April 30, 2004

MCT COMPASS

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Canadian cattle get the cold shoulder

Last May, the United States banned the imports of live Canadian cattle and beef, meat, meat products and certain byproducts after the country detected an animal infected with bovine spongiform encephalopathy (BSE). Simultaneously U.S. beef prices increased, prompting dairy producers to sell their marginal cows while the monthly importation of 5,000-6,000 dairy heifers and cows came to a screeching halt *(see chart below)*. The combined impact of increased slaughter and fewer replacements has contributed to a 1.7% decrease, or 153,000-head reduction, in the U.S. dairy herd vs. last year.

At a recent industry meeting, three dairy economists noted that milk and dairy product prices would likely soften when the Canadian border reopened. But when will that be?

It is safe to say that imports of dairy cattle will occur *after* imports of live beef for immediate slaughter or that are sent to a designated feed lot. The process for reopening the border is ongoing but not final. Last October, USDA issued a proposed rule, in which APHIS (Animal and Plant Health Inspection Service) proposed to allow the importation of certain low-risk live ruminants (under 30 months) and ruminant products and byproducts from minimal risk regions, such as Canada, under certain conditions.

Comments on the proposed rule were due by January 5, 2004. However, the discovery of a BSE-infected dairy cow in Washington state on December 23, 2003, put that process on hold. In early March 2004, USDA re-opened the comment period on the proposed rule and also requested additional comments on whether to allow the importation from BSE minimal risk regions of beef from cattle 30 months of age or older in which the specified risk materials have been removed. That comment period closed April 7, 2004, and USDA has received more than 3,000 comments that APHIS will have to sift through before making its final rule.

Once USDA makes its final rule, it will be implemented immediately. If USDA's final rule looks like the proposed rule, Canadian beef will once again cross the border. That is unless court action interrupts the trade. Just last week a federal judge granted a cattlemen group's request

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KEN'S CORNER

by Ken Meyers
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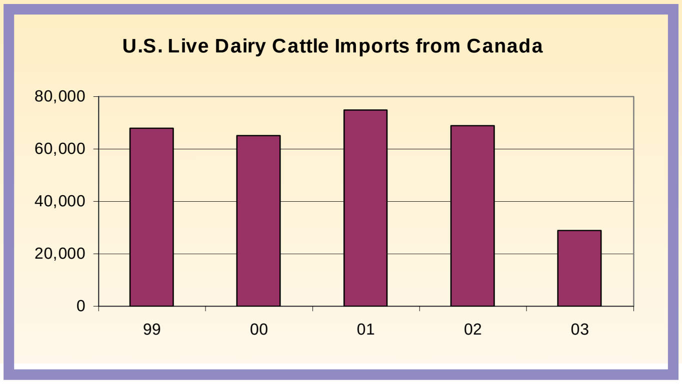
The dairy industry can not count on the opening of the Canadian border to lower milk and dairy product prices in 2004.

The border-opening process is likely to be wrought with political battles and potentially legal battles as the free-trade supporters face-off against the cattlemen and other interests.

Even when the border does open, the market impact may be more psychological, as the historical volume of live dairy cattle imports would suggest *(see chart below)*. MCT



How long can they hold?

The dairy markets are unsettled.

Strong dairy product demand during the first quarter drew down inventory levels and caused prices to soar. Those higher prices will translate into higher retail prices during the second quarter and are likely to curb consumer demand and cap cheese prices.

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV
APR	2.1712	2.1325	19.66	2.2200	14.57
MAY	2.1225	2.0925	20.95	2.1150	14.45
JUN	2.0000	1.9700	20.05	2.1500	14.55
JUL	2.0400	2.0100	19.55	2.1750	14.65
AUG	2.1100	2.0800	20.35	2.2000	14.75
SEP	2.2200	2.1900	21.10	2.2500	15.00

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

Be aware that butter prices could double-dip, softening some and rallying again from September – November. MCT

Cold shoulder ...

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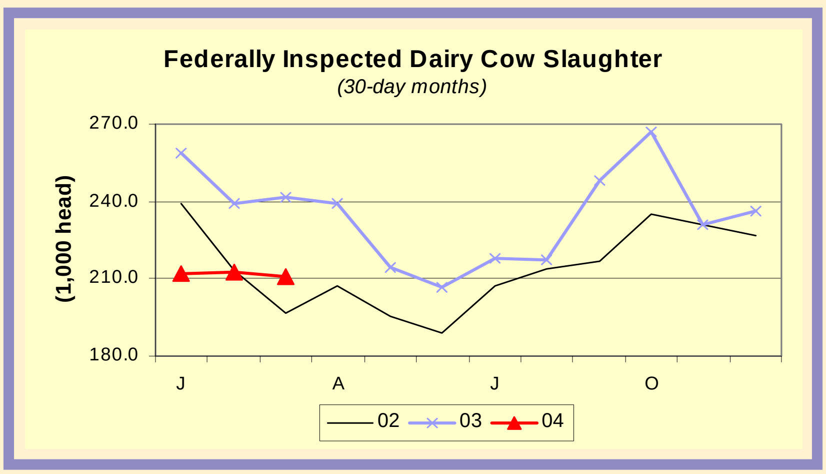
for a court order preventing Canadian imports of "edible bovine meat products," including ground beef. The judge's decision came just five days after USDA issued a memo that indicated additional products beyond boneless beef from cattle under 30 months of age that that been permitted could be allowed into the United States from Canada.

According to USDA, APHIS is currently drafting a supplemental rule that will address the importation of breeding cattle, including dairy animals. Once completed it must gain clearance from USDA and OMB (Office of Management and Budget). Then it will be printed in the Federal Register. The industry will have from 30 to 90 days (as designated in the rule) to comment. USDA will review the comments and then publish a final rule. The time line on such an endeavor has people speculating from nine months to two years.

In the meantime, the only cure dairy producers have for the shortage of dairy cattle is to keep the ones they have longer. This appears to be the case. During the first quarter of 2004, the dairy slaughter totaled 104,000 less than 2003's brisk pace. That more than offsets the traditional volume of Canadian imports. Still dairy producers are looking to add more cows to take advantage of the current record high milk prices. This is not an inexpensive undertaking as the supply of bred heifers is low and the prices high—more than 50% higher than last year.

As a result, the U.S. dairy herd is not expected to grow anytime soon. As long as the Canadian border is closed, beef prices are likely to be strong, and will attract culling when milk prices fall. This will reduce the milk supply and milk and dairy product prices will rise…and the cycle continues. MCT



During the first quarter of 2004, dairy slaughter was off 104,000 from last year's pace, more than offsetting the traditional volume of Canadian dairy cattle imports.

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