

Global Output Slows

If anything is certain heading into 2017, it's that change is on the horizon—change in U.S. politics and change in dairy markets. Milk production in the world's two largest dairy-exporting regions—the European Union and New Zealand—is contracting, which means world dairy product prices are strengthening.



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Despite rising world prices, U.S. dairy exporters will face headwinds in 2017. Rising interest rates and the strengthening U.S. dollar will be key issues facing the U.S. dairy industry in 2017. The sharp rise in the U.S. dollar over the past few years compared to the euro has been undermining the competitiveness of U.S. dairy exporters for some time, and it appears the relationship between U.S. and foreign currencies will continue to disadvantage U.S. exporters in the coming year.

With third-quarter 2016 gross domestic product (GDP) up 3.2% in the United States, the Federal Reserve raised interest rates by 25 basis points in mid-December and stated that there could be three similar increases in 2017. At the same time, other central banks around the world continue to support more accommodative monetary policies due to weak economic growth. The disparity between U.S. monetary policy and that of other major world economies pushed the dollar to its highest level in 13 years against a basket of competing currencies in mid-December. The strengthening U.S. dollar has raised the cost of U.S. dairy products for importing nations.

That said, U.S. output continues to grow. Strong U.S. milk prices and robust demand for U.S. dairy products will support growing U.S. output well into 2017. USDA expects 2017 total U.S. output to climb 2% to an estimated 217 billion pounds. U.S. production in the first

half of the year is expected to climb to 109 billion pounds, up 1.8% from first-half 2016.

Domestic demand for U.S. dairy products is also expected to grow. On a milkfat basis, USDA expects first-half commercial disappearance to climb to 1.048 billion pounds, up 3.25% from the same period in 2016. On a milk solids basis, U.S. demand is expected to rise 1.5% to

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Ken's Corner

*by Ken Meyers
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According to a recent *Wall Street Journal/NBC* poll, 68% of Americans believe President-elect Donald Trump will change the way business is conducted in Washington. What that means for dairy policy is unclear.

If Exxon Mobil CEO Rex Tillerson is confirmed as secretary of state, his relations with Russia could mean an end to U.S. sanctions implemented in 2014 after Russia annexed Crimea, and Russia's retaliatory ban could also be lifted on U.S. commodities. Europe felt the initial consequence of Russia's ban most acutely; cheese exports to Russia dropped from 257,000 tons in 2013 to less than 5,000 tons in 2015. Since then, Europe has increased global market share at the expense of the United States. U.S. cheese exports are forecast to reach only 280,000 tons in 2016 after peaking at 368,000 tons in 2014.

How President-elect Trump will deal with the North American Free Trade Agreement, which he has threatened to scrap or renegotiate, is also uncertain. According to the 1994 agreement, any of the three countries involved—Mexico, Canada, and the United States—can pull out with six months notice. Renegotiation would take longer. Mexico, the number-one destination for U.S. cheese and nonfat dry milk, is a crucial market for U.S. exporters. **MCT**

Market Strength Ushers in 2017

As the page turns on 2016, markets are strengthening. U.S. commercial stocks of butter posted a record-large month-over-month decline of 29.5%, or 67.3 million

pounds, in November, but butter stocks are still 21.2%, or 28.1 million pounds, above year-ago levels. November American cheese stocks fell 3.2%, or 23.3 million pounds,

narrowing this year's year-over-year increase to 1.8%. Strong November drawdowns are likely to buoy U.S. butter and cheese prices. While U.S. cheese and nonfat dry milk are competitive in global markets, rising butter prices are likely to limit U.S. competitiveness unless milk production contractions in Europe and Oceania are steep enough to significantly limit world export supplies. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Dec	1.7330	1.6110	17.40	2.1730	15.05	0.4000	0.9600
Jan	1.6500	1.6000	16.55	2.0700	15.60	0.4150	1.0150
Feb	1.6450	1.6200	16.45	2.0200	15.45	0.4300	1.0500
Mar	1.6750	1.6500	16.70	2.0500	16.05	0.4450	1.1200
Apr	1.7000	1.6800	16.90	2.1000	16.55	0.4500	1.1550
May	1.6800	1.7000	17.05	2.0800	16.75	0.4575	1.1750

* CME prices.

**NASS prices.

...EU milk reduction plan takes hold

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920 million pounds.

At the same time, milk production is declining overseas. Estimated EU-28 milk production in October dropped roughly 957 million pounds below the previous year, or 3.6%, to less than 26.5 billion pounds. October marked the fifth consecutive year-over-year decline in EU milk output and the largest monthly deficit in decades. It was also the first month that the European Commission's Milk Production Reduction Scheme, which pays participating producers a premium to produce less milk than they did the previous year, was in effect. Cash-strapped producers are expected to cull heavily and production is expected to drop below 2016 levels in the first quarter of 2017 before staging a recovery later in the year. For 2017, the commission anticipates EU output will rise 0.5% above 2016 levels.

Heavy financial losses in New Zealand in 2016, expected to average near \$143,000 per herd, have caused producers there to scrimp on supplemental feeds. This practice has cut into milk production,

causing pay prices to rise. Rising pay prices are expected to spur producers to return to supplemental feeding, which will increase calendar year 2017 output by 0.6% over 2016 levels, according to a recent USDA Foreign Agricultural Services report.

China and South America are also reporting sustained milk production deficits. In Argentina, second-half 2016 output is expected to plunge 12% below the previous year, while 2016 output in China is expected to drop 5% below 2015 levels, according to a USDA Foreign Agricultural Service report. These additional declines are adding to the global drop in output and opening doors for U.S. exporters.

Large government-owned stocks of skim milk powder in the European Union, however, will likely compete with U.S. exports in 2017. In an attempt to test the market, the European Commission put out a tender to sell 22,000 metric tons of SMP from Intervention in November. In the end, only 40 metric tons were sold because the bids received were below the minimum price set by the commission, but more sales are expected in 2017. **MCT**



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