class III prices will range between $18 and $25/cwt. As developing countries increase their middle-class population, more dairy will be in demand. The United States is one of the few countries that can consistently market to the developing world, and a comparatively weak dollar will likely keep U.S. exports competitive.

Mary Ledman: The Class III milk price averaged $13.39 from 2000 to 2011. In the most recent five years, the Class III price averaged $14.63, including the low of $11.36 posted in 2009. Looking out to the next 10 years, I expect the Class III price to average near $16. However, the industry is likely to face a couple of years when the average Class III price is less than $13.50/cwt.

Al Levitt: I don't see the U.S. economy returning to consistent GDP growth and lower unemployment for at least three to five years. I believe the economy will continue to "sputter" for a while—still too much excess capacity in housing and construction. Inertia and uncertainty in government is a disincentive for business to invest.

Mark Stephenson: I think that $20 milk will become common. Some of this is due to growing export demand, but much of it is due to higher feed costs. If it were just demand growth, we would see spikes in prices followed by slowly diminishing prices as more milk comes into production. However, with considerably higher feed costs, milk prices will have to remain high to supply the additional milk demand.

 MCT Dairies, Inc., 15 Bleeker St., Millburn, NJ 07041 (973) 258-9600 fax: (973) 258-9222 www.mctdairies.com. For more information, email **info@mctdairies.com.**