

Finding True North

The magnetic poles of the Southern and Northern Hemispheres are battling one another, causing the dairy market compass to stall and end users of dairy products to wonder what will happen next to dislodge the needle.

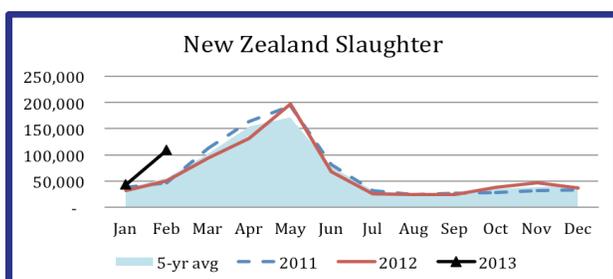


Looking south first, New Zealand—a dairy powerhouse despite its modest size—accounts for nearly half the world’s dairy product exports. The combination of a seasonal low-cost, pasture-based milk production model in a country with twice as many dairy cows as people results in nearly 95% of New Zealand’s dairy product output being produced for the global market.

The impact of drought on New Zealand has been quick and severe; the country’s season-to-date slaughter rate through March 11 is 52% ahead of the five-year average.

The New Zealand milk production season begins in earnest in August, and cows are typically dried off by May. Extremely favorable weather conditions in the 2011-12 season resulted in 19.8 million metric tons of milk production. The current season began favorably, with output running above year-earlier levels through January 2013. But then dry weather conditions surfaced in February

and persisted into March when an official drought declaration was issued for the entire North Island, which accounts for approximately 65% of the country’s milk



production.

The impact of drought on New Zealand’s dairy industry has been quick and severe; the country’s season-to-date slaughter rate through March 11 is 52% ahead of the five-year average. With large numbers of milk cows heading to slaughter and others being dried off early, buyers of dairy products have started to worry that global prices will soar like they did in 2008. Already,

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Ken’s Corner



*by Ken Meyers
President, MCT Dairies Inc.*

It’s clear that volatility has become the norm in U.S. and world dairy markets. An increase in extreme weather conditions has led to peaks and valleys in dairy product prices.

Last year’s record-high milk production in the United States pressured U.S. nonfat dry milk prices to below \$1.10/lb. in June 2012. Then drought surfaced, pushing feed costs skyward, which led to low profitability—or worse yet losses—on dairy farms in both the United States and Europe.

Today, nonfat dry milk prices are back above \$1.50/lb. as output dries up in the Southern Hemisphere and buyers take hold of physical product and hedges in the futures market.

It’s important to remember, though, that the 2007-08 drought in New Zealand occurred at the tail end of a very long global economic boom, which included large gains in dairy product consumption across the developing world.

In 2007, global gross domestic product (GDP) was growing 5.2%. Last year, global GDP rose 3.5%, and it’s forecast to grow 3.9% this year.

GDP growth in the developing world peaked at 8.3% in 2007. This year, it is forecast to grow 5.9%. While that’s a big recovery from 2009’s post-bust gain of only 2.8%, economies in the developing world still have a ways to go to reach pre-2007 levels. **MCT**

Moving off the flat line...

Stocks of butter and cheese increased in February vs. both the prior month and year, according to USDA's recently released Cold

Storage report. A stronger-than-average butter build could be the result of an early Easter/Passover holiday. Nevertheless, stocks are

adequate for both domestic and global demand.

Recent strong gains in butter and cheese markets will result in higher milk prices arriving in producer milk checks during late April and May. Until then, production growth is expected to stagnate, but output could rebound (weather permitting) in May as the milk-feed price relationship improves. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Mar	1.6240	1.5920	16.90	1.6425	17.75	0.6058	1.5230
Apr	1.6650	1.6400	17.10	1.6650	18.00	0.5650	1.5350
May	1.7000	1.6750	17.50	1.7000	18.30	0.5700	1.5550
Jun	1.7500	1.7250	18.00	1.7250	18.80	0.5875	1.5850
Jul	1.8550	1.8300	18.70	1.7550	19.25	0.6050	1.6100
Aug	1.8775	1.8500	19.25	1.8000	19.50	0.6150	1.6250

* CME prices.

**NASS prices.

Deja vu...

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increasing world prices are ahead of U.S. prices.

The last major drought in New Zealand began in the spring of 2007 and lasted through fall 2008. Because the drought began at the end of the country's production season, output in 2006-07 was 2.6% above year-earlier levels and exports were booming. New Zealand's dairy exports hit a record high in the 2006-07 season, and Fonterra, the world's largest dairy cooperative, announced a milk price payout of \$6.40/kg of milk solids to spur additional production, a 43.5% increase over the prior two years. (Just this week, Fonterra announced a 30-cent increase in the payout to \$5.80/kg of milk solids.)

At the end of the 2006-07 season, New Zealand was expecting to see a 4% to 6% increase in production in 2007-08 due to the increased payout. But the country's burgeoning drought took hold, and output in the 2007-08 marketing year plunged 3%.

Today, production in New Zealand is dropping again, conjuring up images of the past, but the dairy industry in the Northern Hemisphere has also reached a critical juncture. Producers are running low on on-

farm feed supplies and what's left is often of lesser quality. Already milk production in Europe has dropped below year-earlier levels and U.S. production is basically flat.

Ample inventories of cheese and butter, however, are weighing down U.S. prices. According to USDA's latest Cold Storage report, more than 1 billion pounds of cheese was in storage at the end of February, which is 4.5% more cheese than in February 2012. Butter stocks of 240 million pounds were 17% larger than the previous year.

With global prices rising and U.S. exporters expecting business to pick up as New Zealand runs short of product, the wild card will be how quickly producers in the Northern Hemisphere respond to a changing market outlook. Current dairy product prices in the United States will support milk prices above \$18/cwt. by midyear. If corn, soybean, and alfalfa prices do not prove cost-prohibitive until new-crop feeds arrive on-farm, milk production could start to trend higher.

The cost of feed will depend on whether the U.S. drought, which still covers the majority of the western Corn Belt, persists through the growing season. If it does, output in the United States and Europe would likely continue to trend lower as feed prices, once again, begin to rise. **MCT**



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