January 31, 2019

MCTCOMPASS

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Impact of Depleted SMP Stocks

At the end of January, Phil Hogan, EU commissioner for agriculture and rural development, was possibly giddy or at least relieved when he put out a press release that the European Union had committed 99% of its skim milk powder (SMP). With that announcement, Europe exited the warehousing and SMP business that it had been in for the past three years.

If the current pace continues, Intervention stocks could be depleted late in second-quarter 2019.

The shift left market participants pondering what would happen next. Would product be consumed immediately, or would it shift from government to private hands and remain in storage? The answer to that question could have a profound impact on the direction of nonfat dry milk (NFDM) and SMP markets.

The European Commission began offering Intervention stocks in December 2016, with the pace of purchases picking up at the end of last year and swelling in January to 98,756 metric tons (MT)—more than a quarter of the peak accumulation. Sales prices ranged from €1,050 to €1,580/MT, or 54¢ to 82¢ per pound (U.S.) at an 88% exchange rate. At the time of sale, prices were favorable compared to market prices. Buyers could choose to replace purchases of higher-priced spot SMP, or they could use Intervention powder to reduce their effective cost by combining Intervention and spot purchases.

While the EU-28 has committed all but 3,300 metric tons (MT) of its Intervention SMP, it still had 175,803 MT on hand at the end of last year. In fourth quarter 2018, Intervention stocks declined by nearly 30,000 MT per month. If the current pace continues, Intervention stocks could be depleted late in second-quarter 2019. The pace of depletion could pick up this spring, but while stocks remain in storage, they cannot be consumed. So that pushes the likely schedule for consumption into third quarter and beyond. That said, European SMP production slowed at the end of 2018, but exports picked up, suggesting that some export volumes included

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Ken's Corner

by Ken Meyers
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Now that EU Intervention stocks are nearly depleted, a weight could be lifting from the market. Each of the plausible market scenarios for SMP and NFDM mentioned in this issue could have a profound impact on powder prices this spring. The resulting impact could also spill into the U.S. cheese market, which has been having a difficult time finding solid footing of late.

For instance, if demand for SMP and NFDM increases, stronger powder prices could draw milk away from cheese vats this spring and summer. While not all cheesemakers would be willing or able to run plants at less than full capacity, some would, and even incremental declines in cheese production could be enough to reinvigorate U.S. cheese prices later this year.

While it is not a given that NFDM prices will lead a U.S. milk and dairy product price recovery, given today's record-high U.S. cheese stocks and lackluster demand growth—coupled with declining world supplies of SMP—a rise in NFDM prices and a subsequent increase in Class IV prices seems the most likely scenario. And that would eventually pull cheese and Class III prices higher as well. However, if NFDM prices have difficultly rising from current levels, cheese prices could continue to flounder. **MCT**

Will NFDM Break $1/lb?

CME nonfat dry milk (NFDM) prices were drifting lower at the end of January. Given slowing milk output and government stock depletion, prices in the mid- to upper-90 cents per pound range seem reasonable through spring. However, if China's milk powder imports remain strong after the Lunar New Year, NFDM prices could rise back above $1/lb. However, whey prices capitulated at the end January, driven by the potential negative impacts from China's widespread outbreak of African Swine Fever. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Jan	1.4100	1.2400	13.96	2.2500	15.48	0.4825	0.9525
Feb	1.4575	1.3050	13.81	2.2800	15.92	0.4725	0.9875
Mar	1.4675	1.3150	14.25	2.3000	16.05	0.4525	0.9900
Apr	1.5200	1.3275	14.36	2.3450	16.08	0.4375	0.9750
May	1.5975	1.4225	14.97	2.2800	15.86	0.4350	0.9675
Jun	1.6075	1.4100	15.41	2.2900	15.95	0.4500	0.9825

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

...slowing supply likely drove Intervention sales

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powder from Intervention. Assuming a 30-day lag for transportation, between 158,000 and 188,000 MT of Intervention powder could be in private hands by the end of January. Thus, Intervention SMP will likely be consumed in this year's second quarter and beyond.

Slowing global milk supplies likely drove buyers to procure Intervention SMP to fend off the possibility of higher prices and potential shortfalls. As of November 2018, combined milk production from Oceania, the EU-28, Argentina, Brazil, and the United States fell 0.2% behind the pace set in 2017. While the numbers will likely be revised in coming months, November's year-over-year decline would be the first since January 2017 and indicates the global milk supply will continue to dwindle. Should demand growth remain stable, buyers should be wary of potentially higher prices and tighter supplies this year—a logical explanation for the heady SMP purchases of the past few months.

History suggests that once government stocks are depleted, SMP prices move higher, but that's not always the case. If buyers are using Intervention SMP to replace spot purchases, sales could slow and prices could drop as Northern Hemisphere milk production increases into spring, allowing buyers to restock below current price levels. That motivation makes sense if buyers think demand will mirror last year's, allowing Intervention SMP to displace new product and forcing prices lower.

However, if buyers expect demand to increase and supply to ease, they could continue to buy spot product and slowly blend in Intervention SMP to keep their average cost near the mid-80-cent range. This strategy would allow NFDM and SMP prices to remain near current levels through spring. And finally, buyers could expect significantly higher demand given China's December 2018 SMP imports, which climbed 70% above 2017 levels. If China continues to import SMP at its current pace, Intervention SMP could be little more than a speed bump on the way to higher prices. For now, though, market participants are left to speculate on which scenario will unfold in 2019. **MCT**

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