



MCT COMPASS

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The Great Balancing Act

Nonfat dry milk powder, *aka* skim milk powder in the global market, is a very versatile product and plays a critical role in balancing the U.S. milk supply. When domestic milk supplies are abundant, the production of nonfat dry milk soaks up the surplus and can be stored for later use, or until a period of milk deficit. When there is a deficit, it can extend the current milk supply by being added into cheese vats, cottage cheese, ice cream mixes, and a variety of other dairy products.

For example, during 2002, U.S. milk production increased more than twice the annual average growth rate at 2.9% to 170.1 billion pounds. During the same year,

nonfat dry milk production increased by 12.9% to 1.6 billion pounds and government removals reached 822 million pounds, or more than half of the total production.

Despite a modest gain in milk production of just 0.2% in 2003, nonfat dry milk production was less than 10 million pounds shy of the prior year. Once again, government removals were the primary market for nonfat dry milk accounting for 42% of total production during 2003.

Just like in 2003, milk production during 2004 increased just 0.2% during the year. This time, however, lower milk production did translate into less powder production. Nonfat dry milk production totaled 1.4 billion pounds in 2004. Government removals were considerably lower at 105.4

million pounds. Nevertheless, USDA reported that on Dec. 31, 2004, its inventory of uncommitted nonfat dry milk powder was bulging at 851.1 million pounds.

To relieve itself of the growing inventory, USDA implemented a variety of “Nonfat for Programs.” There was the “Nonfat for Livestock Feed” program, the “Nonfat for Casein” program, and the “Nonfat for Yogurt” program, just to name a few.

A year later, USDA reports that it did not purchase any nonfat dry milk under the support price program, and its 851.1 million pounds of uncommitted powder has dwindled to zero.

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KEN'S CORNER



*by Ken Meyers
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The U.S. dairy product markets are likely to become more complex as a

greater percentage of U.S. produced powder captures a larger percentage of global powder markets. Given the near-monopoly of the nonfat

dry milk/skim milk powder supply, U.S. buyers of powder are likely to face a three-tired market: an export market, a domestic market, and a government support price market when necessary.

Over the past few years, U.S. produced powder has captured a greater share of the world market due to lower production by traditional suppliers and favorable currency. The world market now factors in the

United States as a consistent powder supplier rather than just a surplus supplier.

The more demand-driven powder market could also challenge our traditional “discount” view of the powder market, compared to the cheese and butter markets, especially in light of growing global demand for protein in powder form rather than in the form of cheese and butter. **MCT**

Bring it on

As we enter 2006, U.S. milk production is expected to continue to post large year-over-year gains in production through Q1. Just the increase in cow numbers vs. the prior year will add at least 1% to production. Add on to that a historical rate of gain in output per cow, and the expected increase in milk production tops 3%. By mid-year, that gain is expected to narrow considerably and potentially even

MCT Forecast					
	Block*	Barrel*	Class III	Butter*	Class IV
Dec	1.4225	1.3898	13.35	1.3518	12.65
Jan	1.3575	1.3275	13.20	1.3650	12.40
Feb	1.3150	1.2850	12.50	1.3750	12.20
Mar	1.3350	1.3050	12.30	1.4000	12.20
Apr	1.3675	1.3375	12.45	1.4500	12.40
May	1.3900	1.3650	12.80	1.5000	12.60

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

become negative as the difference in cow numbers narrows and large increases in output per cow become

less likely vs. the prior year's robust gains of more than 4% in the May through July period. **MCT**

A home for powder...

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In dairy math terms, that means that during 2005, markets, both domestic and abroad, and both animal-feed use and human-grade, were found for 851.1 million pounds of aging nonfat dry milk powder plus the estimated 1.2 billion pounds of current production. In other words, more than 2 billion pounds of nonfat dry milk and skim milk powder were consumed during 2005. That's a hard number to fathom.

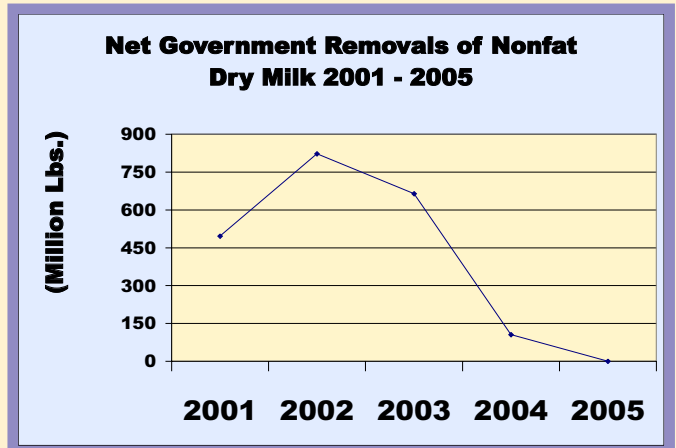
Likewise, it is almost impossible to believe that with a record gain in milk production during 2005 that no nonfat dry milk was sold to the government under the support price program. To the contrary, nonfat dry milk prices continued to rise steadily from the low 90-cent range to more than \$1.00/lb. despite a nearly 4.0% gain in milk production.

Credit for soaking up the surplus milk goes to the export market. Then again, there was really no surplus milk supply in 2005 because all dairy products found commercial

outlets rather than being shipped into government caves. Just how good was the export market in 2005? According to USDA, from January to October 2005, exports of nonfat dry milk and skim milk powder totaled 540.6 million pounds, compared to 376.3 million pounds during the same period in 2004, an increase of 44%.

The export market is expected to continue to support our domestic market in 2006. Once again, Oceania is struggling to produce more milk than the prior year. According to USDA, production in New Zealand is trailing the prior year by 2%, following last year's 3% to 4% production decline. The production outlook in Europe is more optimistic; however, given the quota situation, no significant increase in skim milk powder is expected.

USDA's Economic Research Service expects global dairy product demand to stay firm through the first half of 2006, and credits the good growth in the economies of Asia and parts of Latin America as well as high oil prices for enhancing purchasing power. For the year, ERS forecasts nonfat dry milk prices will range between 90.5 cents and 99 cents per pound. That is a dime to nearly 20 cents above the U.S. nonfat dry milk support price of 80 cents per pound. **MCT**



Nonfat dry milk has been so scarce that government removals dropped to zero in 2005. Source: USDA.

