



MCTCOMPASS

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Mixed Signals

The Chicago Mercantile Exchange (CME) Cheddar block cheese price peaked in October 2012 but didn't make it's way into most dairy producers' milk checks until November or December. By then the markets were signaling a slowdown in demand, but producers responded to their larger milk checks by accelerating production.



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From April through October, the U.S. dairy herd contracted by 84,000 head, but the highest milk prices in 2012 were in November and December, prompting dairy producers to expand the herd in those two months by 29,000 head. The expansion continued into January with an 7,000-head gain. In other words, as the CME block cheese price fell from \$2.11/lb. in early November to less than \$1.75/lb. in December, dairy producers were opening milk checks based on a \$2.00/lb. cheese price. How can this be?

CME-NDPSR Relationship

The most quoted Cheddar cheese prices in the United States are the CME spot Cheddar block and barrel prices and the National Dairy Products Sales Report (NDPSR) Cheddar block and barrel prices. The CME Cheddar block and barrel

prices are determined daily in trading sessions that last less than 10 minutes. The NDPSR prices are surveyed and reported weekly by USDA's Agricultural Market Service (AMS). Both are very important to the industry. The CME spot Cheddar block and barrel cheese prices serve as base prices for 80% or more of total U.S. cheese production. NDPSR Cheddar cheese prices are used to establish the Class III milk price, which is the base price for nearly 70% of the milk used to manufacture cheese in the United States.

The NDPSR prices were formerly known as the NASS dairy product prices prior to April 2012. From January 2000 to April 2012, USDA's National Agricultural

Statistics Service (NASS) compiled, analyzed, and published the weekly price survey. In April 2012, the ownership of the process was transferred to AMS. While the new acronym NDPSR is a tongue twister, the data is now being compiled by the agency that ultimately uses it to calculate the Federal Order Class I, II, III and IV prices.

The use of finished product prices to calculate

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Ken's Corner



*by Ken Meyers
President, MCT Dairies Inc.*

Due to price volatility in dairy markets it would be helpful to have a milk pricing system that sends timely, un-distorting market signals to dairy producers.

Tackling changes in Federal Orders is never easy, though. Federal Orders were established in the 1930s to

address compelling domestic policy issues, which included orderly marketing conditions, income parity for producers, increased bargaining power for producers, and securing an adequate milk supply. Federal Orders have been so successful that these issues are no longer compelling issues for the industry. But Federal Orders are not perfect, particularly when market signals to producers, processors, and consumers are distorted.

Eliminating USDA's survey of dairy products prices (NDPSR) would be a step in the right direction. It is questionable whether the industry needs the NDPSR as a pricing mechanism because it hinders timely market signals. If there is ongoing concern regarding the validity of CME spot prices, a USDA survey of monthly or quarterly prices could be conducted.

Changes in dairy policy tend to be evolutionary rather than revolutionary, but taking one step forward in an effort to eliminate market-distorting signals would be a good start for all involved, producers, manufacturers, and marketers. **MCT**

Newfound Cheese...

USDA's Cold Storage report included a note that the department expanded coverage of cold storage warehouses in 2012. As a result, American and

natural cheese stocks in 2012 are now 30 million to 40 million pounds greater than previously reported.

USDA will not be revising 2011 data, thus historical comparisons past 2012 will be difficult. American cheese stocks totaled 643.5 million pounds as of Jan. 31, up less than 1% vs. year-earlier levels. Stocks grew by 7.9 million pounds during the month, which was above the five-year average build of 4.5 million pounds but significantly less than January 2012's build of 31.2 million pounds. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Feb	1.6420	1.5890	17.25	1.5700	17.75	0.6393	1.5559
Mar	1.6200	1.6000	17.00	1.6175	17.90	0.6075	1.5525
Apr	1.6550	1.6300	17.05	1.6275	18.15	0.6035	1.5675
May	1.7000	1.6750	17.35	1.6500	18.30	0.5950	1.5750
Jun	1.7700	1.7450	17.90	1.7000	18.60	0.5900	1.6000
Jul	1.8550	1.8300	18.70	1.7550	19.00	0.5965	1.6225

* CME prices.

**NASS prices.

Obsolete policies...

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class milk prices is not new. Prior to the implementation of the current Federal Order milk price calculation in 2000, the National Cheese Exchange (NCE) Cheddar cheese price was a component in the Class III milk price calculation. When the NCE closed in 1997 and cash cheese trading moved to the CME, USDA opted for a government-surveyed price rather than the CME cheese price as a replacement for the NCE cheese price used in the milk price calculations. At the time, there was plenty of controversy surrounding the thinness of the cash cheese market and whether it really reflected industry pricing practices.

With more than a decade of USDA-surveyed Cheddar block and barrel cheese prices to compare with CME Cheddar block and barrel cheese prices, it is safe to say that the CME spot cheese prices are the cornerstone of Cheddar cheese pricing in the United States. Over the past five-years, there has been more than a 95% correlation between the CME Cheddar block cheese price and the USDA-surveyed Cheddar block price. Over the past decade,

the monthly average USDA-surveyed Cheddar block price averaged about 0.5 cents higher than the monthly average CME Cheddar block price.

There are, however, monthly differences between the two prices because of the lag in reporting. For example, the average CME block cheese price for the week ending Feb. 22 serves as the base price for most cheese sold the following week, which USDA surveys and publishes on March 6.

Further interference of market signals comes from the Class I (fluid) milk price being an advanced price. For example, the December 2012 Class I price was announced Nov. 21 and calculated using dairy product prices from the last week of October and first week of November. The December Class II, III, and IV milk prices, based on commodity markets from late November and December, were announced Jan. 3. And dairy producers received the weighted average of the December class prices in mid-January.

That means milk checks were rising, signalling producers to make more milk, just when demand was falling seasonally. **MCT**



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