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MCT COMPASS

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New Record-High Prices?

World demand for dairy products, driven in large part by the ability of Europe to solve its sovereign debt problems, along with the worst drought in at least 30 years in the United States will be the major factors influencing milk prices over the next year. And if these uncertainties aren't enough to make markets skittish, the U.S. Congress is considering making some of the most sweeping changes to U.S. dairy policy in decades. With so many unknowns, analysts have started to talk about the possibility of new, record-high prices for Class III milk. The previous all-time high was hit in July 2007 at $21.38 and the record annual average Class III price was $18.37 in 2011.

With so many unknowns, analysts have started to talk about the possibility of new record-high prices for Class III.

"Even though milk prices are rising, feed prices are climbing at a more rapid pace due to the widespread effects of the drought," says one leading dairy economist. "If traditional producers face crop failure or diminished yields, and western-style dairies find feed prices too expensive, then there will not be a major push to expand production. If herds are culled more heavily as a result, there will be a one- to two-year impact."

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, INTL FCStone; Bob Cropp, University of Wisconsin; James Dunn, Pennsylvania State University; Wilson Gray, University of Idaho; Mary Ledman, Keough Ledman Associates, Chicago; and Mark Stephenson, University of Wisconsin. We then added their forecasts to the settlement prices for July 12 futures to create a consensus forecast.

Our panel's average Class III price for the second half of 2012 is $18.16/cwt., only 21 cents below the all-time record high. The group expects the average Class III price in 2013 to be nearly as high at $18.04. The most bullish of the analysts expects the 2013 Class III price to average at a new record-high of $19.95, while the most bearish anticipates a 2013 average Class III price of $17.30, substantially lower than the July 12 futures price average of $17.76. Forecasts for the average NASS cheese price for the next six months range between $1.63 and $1.83, and the 2013 average cheese price forecasts range from $1.72 to $1.82.

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Ken's Corner

by Ken Meyers
President , MCT Dairies Inc.

As our economist panel notes, the industry is on the verge of three scenarios, all of which could be major price drivers: the worst drought in at least 30 years; sweeping changes in dairy policy; and another potential world recession.

Only one scenario is certain: Drought will limit the availability of corn and forage later this year and next. Reports from key dairy sheds are already very unsettling. Forage experts are encouraging dairy producers in the worst-hit areas of the Midwest to replant their devastated cornfields to see if they can harvest some forage from a late planting of corn or small grains, and milk production levels in some states have fallen 10 percent due to unrelenting heat and humidity.

While it's too soon to know how bad the impact will be from this summer's weather, it will be long lived unless world financial markets seize up, and world demand for dairy products tumbles. That, however, seems less likely—but still a possibility.

Finally, supply management provisions remain in both the Senate-passed bill and the House version of the farm bill. If these provisions are enacted next year and U.S. milk production contracts as a result, the industry could lose what it has worked so hard to attain—a growing share of the world market for dairy products. **MCT**

…pending price explosion?

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Our experts are not as bullish on Class IV. The consensus forecast for the second-half 2012 average Class IV price of $15.75 is $2.41/cwt. lower than the Class III forecast. For the second half of this year, the group expects nonfat dry milk prices to average near $1.28 and butter to average just above $1.61.

"It is too soon to determine the magnitude of the 2012 drought impact. At this point, the industry knows that production will be less than anticipated and markets have moved higher, which will curb demand," says one analyst.

Stocks of dairy products, particularly cheese, will prevent milk and cheese prices from soaring near-term, but higher feed costs due to the drought will limit milk production increases going forward and could even lead to a contraction in supply, says another analyst. "The drop in milk production growth could be large enough to offset the lackluster economic situation the world faces and push prices to levels not recorded before," he adds. **MCT**

Consensus Forecast

	Cheese	Class III	Butter	Class IV	Whey*	NFDM
July	1.6545	16.62	1.5314	14.42	50.26	1.17
Aug	1.7303	17.78	1.5825	15.37	53.91	1.23
Sept	1.7758	18.48	1.6154	15.84	55.65	1.30
Oct	1.7988	18.76	1.6428	16.26	56.48	1.33
Nov	1.8064	18.76	1.6670	16.40	56.70	1.33
Dec	1.7794	18.56	1.6500	16.21	55.85	1.29
Avg	1.7575	18.16	1.6149	15.75	54.81	1.28
2013	1.7888	18.04	1.6403	16.23	53.35	1.35

* Whey in cents

What the experts say...

Bill Brooks: If the voluntary supply management program provisions, included in both the House and Senate versions of the farm bill, eventually become law, there will probably not be a huge impact on U.S. dairy prices near term. Other countries, however, could use the unwillingness of U.S. dairy producers to be reliable suppliers in the marketplace to gain market share.

Bob Cropp: If milk prices show considerable strength—Class III price near $18.00 and all-milk near $20.00/cwt.—milk production would pick up, and there are plenty of replacement heifers to expand cow numbers. At the same time, though, widespread drought has developed, which could result in tight feed supplies and sharply higher feed prices this fall and winter. With that, we would likely see cow numbers decline and milk per cow slow.

James Dunn: The weak U.S. dollar, a slowing Chinese economy, and high feed prices have been the major drivers of milk prices. Looking forward, I think the EU debt crisis will depress world growth for the next two years. The economic problems in Europe and the slowdown in the Asian economies will be the main drivers moving forward.

Wilson Gray: Uncertainty about the European Union and whether the euro will remain viable will continue to keep markets guessing (and volatile) until more certainty surfaces regarding the PIIGS (Portugal, Ireland, Italy, Greece and Spain, the weakest EU economies.) Recent indications are that both the U.S. and Chinese economies could grow more slowly than hoped, and if consumers remain cautious, dairy demand could slow or decline.

Mary Ledman: An El Nino weather pattern appears increasingly likely to arrive in New Zealand in the next few months, increasing the chances of drought along New Zealand's eastern coast and more rain in the west. If key milk-producing regions like Europe and Oceania do not have supply constraints, global dairy product prices are unlikely to hit new records. If Europe or Oceania experience challenges, U.S. prices could test market highs.

Mark Stephenson: We can't trivialize Europe's sovereign debt problem and the potential spillover effects it will have on the U.S. economy. However, economies in Asia, India, and Africa are not as closely linked to Europe's crisis. Thus world demand for dairy products will likely grow at a faster pace than what one would expect given the economic slowdown in both Europe and the United States.

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