



# MCT COMPASS

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## Can El Niño save the dairy markets?

The “baby” is back. But this time, he’s not going to get into as much mischief as he did five years ago.

For the last few months, meteorologists have been tracking the warming of the ocean waters in the Pacific, signaling the return of El Niño, the weather phenomenon made famous for the disruption it caused in 1997-98.

In May, equatorial Pacific surface waters were nearly 2 degrees F warmer than normal. Other indicators point to El Niño as well: more rain than usual in parts of South America, less than usual in Indonesia. Over the next 12-18 months, these warmer ocean waters will result in greater evaporation and rising air currents that can

affect wind and weather patterns around the globe. Typically, El Niño causes a cool, wet winter in California and the Southeast, followed by a hot, dry summer in the Midwest.

### Wet Western winter

Dairy industry participants probably have good memories of the last El Niño. A very wet winter in California in 1997-98 resulted in dramatic reversals in production-per-cow in the spring and summer of 1998. From March through November 1998, productivity in California dropped 3.1%, a decline of nearly 2 lbs. of milk per day. For the entire year, California milk production increased only 0.3% in 1998, after climbing 4.6% annually

for the previous five years.

The rest of the country was still in contraction mode, so other states weren’t able to pick up the slack. Nationwide milk production increased just 0.8% in 1998, running below year-earlier levels in June, July and August. Less milk means less cheese and butter. Supplies tightened significantly over the summer, leading prices to skyrocket to record-high levels in the second half of 1998. Blocks topped \$1.50 by mid-June and kept climbing throughout the summer and fall, peaking at \$1.90 in December. The butter market crossed \$2.00 in mid-July and topped \$2.80 in September. To this day, 1998

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## KEN’S CORNER



*by Ken Meyers  
President  
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I guess I’m just one of those people who always sees the glass half full, rather than

half empty. That’s why I think we need to overhaul the current cheese

market psychology.

I’m not naïve enough to think we can “will” the market higher, but it’s time to stop moping about how cheese demand is in the doldrums. It’s really not as bad as all the analysts would like us to believe. Cheese orders are picking up for summer usage, converters are running heavier and I’m sensing a cautious optimism among the trade.

On the supply side, American cheese inventories are up only slightly from a year ago, and below what we had on hand in 2000 or 1999. And though American cheese production in April was up 8.0% vs. a year ago, it was up only 0.6% vs. two years ago.

Clearly the potential is there for the cheese market to tighten. Now all we need is some positive thinking to turn the market psychology around. □

## **\$1.40 cheese still possible this fall**

As cheese demand starts to pick up, prices are expected to climb this summer and fall. We certainly won't see the kind of levels we saw last year, but \$1.40 is still possible for October or November.

Pushing the butter market higher is a taller order. Production, imports and inventories are significantly above previous-year levels, and that will keep a lid on prices in 2002. Fourth-quarter demand could push

MCT Forecast					
	<b>Block*</b>	<b>Barrel*</b>	<b>Class III</b>	<b>Butter*</b>	<b>Class IV</b>
<b>JUN</b>	<b>1.1300</b>	<b>1.1055</b>	<b>10.10</b>	<b>1.0410</b>	<b>10.50</b>
<b>JUL</b>	<b>1.1340</b>	<b>1.1090</b>	<b>9.55</b>	<b>1.0800</b>	<b>10.55</b>
<b>AUG</b>	<b>1.2240</b>	<b>1.1990</b>	<b>10.05</b>	<b>1.1500</b>	<b>10.70</b>
<b>SEP</b>	<b>1.3140</b>	<b>1.2890</b>	<b>11.10</b>	<b>1.2300</b>	<b>10.90</b>
<b>OCT</b>	<b>1.3630</b>	<b>1.3380</b>	<b>12.00</b>	<b>1.2800</b>	<b>11.15</b>
<b>NOV</b>	<b>1.4010</b>	<b>1.3760</b>	<b>12.40</b>	<b>1.2750</b>	<b>11.10</b>

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

prices into the upper-\$1.20s during the holiday demand season.

The Class III price is on track to average about \$11.10 this year,

about a dollar below the average since 1990. The Class IV is on pace to average about \$11.05 in 2002, down from \$13.76 in 2001. □

## **El Niño...**

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remains the highest-price year in dairy history.

Today, with prices weak, traders are watching the developing El Niño to see if it might again disrupt production and cause markets to tighten in 2003. As always, Mother Nature will reveal the answer in her own good time, but the early indications are that this year's event is much weaker than the one five years ago, and thus, less likely to significantly affect production.

This year's El Niño is developing more slowly and moderately than the 1997/98 event. It's a tough act to follow; the most recent El Niño is considered the second strongest of the last 50 years. The strongest of the last half-century came in 1982/83, but the U.S. dairy industry shrugged that one off and posted a 3.0% gain in milk production in 1983

anyway. Two factors came into play: California, whose production increased "just" 1.6% in 1983, represented only 11% of U.S. milk production then, compared with 20% today. But even more importantly, the early '80s were a period of tremendous dairy expansion due to generous government support. The support price in 1983 was \$13.10, and producers were adding cows as quickly as they could get them.

### **20, 25 years ago**

Other El Niños of recent past include 1991/92 and 1986/87. Both events developed slowly and peaked late as far as El Niños go. And it doesn't appear weather played a major role in crimping milk production in either year.

Dairy markets followed fairly typical patterns in 1992. Block cheese rebounded from a very soft year in '91 to average \$1.28, while

butter slumped to 84¢ due to ongoing CCC purchase price tilts. Milk production increased 1.9% nationwide (adjusting for leap day), picking up steam in the second half. California production was up 2.9% that year.

In 1987, block cheese prices remained near support all year, averaging \$1.21, while butter did likewise, averaging \$1.42. Milk production declined 0.3% that year (though it gained 4.1% in California), due to a 3.8% drop in cow numbers.

The low level of government support and the prominence of California as the number-one milk production state make the dairy markets more vulnerable to El Niño-related swings than they were in the past 50 years. But traders waiting for this year's baby to turn the markets around may find themselves disappointed. □

