



# MCT COMPASS

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## Who moved the cheese?

On the surface the June Dairy Products report was in line with expectations. Increased milk production led to higher cheese production, +1.0% vs. June 2001. American cheese production, which accounts for 43% of total U.S. production, posted a healthy gain of 1.6%.

But a closer analysis of the American cheese category reveals that key Western dairy states, California and Idaho, actually posted decreases in American cheese production of -0.4% (-400,000 lbs.) vs. June 2001, while total cheese production in the two states increased by 3.6% (+6.6 million lbs.). That means production of non-American cheese jumped 9.3% (+7.0 million lbs.) during the month.

It's logical, but not correct, to assume that Mozzarella, which accounts for a third of the U.S. cheese production, must have increased in the

two states. After all, the new Land O'Lakes Mozzarella plant in Tulare was online in June. However, according to USDA, California's Mozzarella production fell by 2.3%, or 1.3 million lbs., in June vs. the prior year, and total U.S. Mozzarella production was down by 2.1%. One reason for the shortfall was the closure of two California plants: LOL's Gustine facility, and Suprema's Lathrop plant.

Curiously, in California in June, total cheese production was up 1.9%, but Cheddar output dropped 8.3% and Mozzarella dropped 2.3%. So who moved the cheese? Production of varieties other than Cheddar and Mozzarella shot up 29% during the month.

The biggest gains came from Monterey, up 28.4% (+4.2 million lbs.) in June. For the year, production of Monterey is 24.0% higher than a

year ago, likely due to its growing use in Hispanic dishes. Further, the California Department of Food and Ag (CDFA) reports that production of Hispanic cheese was up 13.5% in the first half of the year.

Remove Cheddar, Mozzarella, Monterey and Hispanic cheese from the equation, and production of other cheeses in California increased 48.1% (+3.6 million lbs.) in June. Data from CDFA suggests the bulk of the increase came from Parmesan and Provolone.

The low CME cheese price helps explain why this would be the case. With CME blocks averaging \$1.13 this June (vs. \$1.66 a year ago), putting away Italian styles – like Parmesan, Provolone, Romano and Asiago – for aging is a good hedge.

Look for this trend to continue in the months ahead. □

## KEN'S CORNER



*by Ken Meyers  
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It's a no-brainer. With the dairy markets mired at two-decade lows and surpluses piling up, there's one simple, obvious move that could provide a modicum of help: autho-

rization of the Dairy Export Incentive Program (DEIP).

USDA has been whining for the last two years about how large its powder stocks have grown and its inability to move them back into the commercial market. Yet when the most obvious tool available stares the bureaucrats in the face, they do nothing.

The United States is allowed to subsidize 68,030 metric tons of skim

milk powder each year, beginning July 1. But eight weeks after the start of the new DEIP year, USDA is still mum on its plans and export sales remain on hold. What is USDA waiting for? Nobody knows.

In the meantime, overseas customers are getting impatient and sales are being lost. Powder users all around the world want to buy from the United States. But they won't wait forever for our government to pull the trigger. □

## Seasonal price increase due

With milk and cheese supplies tightening in the Midwest, we think the cheese market could rally into the mid-\$1.30s this fall. Inventories are not overwhelming and a seasonal spike in demand could firm things up in a hurry. That would push Class III prices near \$12.00 in December.

The butter market, too, has some

MCT Forecast					
	Block*	Barrel*	Class III	Butter*	Class IV
<b>AUG</b>	<b>1.1633</b>	<b>1.1315</b>	<b>9.56</b>	<b>0.9827</b>	<b>10.43</b>
<b>SEP</b>	<b>1.2475</b>	<b>1.2225</b>	<b>10.28</b>	<b>1.0800</b>	<b>10.51</b>
<b>OCT</b>	<b>1.3100</b>	<b>1.2850</b>	<b>11.30</b>	<b>1.2475</b>	<b>11.24</b>
<b>NOV</b>	<b>1.3500</b>	<b>1.3250</b>	<b>11.70</b>	<b>1.2625</b>	<b>11.59</b>
<b>DEC</b>	<b>1.3225</b>	<b>1.2975</b>	<b>11.85</b>	<b>1.2000</b>	<b>11.36</b>
<b>JAN</b>	<b>1.3000</b>	<b>1.2700</b>	<b>11.49</b>	<b>1.1500</b>	<b>10.85</b>

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

potential to move higher in the fourth quarter. Heavy stocks will limit upward gains (see story below), but

we look for cash prices to reach the mid-\$1.20s in October or November, before fading in December. □

## Butter meltdown

In the “free-market butter era” – 1996 to present – the cash butter market has averaged \$1.58 in August. This year, that price will come in at about 98¢.

Over the last year, a steady build-up of production and inventories have put a lid on this market. Where butter was once excruciatingly tight, it’s now oppressively long.

At the end of June, commercial butter stocks had swelled to 243.0 million lbs., up from an average of 139.5 million lbs. in the previous three years. Putting pencil to paper reveals that it could take two years to work down that stockpile into a manageable level.

Here’s why: During the second half of the year, the industry typically pulls about 100 million lbs. of butter out of storage. If that happens this year, we’ll still be looking at roughly 140 million lbs. on New Year’s Eve.

We expect consumption to outstrip production in 2003. Butter production is up 14.4% this year, so it’s safe to assume that production

will decline next year, particularly if milk supplies contract. Lower prices are helping to spur butter consumption, which is up 2.6% this year; it’s reasonable to expect commercial use to continue a modest growth rate over the next year or two.

Therefore, even under an optimistic scenario, one in which butter production drops 8%, consumption rises 3% and imports remain at 2 million lbs. per month next year, the industry will still only be able to work inventories down to about 90 million

lbs. by the end of 2003 (see chart).

If production and consumption are flat in 2004 (and imports remain at 2 million lbs./mo.), commercial butter stocks will peak around 190 million lbs. at the end of June 2004, but drop back to about 30 million lbs. by the end of the year. This level is consistent with previous end-of-year carry-outs.

One caveat: If USDA authorizes DEIP for butter, the stockpile will decline much faster. The United States is allowed to subsidize exports of 46.5 million lbs. of butter per year. □

Butter Supply and Demand							
	BegStocks	+	Production	+	Imports	- Consumption	= EndStocks
2001 H1	24		657		39	567	<b>153</b>
H2	153		580		37	715	<b>55</b>
<b>TOT</b>			<b>1237</b>			<b>1282</b>	
2002 H1	55		752		17	581	<b>243</b>
H2	243		627		12	736	<b>146</b>
<b>TOT</b>			<b>1379</b>			<b>1317</b>	
2003 H1	146		694		12	598	<b>254</b>
H2	254		579		12	758	<b>86</b>
<b>TOT</b>			<b>1273</b>			<b>1357</b>	
2004 H1	86		694		12	598	<b>194</b>
H2	194		579		12	758	<b>27</b>
<b>TOT</b>			<b>1273</b>			<b>1357</b>	

Source: USDA; hypotheticals (in italics) by MCT Dairies Inc.

