

Ushering in 2016

Global dairy product prices are near multi-year lows as 2015 comes to a close and markets adjust to ample world milk and dairy product production. Lower demand from China and Russia and decreased purchasing power in oil-dependent economies have led to growing stocks.



The combination of lower on-farm margins and poor weather conditions will continue to restrain milk production growth in some areas.

U.S. milk production is expected to top 208.3 billion pounds in 2015, up 2 billion pounds or 1.1% more than in 2014. However, year-over-year growth in U.S. milk production slowed to less than 0.5% in the fourth-quarter of this year. Despite lower feed and energy costs, dairy producer margins continue to erode due to weakening milk prices. As a result, year-over-year gains in U.S. milk production for the first half of 2016 are likely to be tepid and not evenly distributed.

Dairy producers in the Upper Midwest and Great Lakes regions are expected to drive milk production growth in 2016. Once again, producers in these regions may be forced to dump surplus milk due to the lack of processing capacity during the

peak production months of May and June.

Meanwhile, year-over-year 2016 output in states along the West Coast and in the Southwest and Southeast is expected to be lower than this year. The combination of lower on-farm margins and poor weather conditions will continue to restrain milk production growth in some areas. USDA's 2016 milk production estimate of 212.4 billion pounds, a nearly 2% gain compared to 2015, will likely prove optimistic and largely depend on strong milk growth in the second half of 2016 compared to below-trend gains in 2015. There's an adage in the dairy industry: "Money moves milk, and more money moves more milk." The current on-farm margins are not sufficient to propel an

above-trend milk production gain of 1.5% or more.

Improved on-farm margins will be contingent on a recovery in milk prices. For milk prices to rebound, a resurgence in global dairy product prices needs to occur, and a rebound in global dairy product prices remains elusive because milk output in the European Union,

Continued on page 2

Ken's Corner



*by Ken Meyers
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The outlook for global dairy markets into at least the first half of 2016 remains weak, but buyers of dairy products should not get lulled into a false sense of security that prices will continue to languish at current lows for the long term.

No question, the dairy market is global, but the United States is somewhat isolated from its two largest global competitors due to geographical distance. That doesn't mean imports won't make their way to U.S. shores, but they cannot just flow freely into the country because they are limited by quotas and tariffs. Due to its large, stable, and growing economy, the United States has an enviable domestic market that will continue to be serviced primarily by U.S. dairy companies.

Moreover, the U.S. consumer environment is robust. Unemployment remains at multi-year lows, the lowest gas prices in years continue to boost consumer-spending power, inflation continues at extremely low levels, and U.S. consumers love their dairy products. Thus, U.S. milk prices could—and likely will—rebound sooner than global prices.

Just like U.S. consumers have been encouraged to lock in the lowest interest rates in decades, buyers of dairy products might benefit from locking in at least a portion of their needs when dairy product prices hit their lows. **MCT**

Butter Starts New Year with Record

Cheese, whey, and milk powders—but not butter—will ring in the New Year on a bearish note. The U.S. domestic butter market closed 2015 at a record level,

smashing December 2014's high of \$1.7633/lb. by more than 30%. The 2016 butter futures are shrugging off data that indicate butter stocks are running 20% above

2014's level. At the current lofty price levels, butter manufacturers are unlikely to churn more butter than they have commitments. Butter orders are expected to roll in earlier than normal because Easter lands on March 27. As a result, butter manufacturers have only a couple of months to build stocks for the spring holiday-demand period. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Dec	1.4590	1.4615	14.44	2.3315	15.52	0.2336	0.7893
Jan	1.4700	1.4500	13.40	2.0300	13.30	0.2365	0.8000
Feb	1.5500	1.5200	14.00	2.0500	13.85	0.2450	0.8550
Mar	1.5700	1.5400	14.55	1.9200	14.40	0.2550	0.9400
Apr	1.5500	1.5200	14.50	1.7800	14.05	0.2650	1.0100
May	1.6000	1.5700	14.70	1.7500	14.25	0.2800	1.0500

* CME prices.

**NASS prices.

...unfettered EU output

Continued from page 1

the largest cow-milk producing region in the world, continues unfettered. EU annual milk production exceeds U.S. output by one-and-a-half times and is more than six times larger than New Zealand's annual production.

A year ago, EU milk producers were attempting to put the skids on year-end and first-quarter 2015 output to avoid financial penalties for exceeding milk quotas. Therefore, year-over-year EU milk production gains are expected to continue through March 2016. However, the current level of growth, which exceeded 3% in the last quarter of this year, could be tempered somewhat in early 2016. Nevertheless, greater year-over-year EU milk production will be more than enough to offset slower growth in the United States and negative growth in Oceania.

Most analysts concur that a meaningful contraction in the European milk supply is not expected until the second half of 2016, if then. The European dairy sector is in uncharted territory. Milk producers and dairy processors expanded milk production and processing capacity in anticipation of

the elimination of the milk quota system established in 1984. Despite the current dismal financial situation, it is unlikely that many large-scale European operations will exit the sector. Similar to the economic meltdown that occurred in the U.S. dairy sector in 2009, when agricultural lenders continued to support marginally profitable operations to avoid a devastating write-down of their entire dairy portfolios, financial backers of the European dairy sector are expected to ride out the current downturn. As a result, European milk producers and dairy processors who exit the industry during the upcoming months are likely to be those who have lost their appetite for price volatility. Those who remain are expected to maximize profit rather than production, which is likely to reduce year-over-year growth in output after April 1, 2016.

Despite the anticipated reduction in milk production growth, a stockpile of dairy products—primarily milk powders—overhangs the market. European intervention stocks and government-subsidized private storage stocks of skim milk powder of more than 215 million pounds are growing. As a result, European dairy buyers are procuring product as needed rather than covering long-term needs, which is contributing to government stock building. Eventually, these stocks will hit the market, further delaying a global recovery. **MCT**



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