



MCT COMPASS

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What's in the numbers?

When the cash cheddar market soars above \$1.50 per lb. it causes market players to pause. End users ask: "Should I acquire more inventory because the market is likely to go higher, or should I go hand-to-mouth because the market could crash?"

In the free-market era, the first time the price reached this level was July-October 1996. But then a slowdown in demand and a recovery in production sent the markets lower for the next 19 months.

In June 1998, the price topped \$1.50 again on its way to a record-high \$1.90 by year-end. This time, though, demand remained strong throughout the run-up. Within seven months, the market topped \$1.50 again and managed to hold there for three months, until a correction in a USDA inventory report ignited another 19-month period of price deflation.

Dairy producers responded to the high prices in 1998 and 1999 by expanding their herds. From the third quarter of 1998 through the third quarter of 2000, nearly 100,000 more cows were added to the U.S. dairy herd. U.S. milk production and American cheese production posted record gains in 1999 and 2000. The industry learned how much was too much as the cash cheddar cheese price fell to below \$1.00 by the fourth quarter of 2000. Dairy producers responded to the low prices. Cow numbers tumbled and set the stage for this year's market rally.

Is it just coincidence that the market has moved in 20-month cycles? Maybe not.

Twenty-months is just about the length of time it takes a calf to become a milk producing cow. Dairy

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KEN'S CORNER



*by Ken Meyers
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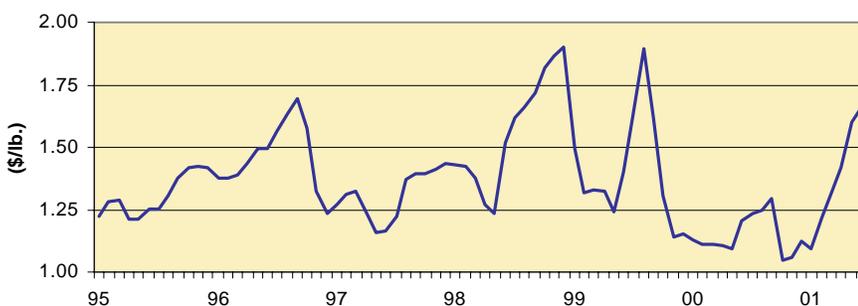
Elevated and volatile cheese prices have added to the stress of operat-

ing a dairy company over the past few years. This month's feature story provides an overview of market prices and their impact on dairy producers, manufacturers, marketers and consumers.

Over the years, MCT Dairies has tried to anticipate the needs of its customers. To that aim, I'm excited to announce the addition of MCT Manufacturing Inc., a new phase of services offered by our company. MCT Manufacturing is a boutique-style operation designed to reclaim and enhance value of re-conditioned cheeses. The new plant, located in Appleton, Wis., has the capability of reclaiming cheese from individually wrapped singles, cleaning and correcting cheese for further use in processing or retail lines, and producing custom cuttings of 640 lb. block cheese.

To learn more about this new service, give our office a call. □

Cash cheddar block price



Markets remain steady

American cheese production seasonally increased 1.8% in May 2001 vs. April 2001, and was 3.9% less vs. May 2001 – but still an improvement vs. April’s 5.9% deficit vs. a year ago. The year to date shortfall vs. 2000 is 5.2%.

For the first time this year, butter production in May 2001 was higher than the prior month and the prior year. Production increased 1.1% in May 2001 vs. April 2001 and was 1.6% higher than May 2000 – but year-to-date production

MCT Forecast					
	<u>Block*</u>	<u>Barrel*</u>	<u>Class III</u>	<u>Butter*</u>	<u>Class IV</u>
JUL	1.6600	1.6200	15.22	1.8900	14.79
AUG	1.6850	1.6575	15.60	1.8550	14.16
SEP	1.7100	1.6800	15.81	1.9450	14.37
OCT	1.7175	1.7025	15.90	2.0250	14.80
NOV	1.7200	1.7050	15.80	2.1000	15.18
DEC	1.6700	1.6400	15.17	1.5700	14.14

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

is off 7.8% vs. 2000.

Dairy product prices have moved pennies in either direction over the past few weeks, but strong demand with rebounding produc-

tion is expected to drive prices modestly higher through the summer and into the fall. We look for blocks to peak in the mid-\$1.70s in October-November. □

In the numbers...

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producers do respond to price. In the short run producers can feed and manage their herd to obtain the maximum production. However, in the long run it takes producers at least 20 months to add additional cows to their herds.

So now that we’ve reached the \$1.65 level earlier than in any previous year, will this market

maintain its strength through year-end or even approach the \$1.90 like it did in 1998? Or will it crash and burn early as in 1999? Most crystal balls are too cracked or just aren’t telling.

The way consumers respond to record high cheese prices may be the key. The chart below illustrates the annual commercial disappearance of American cheese, the annual average cash cheddar block

price and the annual average Consumer Price Index (CPI) for cheese from 1995 through 2000 and first quarter data for 2001.

According to USDA, commercial disappearance of American cheese increased 6.1% in 1999 while the cash cheddar block price averaged \$1.40, or 10.5% less than 1998. Commercial disappearance in 2000, a year when the cash cheddar price averaged less than \$1.15, reportedly increased just 1.3%. So the correlations are unclear.

These data suggest that the volatile cheese prices experienced since the mid-1990s are more a function of the supply side than the demand side. The strong economy of the last decade has made cheese demand relatively inelastic, meaning it doesn’t respond very strongly to changes in price. We’ll see if this year’s economic slowdown changes that pattern. □

Does cheese price affect demand?

<u>Year</u>	<u>American Cheese Sales (million lbs.)</u>	<u>Cash Block Cheddar Price*</u>	<u>Cheese CPI*</u>
1995	3,149 (+3.8%)	1.3044 (+1.3%)	137.9 (+1.1%)
1996	3,230 (+2.6%)	1.4663 (+12.4%)	144.7 (+4.9%)
1997	3,269 (+1.2%)	1.3082 (-10.8%)	147.7 (+2.1%)
1998	3,338 (+2.1%)	1.5687 (+19.9%)	152.3 (+3.1%)
1999	3,543 (+6.1%)	1.4037 (-10.5%)	162.6 (+6.8%)
2000	3,588 (+1.3%)	1.1466 (-18.3%)	162.8 (-0.1%)
2001 Q1	906 (+6.7%)	1.2086 (+8.2%)	163.1 (-0.4%)

* - annual average

Source: USDA, compiled by MCT Dairies Inc.

