December 5, 2000

MCT COMPASS

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

All hail mandatory reporting

For two straight years, the dairy industry has been embarrassed by glaring errors in inventory reporting. These fumbles have eroded confidence in the dairy markets and undermined the ability of industry executives to effectively manage their businesses.

This fall, Congress heard industry's cries and passed the "Dairy Market Enhancement Act of 2000."

The bill requires manufacturers to report to USDA the sale price, quantity and moisture content of 40-lb. block and 500-lb. barrel cheddar cheese, bulk grade AA butter, nonfat dry milk and dry whey. In addition it requires anyone storing these products to report inventories. The Act gave USDA a couple big sticks to ensure better information: it requires the department to conduct periodic audits to verify reports, and authorizes fines of up to $10,000 per offense on companies that don't comply with the new procedures.

Now, USDA is setting about the task of implementing the new law.

USDA's NASS state offices currently collect this information from plants willing to share it, but they didn't have the authority – until now – to *require* plants to report. In late November, state offices began contacting hold-outs to bring these plants into the system. However, reports may not reflect full participation for several months, because it may take time for some companies to develop weekly reporting programs.

The mandatory stock reporting provisions, on the other hand, are a little less straightforward. The bill requires manufacturers and "other persons" storing dairy products to report their inventories. However, USDA is uncertain whether "other persons" refers to the companies owning the stocks or to the warehouses holding the products. The department hopes to get a ruling on this provision shortly.

In the meantime, while USDA reports total American cheese stocks in its monthly report, the Act only requires companies to report holdings of cheddar blocks and barrels. Reporting on 640s, as well as colby and jack, will still be voluntary. Blocks and barrels make up the majority of American cheese stocks, but it's worth remembering that only part of the published monthly inventory number will reflect mandatory reporting.

Still, the Act is a step in the right direction. It should ensure more timely, accurate and reliable market information that will facilitate better marketing decisions. In all, good information is good for the dairy industry. ❑

KEN'S CORNER

by Ken Meyers
President
MCT Dairies, Inc.

By now you should know I'm a big fan of mandatory price and inventory reporting. But in the short run, we'll need to be a little cautious in interpreting USDA stats.

Year-on-year comparisons will be difficult in 2001. If USDA tells us cheese stocks are up 10% versus a year earlier, how will we know we're comparing apples to apples? It could simply be a case of more warehouses reporting. We won't really know.

Keep on your toes for other changes, too. For instance, the addition of new contract months for butter futures will change the dynamics of the butter business in fall 2001.

Deliveries on butter can be made anytime after the third business day after the first Friday of the month. But it's the seller who decides when to deliver. Therefore, with the new December contract, it's likely that buyers of butter futures will get stuck taking all their deliveries in the week after Christmas, when they need it least.

Ultimately, changes like these will be positive steps for the dairy industry. But for now managers need to think about how their businesses will be affected. ❑

Class III/IV formulas tweaked by USDA

Last Friday, USDA published a "tentative final rule" that makes small changes to the Class III and Class IV formulas. The most significant modifications are in the way fat and protein are valued in Class III milk.

Under the current method, the Class III price moves in the opposite direction as the butter price. Now the Class III butterfat value will be calculated solely off the cheese price.

This change will raise the price of fat used in cheese-making, to the detriment of manufacturers of higher-fat cheeses (such as cream cheese) and the benefit of makers of lower-fat cheeses (like mozzarella). Further, it changes the dynamics of surplus cream disposal, because there will be a different price of butterfat for every class of milk.

USDA also tinkered with the Class III and IV make allowances, but the overall net effect is minimal. Had the new system been in place this year, Class III prices would have averaged the same, while Class I, II and IV would have been boosted by 11-12¢/cwt.

The new formulas take effect with January Class III/IV prices. ❑

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV
DEC	1.1230	1.0930	9.56	1.6917	14.09
JAN	1.1200	1.0900	9.63	1.0375	11.68
FEB	1.1000	1.0700	9.44	0.9900	11.29
MAR	1.1125	1.0825	9.24	1.1050	11.77
APR	1.1410	1.1110	9.49	1.1850	12.11
MAY	1.1500	1.1200	9.64	1.1763	12.07

** Block, barrel and butter are monthly averages of CME prices.*

Buckle up for bumpy butter ride

Usually when a price shoots up 42% in a single day, we're talking about some hot internet stock. But on Nov. 8, the butter market veered from its steady course, soaring 51.25¢ to $1.7300. Traders added another 6.50¢ the following trading session.

Participants braced themselves for the next round, as an anxious buyer bid the market to $1.8500. With no willing seller in sight, the bid was cancelled before the last call was heard.

Such is the CME butter market.

Many market participants thought that the butter price could rise in November because there was no threat of deliveries from a futures contract. Still, no one predicted such a dramatic spike. How was it that this price increase caught the market off-guard?

The industry was led into a false sense of security, thinking there would be plenty of butter this year. The numbers seemed to warrant a relaxed approach: production year-to-date was 3% higher than last year, when supplies were more than adequate. Meanwhile, inventory revisions boosted the amount reported in storage, putting stocks 20% higher than last year's level by mid-year.

The presence of Class IV futures also played a role in masking the real tightness. This new contract allowed butterfat users to hedge their fat costs with cash-settled futures contracts, rather than holding physical hedges. In the past, users would have been selling this butter back onto the market during the fourth quarter. This year, they unloaded it earlier, so less was available to the market for the holiday buying surge.

So what's ahead for next year? Unlike cheese and powder, the butter market is susceptible to periodic and often unforeseen price spikes. Volatility seems to be the watch-word of the industry. ❑

MCT Compass gathers information from reliable sources but it cannot warrant the accuracy of any of the data included in the report. © 2000. 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.