



MCT COMPASS

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Are High Prices Settling in?

During 2007, nonfat dry milk and cheese prices ranged from the \$1.20s to the \$2.20s. As the year comes to a close, prices have retreated from their highs, but remain significantly higher than in any previous year.

The mainstream media points to the ethanol boom and the demand for biofuels as the culprit behind rising food costs. According to the U.S. Department of Agriculture (USDA), Americans are facing more than a 4% increase in food prices this year, after increases of 2.4% during the past two years.

For several years, political support for ethanol production had more to do with income support for

corn farmers than reducing U.S. dependency on foreign oil. That changed with the passage of the 2005 Energy Policy Act, which mandated the mixture of 7.5 billion gallons of corn-based ethanol with gasoline by 2012. Last week, President George W. Bush upped the ante when he signed into law a new energy bill that requires 15 billion gallons of corn-based ethanol by 2015. In addition, the law provides for the majority of alternative fuels to come from sources other than corn such as prairie grasses, vegetable oil, and waste by 2022.

No doubt, demand for ethanol has created a new market for corn, which has in turn pushed corn and other feed crops substantially higher.

According to USDA, the average price per bushel of corn received by growers has increased from \$2.00/bu. in 2005 to over \$3.50/bu. in June 2007. Corn futures in 2008 exceed \$4.50/bu. — despite a bumper crop of 13.1 billion bushels harvested this fall.

The force behind higher corn prices, however, is more than just ethanol demand. It includes the competition for crop acreage and strong exports. For example, U.S. wheat stocks are projected at their lowest level in 60 years. Greater exports along with reduced supplies pushed wheat prices above \$6.50/bu. this year, well above the

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KEN'S CORNER



*by Ken Meyers
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Not that long ago, we would have considered \$1.80/lb. Cheddar blocks expensive.

Today, some might say that's a bargain. Could it be that consumer sticker shock is wearing off?

American consumers are resilient as well as

optimistic. As long as they have their jobs, they are likely to continue spending, particularly on products they like, including pizzas, nachos, artisan cheeses, and a host of other dairy products.

Global consumers appear to be waiting for more weakness in the world dairy markets, particularly in the skim milk powder and cheese markets, with

the butterfat market to follow.

If the domestic economy staves off a recession and the housing market stabilizes, U.S. dairy demand in 2008 should continue strong right into 2009. As the markets find a new lower equilibrium, dairy product exports in 2008 are likely to exceed those in 2007.

Happy New Year! **MCT**

Deep discounts

Price volatility in the CME cash cheese markets has prevented manufacturers from stockpiling cheese. We expect the market to remain in balance until discounted nonfat dry milk or discounted surplus milk make their way back to the cheese vats. This could happen sooner than later as surplus milk is

| MCT Forecast | | | | | | | |
|--------------|--------|---------|---------|--------|--------|-----------|----------|
| | Block* | Barrel* | Butter* | Whey** | NFDM** | Class III | Class IV |
| Dec | 2.0080 | 2.0150 | 1.3190 | 0.4540 | 1.835 | 20.50 | 19.45 |
| Jan | 1.9250 | 1.8950 | 1.3250 | 0.4450 | 1.685 | 18.70 | 18.50 |
| Feb | 1.8000 | 1.7750 | 1.3750 | 0.4450 | 1.645 | 17.70 | 18.00 |
| Mar | 1.7000 | 1.6700 | 1.3900 | 0.4500 | 1.595 | 16.75 | 17.70 |
| Apr | 1.6500 | 1.6250 | 1.4000 | 0.4500 | 1.570 | 16.20 | 17.50 |
| May | 1.6000 | 1.5750 | 1.4250 | 0.4500 | 1.520 | 15.75 | 17.20 |

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

selling at \$2.00/cwt. below the class price and spot nonfat dry

milk is selling at a 30 to 50 cent discount to cash cheese. **MCT**

The feed factor...

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previous record of \$4.55/bu. hit in 1995/96. Record-high wheat prices attracted 3.1 million more acres, a 5.4% increase, to wheat production in the 2007/08 marketing year, compared with 2006/07 acreage.

Meanwhile, USDA is projecting a 16% reduction in soybean acreage in 2008. This, along with strong export demand

has propelled 2008 soybean prices above \$12.00/bu. If the outlook for soybean prices remains above \$12.00/bu., corn prices could soar above \$4.50/bu. to attract adequate plantings in 2008.

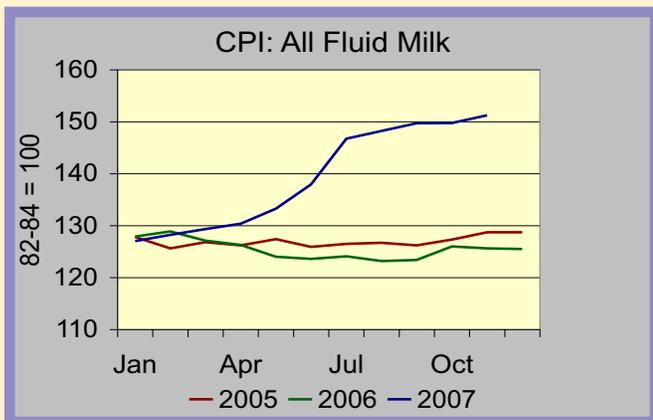
Despite rising commodity prices, international demand has not decreased appreciably, mainly because the weak U.S. dollar has mitigated the effect of the price run-up. Domestically, high feed costs have

translated into higher wholesale prices on eggs, meat, and dairy. But not all of the increase has been passed along to consumers, at least not yet.

In the U.S. milk market, for example, fluid milk sales are

down just 0.2% through October 2007, even though the consumer price index for milk has increased 19.0%. What is more surprising, perhaps, is that the Federal Order Class I milk price increased 57% from the first quarter of 2007 to the third quarter of 2007, but the retail milk price index increased less than 20%. Likewise, the consumer price index for cheese has increased just 12%, despite an almost 60% gain in the Chicago Mercantile Exchange Cheddar cheese price since January 2007.

Should consumers consider themselves lucky that their food costs have only increased 4%, despite significantly higher wholesale commodity costs? Or should they brace themselves for an even higher increase next year? If consumer prices catch up to wholesale prices, the dairy industry may also want to brace itself. **MCT**



Source: U.S. Bureau of Labor Statistics, compiled by MCT Dairies.



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