



MCTCOMPASS

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Fuel for Today's Hot Butter Market

The U.S. butter market is sizzling as we enter the second half of the year. Unlike the domestic cheese and nonfat dry milk (NFDM) markets, which have eased from their lofty levels posted in March, the butter market continues to rise. Lower year-over-year production, smaller stocks, and greater exports have propelled the butter market to a level not seen since 2011.



The makings of a \$2-plus butter market did not happen overnight.

This is not the first time that the butter market has followed a different trend from cheese and NFDM. In August 2013, the CME Group (CME) spot butter price fell below \$1.40/lb. as the cheese and NFDM markets moved into the high \$1.70s. For much of Q4 2013, the butter market languished below \$1.60, while the cheese and NFDM markets moved above \$2/lb.

The makings of a \$2-plus butter market did not happen overnight. Since mid-2013, higher returns for cheese and

NFDM as well as burdensome butter stocks resulted in less milk and cream going into butter churns. In fact, during six of the 12 months in 2013, butter production was lower than the prior-year's level. This trend has continued into 2014, with U.S. butter output trailing last year by 5.8%, or 31.4 million pounds.

U.S. butter stocks grew during the first half of 2013 despite marginal gains in output. By midyear U.S. butter stocks topped 320 million pounds—a level not seen since 2003. In 2003 excessive stocks drove CME butter prices below the government support price of \$1.05/lb., and the United States started to export butter under the government subsidized Dairy Export Incentive Program (DEIP). By the end of 2003, U.S. butter stocks stood at less than 100 million pounds. U.S. butter prices did not fall to government support levels in 2013; nevertheless, they were low enough to spur significant exports—especially

when traditional global butterfat suppliers in Oceania and Europe were short of product. U.S. butter exports in 2013 topped 203 million pounds, up nearly 100 million pounds vs. the prior year and played a key role in bringing U.S. butter stocks down to 112.5 million pounds by the end of the year.

The continuation of strong butter exports into Q1

Continued on page 2

Ken's Corner



*by Ken Meyers
President, MCT Dairies Inc.*

China continues to play a key role in global dairy markets. Last year, milk production in China dropped 6% below 2012 output, which spurred the country to import 475 million pounds more whole milk powder (WMP) than it purchased in 2013. Much

of that product came from New Zealand.

As New Zealand focused on meeting China's need for WMP, the global butter market tightened and importers turned to Europe and the United States for product. China's WMP imports continued to best year-earlier levels into 2014. For the first four months, China's WMP imports outpaced the comparable period a year earlier by 73%, or 390 million pounds. A rebound in China's milk production likely contributed to lower month-over-month WMP imports in April.

A slowdown in Chinese demand for WMP has the potential to send ripples through global dairy markets if key countries shift their surplus milk supplies out of WMP production and into SMP and butter in the second half of the year. However, China also could be sitting on the sidelines testing market resolve. We have seen this before when the Chinese have believed they were the price maker. If China's output is not as strong as the country reports, second-half prices could soar. **MCT**

Stocks Precariously Low..

The U.S. and global dairy product markets are in flux. The recent surge in European milk production and strong finish to the Oceania production season

have helped ease some of the tightness in global dairy product supplies. However, U.S. stocks of butter and cheese are at precariously low levels for this time of year,

and it is questionable how much inventories will grow as the United States struggles to post year-over-year milk gains in excess of 1%. Likewise, the strong possibility of an El Niño in the Southern Hemisphere threatens the start of Oceania's production season. Therefore, the risk for higher prices looms in the second half of the year. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
May	2.0150	1.9986	22.55	2.1763	22.55	0.6755	1.8650
Jun	1.9500	1.9300	21.30	2.2500	22.88	0.6775	1.7950
Jul	1.9750	1.9500	21.05	2.2500	22.70	0.6725	1.7850
Aug	2.0500	2.0250	21.55	2.3000	22.50	0.6650	1.7500
Sep	2.0700	2.0450	21.95	2.3300	22.35	0.6550	1.7300
Oct	1.9800	1.9550	21.50	2.2800	22.15	0.6350	1.7100

* CME prices.

**NASS prices.

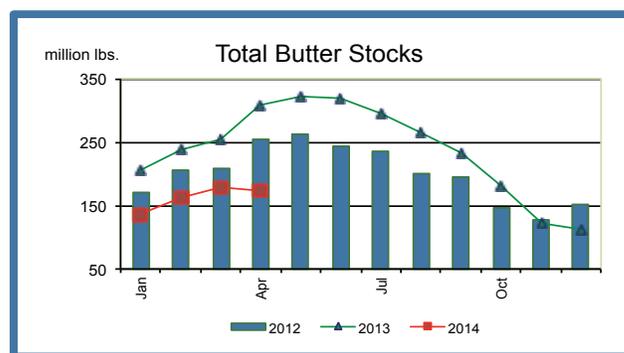
Not much fat...

Continued from page 1

2014 at 70 million pounds has also prevented the traditional seasonal inventory build. In fact, butter stocks in April actually declined vs. the prior month, setting the stage for the recent rally in spot butter prices. Furthermore, the most recent milk production report indicates that U.S. milk production is struggling to surpass the prior year by more than 1%. In addition, the average butterfat content in milk this year has been below last year's fat level. Therefore, the available butterfat supply is barely more than last year's.

Many end users of butterfat are hopeful that the delayed spring flush east of the Rockies will linger into summer. Still, as the seasonal pull for milk and butterfat builds, butter churns will have to compete with ice cream manufacturers and cheesemakers who also need to bolster stocks to fill 2H 2014 demand.

The combination of reduced exports and increased imports could provide some price relief by Q4 2014 if U.S. butter prices remain above European and Oceania prices in the near term. USDA reports that European butter prices (adjusted to 80% butterfat)



range from \$1.96 to \$2.16/lb. Nevertheless, European manufacturers report that prices are firming as end users build stocks.

In contrast to firm European butter prices, the most recent Global Dairy Trade (GDT) auction pegs Fonterra butter prices at less than \$1.65/lb. through October 2014, which is likely to spur U.S. imports of Oceania butterfat. Approximately 13.4 million pounds of butter and 15.4 million pounds of butter substitutes (primarily butteroil) are eligible for import at favorable tariff rates. In addition, greater imports of food preparations containing butterfat are also likely but not until later in the year and only if supplies can arrive prior to a turnaround in domestic butter prices. **MCT**



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