

Can We Depend on China?

With U.S. dairy prices still at historical highs, U.S. exports of dairy products are expected to slow. While that is concerning, the slowdown in Chinese dairy product imports is even more worrisome. Or is it?



In fact, China is on track to surpass Canada as the second most important market for U.S. dairy products following Mexico.

In fiscal year 2014, total U.S. dairy exports are expected to reach a record \$6.8 billion, thanks in large part to Chinese demand, according to USDA. The U.S. dairy industry has become dependent on the Chinese market. In fact, China is on track to surpass Canada as the second most important market for U.S. dairy products following Mexico.

China's 2014 imports, while still slated to be much stronger than last year, appear to be slowing, at least for now. From January through August, China imported 787,894 metric tons (MT) or 1.74 billion pounds of milk powder, up a strong 62% from the first eight months of 2013. By comparison, Chinese imports of dairy products for the first five months of the year were 89% higher than the same period

in 2013.

On a month-to-month basis, though, Chinese imports of dairy products continue to slip and are now just slightly above 2013 levels. Combined imports of skim milk powder (SMP) and whole milk powder (WMP) in August were 1.8% greater than the previous year but 32.3% lower than July volumes. At 39 million pounds, Chinese SMP imports in August fell 17.4% below 2013 levels and were 25.2% below July's volume. Chinese imports of WMP at 58 million pounds in August were 59.1% lower than in July but still 21% above previous-year levels.

Even though the pace of imports is slowing in China, demand from the world's most populous country should

remain strong for some time to come. China's dairy market appears to be evolving from one focused on milk powders to one attracting a wider array of products including cheese and butterfat. While still small by comparison, China's 2014 imports of cheese and butterfat through May 2014 were up 67% and 121%, respectively, over the same period last year.

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Ken's Corner



*by Ken Meyers
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China was apparently sitting on a record-high 400,000 metric tons of milk powder in July, according news reports from Beijing. These reports project that it will take until October or November for China to work through these stocks given the

supply that is being added.

China's very strong purchases of milk powders in late 2013 and early 2014 were, in retrospect, too aggressive, according to Rabobank. China's aggressive buying collided with high retail prices that slowed consumer demand. As China works through its mountain of milk powders, weaker retail prices should eventually attract consumers back to the dairy aisle, helping to stabilize world prices.

However, global milk supplies are also increasing which could anchor milk and dairy product prices. In addition, record-high U.S. dairy prices have not yet worked their way through the domestic supply chain. At the same time consumer prices are rising, strong dairy farm margins will continue to encourage dairy producers to increase the domestic milk supply.

Looking ahead, Chinese demand likely will not be strong enough to totally offset growing world supplies but it could help cushion the price landing. Even so, U.S. milk and dairy product prices are expected to converge with world prices early next year. **MCT**

Price Retreat Begins

After posting new record highs in September 2014, the CME Group spot Cheddar block and barrel cheese and the butter markets are retreating, but they still

remain at higher-than-historical averages. American cheese stocks increased modestly in July and August when historically stocks have moved lower in these months. Nevertheless, American cheese stocks as of Aug. 31 totaled 662.4 million pounds, down just 0.9% compared to last year. Butter stocks remain in a much tighter situation. At 165.1 million pounds, butter inventories are 37% below last year's record level and 18% less than August 2012 stocks. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Sep	2.3510	2.3660	24.55	2.9800	22.60	0.6690	1.4625
Oct	2.1500	2.1250	24.15	2.6800	21.80	0.6375	1.4000
Nov	2.0000	1.9750	21.70	2.2800	19.15	0.6200	1.3500
Dec	1.8750	1.8250	20.25	1.9400	17.85	0.6075	1.3300
Jan	1.7800	1.7300	18.90	1.8200	16.85	0.6050	1.3000
Feb	1.7300	1.6800	18.20	1.7000	16.15	0.6000	1.2750

* CME prices.

**NASS prices.

Chinese want cheese...

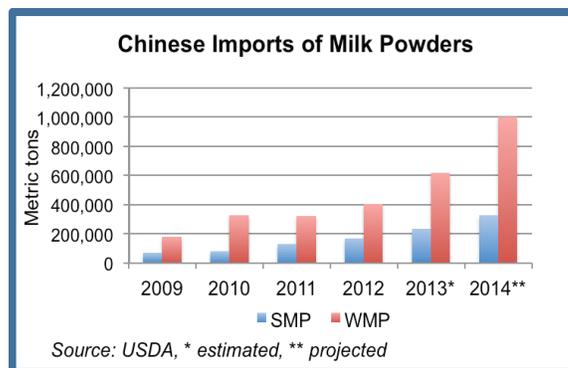
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While the United States primarily exports SMP and whey to China, the prospects for U.S. cheese exports look bright. In fact, U.S. exports of cheese to China through May were 44% larger than the prior year.

Rising incomes, growing urbanization, and an expanding population should support China's imports of dairy products long term. The Chinese government has tried to support its domestic industry by introducing regulatory reforms, but confidence in locally sourced dairy products remains a concern, particularly among parents of infants and higher-income consumers. These people appear willing to pay premium prices for imported products such as infant formulas, milk powder, and ultra-high temperature (UHT) milk.

Due to strong demand and tight supplies, China's demand for imported UHT and fresh milk has been growing. This year, USDA expects China to import 300,000 metric tons of UHT and fresh milk. While U.S. exports of fresh and UHT milk to China are growing, Germany supplies about 40% of China's needs in this category, according to USDA.

While China has been working to increase its domestic milk production, the forecast for 2014 milk



production is falling, down 3% from December's estimate to 36 million metric tons due primarily to stricter health requirements for milk that are expected to reduce supplies from small-scale dairy farmers. In addition, a 30% year-over-year increase in beef prices has created an incentive for Chinese dairies to slaughter low-producing milk cows. As a result, USDA expects the 2014 Chinese milk herd to drop 4% below 2013 levels to 8.71 million head.

After recovering from drought, New Zealand has regained its foothold in China. New Zealand accounted for 50% of China's SMP imports in August and 97.3% of its total WMP imports. While this, too, could impact U.S. exports to China, U.S. dairy exporters appear to have earned a foothold in China as well. **MCT**



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