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MCT COMPASS

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# Policy Shifts in Focus

With milk and dairy product prices still at lofty levels, it's no surprise that analysts expect prices to weaken through the rest of the year, but prices will remain buoyant, nonetheless. Many of the major drivers of today's strong dairy prices continue to be in play—but not all. The biggest drivers, drought and high feed costs, have ended for producers east of the Rocky Mountains, but western producers are still wrestling with drought and high forage costs. Low-quality forage also continues to be a problem in the Midwest where spring and summer rainfall has been excessive. And China's rapid pace of growth in dairy demand, while still robust, has slowed.

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Looking toward the rest of the year and 2015, U.S. dairy producer financials should be stronger as balance sheets heal from the low margins of 2009 and 2012. Additional milk will help meet world demand, but the global market will remain tight. That said, several simultaneous policy shifts—elimination of EU quota, an amended one-child policy in China, and the new U.S. Margin Protection Program (MPP)—are clouding forecasts.

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 economists: Bill Brooks, INTL FCStone; Bob Cropp, University of Wisconsin; James Dunn, Pennsylvania State University; Wilson Gray, University of Idaho; Mary Ledman, Keough Ledman and Associates and the *Daily Dairy Report*; and Mark Stephenson, University of Wisconsin. We then added their forecasts to CME Group settlement prices for July 23 futures to create a consensus forecast.

Our panel's average Class III price for second-half 2014 is $20.43. The group expects the Class III price in 2015 to drop to $18.01. The most bullish of the analysts expects a Class III 2015 average of $19/cwt., while the most bearish anticipates a 2015 average of $17.25. The futures market on July 23 was predicting a 2015 Class III average right in between at $18.05. Forecasts for the average NASS cheese price for the next six months range between $1.92 and $2.01, and for 2015, cheese price forecasts range from $1.71 to $1.85.

Like last year, our experts are more bullish on the Class IV market. The consensus forecast for the second-

*Continued on page 2*

## Ken's Corner

***by Ken Meyers***
***President , MCT Dairies Inc.***

Market signals are mixed, but global dairy supplies should remain tight into next year given strong world and domestic demand. While global demand for dairy products has weakened somewhat, primarily due to a slowdown in Chinese demand, China will continue to be one of the largest driving forces in world dairy markets.

China's economy remains a bit wobbly, but the country's second quarter gross domestic product (GDP) grew 7.5%—strong by any standards. And the long-term trends that have been increasing dairy demand in the country are only likely to accelerate as more babies are born, more people move from rural agricultural areas to large urban centers, and more people ascend from poverty into the middle class.

At the same time, though milk production in all three major exporting regions—Oceania, the European Union, and the United States—is expected to increase, due in part to upcoming policy changes, but market factors are also at work. With milk prices still strong around the world and feed prices continuing to drop, production in both hemispheres will likely expand, which could eventually lead to much lower prices.

For now, though, it appears that prices will remain historically high and demand for dairy products worldwide will continue to grow due to its nutrient profile as a cost-competitive protein. **MCT**

## …unknowns ahead

*Continued from page 1*

half 2014 average Class IV price of $21.51 is $1.08 higher than the Class III forecast. In 2015, however, they anticipate Class IV prices to drop to $18.35. For the second half of this year, the group expects nonfat dry milk prices to average near $1.72, with the butter price forecast above $2.13.

The new MPP, which is expected to be implemented this fall, elimination of EU quota in 2015, and the potential for more births in China to increase demand for imported infant formulas won't have much impact on prices this year or early next, the group says, but prices could start to respond to these changes in late 2015.

"One would expect there will be more babies in China, and foreign-made formulas have been preferred, so China's imports of formula would increase. But more significant than the two-child policy is China's objective of increasing the nutrition of its people and China's inability to increase milk production at a rate to meet the growing demand," says one analyst.

Another says: "Like any safety net program, the MPP won't have any impact until we have our first crash." **MCT**

**Consensus Forecast**

| | Cheese | Class III | Butter | Class IV | Whey* | NFDM |
|---|---|---|---|---|---|---|
| July | 2.0375 | 21.38 | 2.3165 | 22.26 | 67.63 | 1.86 |
| Aug | 2.0189 | 21.14 | 2.3220 | 22.86 | 66.24 | 1.79 |
| Sept | 1.9875 | 20.68 | 2.2403 | 22.01 | 64.10 | 1.72 |
| Oct | 1.9577 | 20.19 | 2.1127 | 21.11 | 62.40 | 1.68 |
| Nov | 1.9265 | 19.88 | 1.9890 | 20.25 | 60.53 | 1.65 |
| Dec | 1.8578 | 19.32 | 1.8278 | 19.56 | 59.96 | 1.64 |
| 2H Avg | 1.9643 | 20.43 | 2.1347 | 21.51 | 63.48 | 1.72 |
| 2015 Avg | 1.7708 | 18.01 | 1.7179 | 18.35 | 56.11 | 1.55 |

* Whey in cents

## What the experts say...

**Bill Brooks:** China's amended one-child policy, allowing many people to have two children, should allow for additional growth in demand for dairy products, but it is uncertain how many additional children will be born given the limitations of eligible families and the cost of raising more than one child. However, Chinese demand will continue to be a major unknown over the next year. Slower demand from China has put downward pressure on prices.

**Bob Cropp:** Less than 3% of U.S. dairy herds have 1,000 cows or more, but they produce 51% of the milk. I question whether the majority of these herds will participate in the MPP. Instead they are likely to continue to use futures and options to protect margins. Nevertheless, if a majority of producers reduce margin risk one could assume more milk will be produced, lowering average milk prices for longer periods. We could start seeing the impact in late 2015.

**James Dunn:** I think the end of EU quotas will mean a lot of small-herd producers in the European Union will exit while large operations expand. I also think EU milk prices will fall as the intervention program phases out. I don't see a big change in milk production but rather a greater concentration of production in northern Europe, creating more regional specialization than exists now.

**Wilson Gray:** By keeping margins positive, the MPP could hold production higher than the market would otherwise support. It's a no-brainer for all dairies to participate initially regardless of what protection levels they use later. More than 88% of U.S. dairies have fewer than 200 cows, so most dairies produce less than 4 million pounds of milk and would receive the $4/cwt. margin protection for the $100 sign-up fee on all of their production.

**Mary Ledman:** EU milk production is posting a year-over-year rebound of 3-4%, which could temper next year's increases. EU quota has expanded by 2% annually since 2007, yet production has not exceeded quota. Additional processing capacity, particularly in milk powders, has been added in anticipation of greater output in Denmark, France, Germany, the Netherlands, and Ireland, which is likely to impact the global market.

**Mark Stephenson:** Growth in China's economy is slowing, but the economies of other Asian and many African countries have been growing, and we expect more demand for dairy products from these countries. Weather continues to be a concern for U.S. milk production. Extreme drought in California has not had much direct impact yet, but the state probably cannot continue to draw down its water table. California feed—especially forages—could become more expensive in 2015.

 **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.**