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MCT COMPASS

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Markets at Crossroads in 2019

Markets will begin 2019 at a crossroad. On the one side, supply and demand fundamentals are starting to show signs that higher dairy prices—like those not seen in a few years—could be in the near future as global milk production slows and demand remains buoyant throughout much of the world. On the other side, threats to dairy consumption are springing up around the globe and faltering demand could offset a contraction in global milk supply.

Uncertainty abounds, with Brexit, U.S. trade tensions, and fears of recession all at the top of the news cycle. If the United Kingdom and the European Union ultimately fail to reach a mutually satisfying agreement, economic uncertainty would increase and significant cheese trade into the United Kingdom would be disrupted following the kingdom's exit from the European Union in late March 2019. At the same time, U.S. trade tensions with China have driven U.S. stock markets to their worst December performance since the Great Depression, unsettling U.S. consumers.

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While mainstream U.S. economists are still predicting economic growth for the United States in 2019, almost half (48.6%) of U.S. chief financial officers fear that the United States will be in recession by the end of the coming year, according to the Duke University/CFO Global Business Outlook survey. By contrast, a vast majority (82%) think recession will hit by the end of 2020. A U.S. recession would impact cheese consumption the hardest. With new cheese capacity now online and ongoing trade disputes potentially slowing exports, U.S. cheese processors would need to rely heavily on higher domestic consumption. In recent years, dining out has been the primary driver behind year-over-year cheese consumption growth. A recession would likely slow restaurant foot traffic as well as domestic cheese sales next year.

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Ken's Corner

by Ken Meyers
President, MCT Dairies Inc.

One can only hope the new year brings more calm than chaos, but that is probably asking for a lot. After a decade of economic expansion, fears of a U.S. economic recession are looming. If a recession were to occur, it would likely be followed by an accompanying slowdown in dairy demand.

For now, robust dairy demand—particularly if trade tensions are resolved—will likely collide with a slowdown in world milk production growth. Following several interest rate hikes in 2018, the Federal Reserve announced that it intends to raise rates only twice in 2019. The end of tightening would prevent disposable income from contracting further and weaken the U.S. dollar—both would support U.S. dairy demand.

On the downside, what happens in Asia as well as in oil-rich countries in the Middle East, North Africa, and Latin America could dampen overall world dairy trade. Southeast Asia will remain a key driver of growth in cheese and milk powder demand as long as the region can maintain economic and geopolitical stability.

Expect a rocky start to 2019, but then as demand begins to offset supply, both milk and dairy product prices should rise. **MCT**

EU Stocks no Longer Matter

As long as the European Union held Intervention skim milk powder (SMP) stocks off the market, prices were unable to move higher than the low 90-cent range or lower than the upper 60-cent range. With just over 100,000 metric tons of Intervention SMP still uncommitted, markets are anticipating that the stocks, which have overshadowed markets since 2015, will soon be gone. That is lifting nearby nonfat dry milk and SMP prices. With the holiday push over, cheese buying interest has cooled. Cheese futures portend higher prices headed into spring, but with additional capacity and flat commercial disappearance, cheese prices could feel more pressure once football playoff season ends. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Dec	1.3775	1.2825	13.82	2.2050	15.09	0.4700	0.9025
Jan	1.4250	1.2750	14.01	2.1675	14.91	0.4675	0.9100
Feb	1.4150	1.3025	13.95	2.1000	14.56	0.4525	0.9025
Mar	1.4775	1.3225	14.11	2.1100	14.36	0.4325	0.8875
Apr	1.5050	1.4100	14.60	2.2125	14.66	0.4300	0.8850
May	1.5475	1.4350	15.09	2.2225	14.98	0.4300	0.9025

** CME prices.*
***NASS prices.*

...supply forecasts likely optimistic

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Growth in Asian economies has slowed. The Central Economic Work Conference is expected to lower China's GDP growth target for 2019 to 6%, after the Chinese economy grew by 6.8% in the first half of 2018. A drop off in trade with the United States has been driving much of China's current economic slowdown. At the same time, Asian countries have imported heady levels of dairy products this year. Most EU Intervention skim milk powder (SMP) has headed to China and Southeast Asia. That continued level of trade would bode well for milk powder prices and eventually all dairy product prices in 2019. Meanwhile, with China's current milk production lower than last year and stocks at multi-year lows, China could import considerable volumes of dairy products, assuming 2019 demand remains consistent with this year.

On the supply side, dairy producers in much of the world have been struggling with low milk prices and tight margins. A slowdown in global milk production at the end of 2018 likely will continue into 2019. For now, though, the European Commission projects that EU milk production will best 2018 levels by 0.9%. USDA is also optimistic, predicting that total U.S. output will grow 1.4% above this year's levels to 220.9 billion pounds—a forecast that could prove overly aggressive given the degree of current on-farm financial stress created by several years of low margins.

In the Southern Hemisphere, New Zealand kicked off its new production season with a surge in output, and if gains remain strong, 2018-19 milk production could best the record high set in 2014-15. Dairy Australia predicts that output in Australia, where drought has gripped the southern production regions, will drop 6% below the previous season to levels not seen since the mid-1990s. And while more stable weather in Latin America has helped lift production in many South American countries, economic turbulence, rampant inflation, and deflating currency values could limit future milk production growth.

With all of these factors colliding at the start of 2019, the only real guarantee is that more price volatilty is in store for the upcoming year. **MCT**

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