

Are Prices Headed for a Crash?

Looking toward next year, one wonders whether milk and dairy product prices will see a continuation of the three-year, milk-price cycle in which low prices follow two years of high milk prices.

For instance, looking at the three-year period that began in 2004, U.S. all-milk prices averaged \$16.13 in 2004 and \$15.19 in 2005 followed by a \$12.96 all-milk price in 2006. More recently in 2007 and 2008, all-milk prices averaged \$19.21 and \$18.45, respectively, followed by the disastrously low milk price of \$12.83 in 2009. The latest three-year cycle is based off of a \$16.29 all-milk price in 2010 and projected average all-milk price of \$20.25 this year. USDA's September 2011 estimate for the 2012 all-milk price is between \$17.80 and \$18.80. If USDA turns out to be correct, the three-year cycle would be broken.



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USDA's price forecasts in the years just prior to the two downturns, however, were optimistic. For example, in October 2005, USDA forecast the 2006 all-milk price at \$13.35 to \$14.25. In October 2008, USDA forecast the 2009 all-milk price at \$16.50 to \$17.40. In both cases, USDA's forecasts were much higher than actual prices: 84 cents higher for 2006 and \$4.12 higher for 2009. Furthermore, in both cases, Class III futures in October 2005 and 2008 offered producers an opportunity to lock in Class III prices for the following year that averaged more than \$1.00/cwt. higher in 2006 and more than \$4.00/cwt. higher in 2009 than the actual Class III prices.

This week, producers could have locked in an average annual Class III milk price of \$16.79/cwt., using the Sept. 28 settlement prices for CME Group Class III futures.

Supply and Demand Factors

Just how far global dairy product prices ease depends in part on growth in the world's milk supply. Hot, dry weather during the third quarter of this year has reduced European milk production growth. Rising feed costs, lower milk prices, and quota considerations are likely to mitigate production growth in Europe into

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Ken's Corner



*by Ken Meyers
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So what's different today that could lessen the likelihood of a price collapse next year?

During the unprecedented high milk prices of 2008 and 2009, the U.S. dairy herd increased by more than 200,000 head from 9.129 million to 9.334 million head, indicating a certain amount of producer confidence. From 2010 through August 2011, the U.S. dairy herd increased by only 128,000 to 9.217 million head. Likewise, milk production per cow growth in 2007 and 2008 was much stronger than in 2010 and 2011: 2.1 percent and 2.3 percent in 2008 and 2009, respectively. By comparison, in 2010 and 2011, milk per cow increased by less than 1.5 percent, compared to the prior year.

Today, U.S. milk producers tend to be bearish on milk production growth in 2012 due to surging feed costs. Supplies of good-quality feed will be limited next year and what supplies are available will be costly.

However, milk produced in areas of the world where cows are pastured—particularly Australia and New Zealand—will not face the same supply constraints.

Global dairy markets have continued to expand since 2008, which has helped support domestic milk and dairy product prices. Mexico, China, South Korea, and Vietnam have all been vibrant markets for the United States. However, increased production in the Southern Hemisphere and a softening of demand in debt-ridden Europe and the United States will likely intensify competition in our key global markets. **MCT**

Uncertain future...

There is tremendous uncertainty in the domestic and global dairy product markets. U.S. and

global markets are coming off a period of high prices. The seasonal flush in Oceania is increasing trading volumes and additional volume is coming from new market participant Dairy America. Steady to stronger Asian demand could pull U.S. markets out of the expected lower price plateau. However, a pullback in Asian demand would likely move prices lower, allowing global customers to restock at lower prices. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Sep	1.7563	1.7033	19.07	1.8719	19.53	0.5926	1.5439
Oct	1.7525	1.7175	18.20	1.7275	18.20	0.6190	1.5050
Nov	1.7900	1.7600	18.50	1.6350	17.15	0.6100	1.4450
Dec	1.7125	1.6800	18.35	1.5775	16.40	0.5750	1.3800
Jan	1.6500	1.6250	17.50	1.5650	15.80	0.5325	1.3500
Feb	1.6150	1.5900	16.40	1.6000	15.80	0.5000	1.3100

* CME prices.

**NASS prices.

Slower growth...

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2012. U.S. milk production topped 16.4 billion pounds in August, 2.1% more than the previous year. Greater milk production was driven by a 1.1% gain in milk per cow and a 94,000-head gain in the dairy herd (+1.0%).

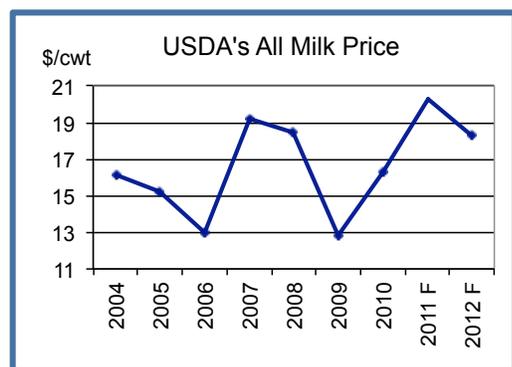
The milk production season in Oceania is just getting started but forecasts there are optimistic, with both Australia and New Zealand production expected to best last year's output.

Global dairy product demand has remained robust. U.S. dairy exports trended lower in July 2011, compared

with the prior month, but continue to outpace 2010's level by a significant margin. On a volume basis, nonfat dry milk/skim milk powder (NFDM/SMP) exports through July 2011 were 562.6 million pounds, up 36%, exports of butter and milkfat totaled 99.3 million pounds, up 37%, and cheese and curd were 300 million pounds, up 41%, compared with last year. Total year-to-date export value for the first seven months of 2010 is \$2.707 billion, a 33% increase over the same period last year.

Stronger exports boosted U.S. commercial disappearance through July 2011 to 1.5% over previous-year levels. During this period, commercial disappearance of butter (+8.8%), American cheese (+3.4%), and other cheese (+6.1%) increased while sales of nonfat dry milk (-4.4%) and fluid milk products (-1.6%) declined. During the latest three-month period, April to June 2011, commercial disappearance declined 0.3%, compared with the prior year, driven by a 9.2% decrease in sales of nonfat dry milk and a 1.8% drop in fluid milk sales.

However, rising consumer prices in Europe and the United States along with sluggish job markets and declining real wages have resulted in increasing dairy product stocks in both regions. These stocks are now competing for export markets. **MCT**



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