October 30, 2014

MCTCOMPASS

A complimentary service of MCT Dairies, Inc. www.mctdairies.com

U.S. Contraction Will Lag World's

World and U.S. dairy markets are elastic, at least for demand. As milk and dairy prices rise at the retail level, consumers of dairy products cut back their consumption or switch to more economical protein substitutes. Milk production is also elastic in many parts of the world, but in the United States, market signals to producers during times of surplus or deficit are delayed due to the Federal Milk Marketing Order's classified milk pricing system.

Given the recent period of very high world milk prices as well as Russia's ban on imported dairy products from Europe, the United States, and New Zealand, dairy producers in Oceania and Europe are already receiving signals to reduce milk supplies. While the slowdown in EU and New Zealand milk production will likely take months to complete, the contraction in U.S. milk production will take even longer.

While the slowdwon in EU and New Zealand production will likely take months to complete, the contraction in U.S. milk production will take even longer.

European dairy producers first started to see signs of lower milk prices this summer, yet EU-28 milk output rose 4.4% above year-ago levels in August to 12.4 million metric tons, according to Eurostat. For the January through August period, EU-28 output was 5.25% ahead of the same period last year.

As demand slows for perishable dairy products, European manufacturers are already diverting milk to driers and away from bottling plants and cheese vats. Drinking milk production in the European Union fell 1.8% below year-earlier levels and 0.8% from July levels. EU cheese production declined 5.7%, compared to August 2013. At the same time, production of whole milk powder, a product made primarily for the export market, fell 10.6% to 98.8 million pounds, the lowest monthly output in 2014. However, EU skim milk powder production rose a phenomenal 29.8% above the previous year to 244 million pounds as processors rush to balance the market.

If world demand continues to slow, lower EU farm milk prices will encourage producers to manage costs by cutting back on supplemental feeds and culling low-producing milk cows. These management strategies,

Continued on page 2

Ken's Corner

by Ken Meyers
President , MCT Dairies Inc.

It looks like a return to balanced world markets won't occur until sometime next year after world milk production begins to contract. Until then, dairy processors will divert milk from fresh dairy products into storable milk powder products and butter.

As the supply of these products increases, prices will likely drop further until producers worldwide are forced into implementing cost-management strategies. However, this scenario is not guaranteed to play out. Weather issues could develop to dramatically curtail output in one region, quickly sending world prices higher. China could resume its buying spree as milk powder prices fall, stabilizing a price drop. Farm prices could plunge dramatically (New Zealand's prices are expected to decrease 35% or more) causing a sharp contraction in producer and cow numbers. If extended, Russia's ban on imported dairy products could further curtail demand, while lifting the ban, could spark an uptick in exports. And, of course, no one knows for sure how much milk European producers will put on the market once quotas are eliminated next year.

This tells me the United States needs a pricing mechanism that provides producers with more timely market signals, or we could be dealing with a major milk surplus that perpetuates low milk prices for an extended period of time. **MCT**

Stocks to Cushion Price Drop

CME Group (CME) spot cheese and butter prices remain at higher-than-average levels entering the peak demand period. Cheese and butter prices have fallen from record-highs posted earlier but are being buoyed by low stock levels. American cheese stocks totaled 631.3 million pounds as of the end of September, 4.5% less than the prior year. During the past two months, the drawdown in American cheese stocks of 29.2 million pounds exceeds the five-year average by 11 million pounds, suggesting strong demand. Conversely, butter stocks fell 24.9 million pounds, about half the average drawdown. Nevertheless, at 146.1 million pounds, U.S. butter stocks are 37% less than last year, which will cushion the fall. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Oct	2.1936	2.0762	23.80	2.0762	21.45	0.6515	1.4925
Nov	2.0000	1.9550	21.50	1.9300	18.15	0.6150	1.4250
Dec	1.8750	1.8250	19.50	1.8325	17.40	0.5700	1.3625
Jan	1.7800	1.7300	18.35	1.7500	16.50	0.5350	1.3000
Feb	1.7300	1.6800	17.60	1.7300	15.90	0.5150	1.2500
Mar	1.6500	1.6250	17.00	1.7000	15.50	0.5000	1.2250

** CME prices.*
***NASS prices.*

Weather overrides price...

Continued from page 1

however, could take months to play out, keeping the milk supply above 2013's for the remainder of the year and putting more skim milk powder on world markets.

New Zealand's output also continues to expand, up 5% over year-earlier levels in September—despite much lower milk prices. New Zealand's pasture-based system is more dependent on weather than price, and pasture conditions across most of New Zealand are good. The country's milk herd has also expanded, and producers are using more supplemental feeds. New Zealand's dairy herd of 5.1 million milk cows is now 87,000 head larger than a year ago, according to a recent USDA GAIN report. An estimated 100 new dairies were operating in August 2014 as a result of New Zealand farmers converting cropland, sheep and beef pasture, and forestry land to dairy operations. Imports of palm kernel extract, which is used as a feed supplement, are reportedly 39% above last year, suggesting last season's strong milk payout was used in part to purchase supplemental feed. New Zealand's calendar year 2015 milk production is expected to climb 1.75% to 22.1 million metric tons (48.7 billion pounds) despite severe price drops.

U.S. Producers, however, have only received muted signals to slow milk production due to a lag in pricing. For instance, the November Class I base price, announced Oct. 21 at $24.06, was down only 13 cents from October's price and won't hit mailboxes until Dec. 15. Class III and IV prices also remain historically high. U.S. producers are currently receiving a Class III price of $24.60 for September marketings, up $2.35 from August's price. October's price will be announced Nov. 5 and is expected to drop 80 cents to $23.80, but that's still historically high. The September Class IV price of $22.58 was $1.31 lower than August's price but is still well above historical levels. The October Class IV price, announced Nov. 5, is expected to drop to $21.45, but it also won't show up in producers' mailboxes until Dec. 15. Class III and IV prices have been above $21/cwt. in every month this year.

Given the delayed pricing along with the new crop year and lower feed prices, it's no wonder that U.S. milk production continues to expand well beyond last year's levels with no sign of a slowdown. **MCT**

The information contained in this newsletter is for general guidance only. It is not intended to constitute or substitute investment, consulting or other professional advice or services. The information presented is not an offer to buy or sell commodities. Compass accumulates then distributes opinions, comments and information from and based upon other public and reliable sources, but it cannot warrant or guarantee the accuracy of any of the data included in the newsletter. From time to time MCT Dairies, Inc. may hold futures positions in commodities discussed in the newsletter. Always contact a registered financial advisor before making any decisions. MCT Dairies, Inc. shall not be held liable for any improper or incorrect use of the information contained in the Compass or for any decision made or action taken in reliance on the information in this newsletter. Reproduction with permission only. **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.**