

Cheese Price Spread Variability

Variation in the Cheddar block and barrel cheese prices has increased dramatically in recent years. Historically, the annual average CME block-barrel price spread has averaged between 2 and 4 cents per pound, with the block price typically selling at a premium



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to the barrel market. Through the first nine months of 2017, the block-barrel price spread has averaged more than 10 cents, with June's and July's monthly average block prices posting more than a 20-cent premium to the barrel market. This year's CME block-barrel price spread has been drastically different than 2016's market. From January through August 2016, the monthly average CME cash barrel price surpassed the block price in six out of eight months. The largest monthly barrel premium occurred in July 2016 at 7.5 cents.

Why does the block-barrel price spread matter? Cheese manufacturers that participate in Federal Milk Marketing Orders are required to pay the Class III price for milk used to manufacture cheese. The Class III milk price is derived, in part, from the monthly weighted-average, USDA-surveyed, FOB plant sale prices for bulk (truck-load quantity) Cheddar

40-lb. blocks and 500-lb. barrels. Ever since 2000, manufacturers of bulk Cheddar block and barrel cheese have been required by law to report weekly sales volumes and prices. For example, weekly average sales prices for the week ending Sept. 23 had to be reported to USDA by Tuesday, Sept. 26, and were then published in the National Dairy Products Sales Report (NDPSR) at 3 p.m., EST, on Wednesday, Sept. 27.

In 2000, weekly average Cheddar block and barrel

cheese volume totaled 6 million and 8.5 million pounds, respectively. Barrel cheese sales accounted for nearly 60% of the USDA-surveyed cheese prices and averaged 5 cents less than blocks. By 2016, weekly average sales grew to 23.3 million pounds, with block cheese accounting for 56% of the volume and the share of barrel cheese slipping to 44%. In 2016, the NDPSR barrel cheese price

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Ken's Corner

*by Ken Meyers
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Per capita demand for Cheddar cheese increased steadily between 1995 and 2006, from 9.04 lbs. to 10.53 lbs. Per capita Cheddar consumption then began to fluctuate between 2007 and 2010, before starting to steadily rise again, reaching

10.17 lbs. in 2015 and 10.37 lbs. in 2016, according to data released this week by USDA.

At the same time, demand for processed cheese, primarily Cheddar, steadily declined from 1995 to 2013, from 5.44 lbs. to 3.63 lbs. per person (about 38% of total per capita Cheddar demand). However, in 2014 per capita demand for processed cheese started to rise again, hitting 4.48 lbs. in 2015 and 4.86 lbs. in 2016.

With per capita demand for natural Cheddar and processed cheese increasing, manufacturers will need to add more capacity for both Cheddar blocks and barrels. Cheddar blocks are typically cut into natural Cheddar slices, chunks, and shreds. Cheddar barrels are most often converted into process cheese loaves, slices, cold pack cheese, and spreads. It is clear that in 2017 manufacturers expanded barrel capacity. Looking forward, additional block cheese capacity will come online in 2018, which could serve to return the block-barrel price spread to more historical averages. **MCT**

U.S. Exports Should Improve

August stock drawdowns of butter and American cheese exceeded the five-year average, according to USDA's recent Cold Storage report. Month-ending August butter

stocks at 280.2 million pounds fell 8.8%, or 27.2 million pounds from last month, besting the five-year average of 25.9 million pounds. Butter stocks were 12.1% lower than last year but still the second highest August tally of the past decade. American cheese stocks fell 31 million pounds, besting the five-year average drawdown of 16.6 million pounds. At 800.5 million pounds, American cheese stocks are 7.8% above 2016, and the highest level of commercial stocks on record for the month. U.S. butter and cheese prices are below prices in Europe and Oceania, which should spur exports. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Sep	1.6375	1.5705	16.35	2.4400	15.85	0.4170	0.8500
Oct	1.7000	1.6500	16.65	2.5200	15.55	0.4025	0.8450
Nov	1.7250	1.6250	16.95	2.7000	16.45	0.3975	0.8475
Dec	1.7000	1.6250	16.85	2.3800	15.80	0.3925	0.8550
Jan	1.6850	1.6000	16.60	2.1000	14.40	0.3975	0.8650
Feb	1.5900	1.5400	16.15	2.0750	14.15	0.4000	0.8700

* CME prices.

**NASS prices.

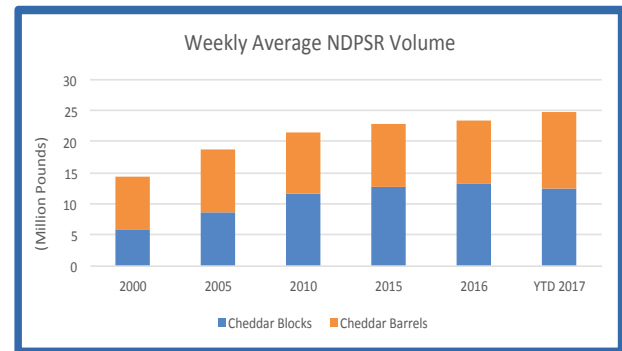
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averaged just 1.8 cents less than the block price. However, during June-August 2016, the NDPSR barrel cheese price exceeded the block price by 7 cents.

Most Cheddar cheese production capacity added since 2000 has been in 40-lb. and 640-lb. blocks. As a result, barrel cheese production has declined as a percent of total Cheddar cheese production, and the block-barrel price spread has narrowed. The rising premium on barrel cheese raised the cost of milk to manufacturers of block cheese, squeezing margins.

In late 2016, U.S. processors increased processing capacity for barrels with no significant change in Cheddar block capacity. Through September 2017, weekly average NDPSR cheese sales volume totaled 24.7 million pounds, up 5.7% from 2016. However, over the same period, weekly average barrel cheese sales soared nearly 19% to 12.1 million pounds, representing 49% of total volume. Through September 2017, weekly blocks averaged 12.6 million pounds, down 4.4% from 2016. The large block premium during most of the year squeezed margins of cheese manufacturers that solely produce barrel cheese.



Production line expansions in modern cheese facilities can boost weekly cheese production by more than 1.5 million pounds. From January to September, the CME spot markets traded 450 loads of blocks and 1,300 loads of barrels, with barrels accounting for 76% of the traded volume. It appears that some of the added barrel cheese production is clearing the market at the CME rather than as contract sales. During September, barrel trades were record large at 216, the highest monthly tally in several years. Going forward, wide variability in the block-barrel price spread could be the norm until additional 40-lb. block capacity comes online or the supply-and-demand picture for barrels finds balance. **MCT**



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