MCT Dairies est. 1983

August 31, 2011

MCT COMPASS

A complimentary service of MCT Dairies, Inc. www.mctdairies.com

New Highs? New Lows?

Last month's *Compass* featured the economic outlooks of several noted dairy economists and industry analysts. Most of these analysts agreed that dairy product prices are likely to trend higher toward a new price level. In addition, several mentioned price volatility.

Most of these analysts agreed that dairy product prices are likely to trend higher toward a new price level.

Price volatility has become such a hot topic that G20 leaders at their summit meeting in November 2010 requested several organizations to work with key stakeholders to "develop options for G20 consideration on how to better mitigate and manage the risk associated with the price volatility of food and other agriculture commodities, without distorting market behavior, ultimately to protect the most vulnerable." That statement was made in *Price Volatility in Food and Agricultural Markets: Policy Responses,* a report published in June 2011.

The organizations involved were: the United Nation's Food and Agriculture Organization (FAO), the International Fund for Agricultural Development (IFAD), the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD), United Nations Conference on Trade and Development (UNCTAD), World Food Program (WFP), World Bank, and the World Trade Organization (WTO).

According to the report, there is little or no evidence that volatility in international agricultural commodities is increasing, as measured by standard statistical measures in either nominal or real prices. However, the report concedes that volatility has been higher during the decade that began in 2000 than in the previous two decades. The report also concludes from its analysis of long-run trends in volatility that periods of high and volatile prices are often followed by long periods of fairly low and stable prices.

The chart on page two illustrates annual commodity price indices for sugar, cereals, and dairy published by FAO. Annual data mutes the month-to-month variation but nevertheless still illustrates the variability in annual commodity price indices and the trend toward higher price levels. Sugar appears to have greater price variability than either cereals or dairy.

Reviewing the trading range of a commodity from

Continued on page 2

Ken's Corner

by Ken Meyers
President , MCT Dairies Inc.

Uncertainty appears to be the catchword of the day. U.S. equity markets experienced unprecedented volatility in August. The gold market, considered a safe haven by many, plunged last week. And CME spot cheese prices lost more than 40 cents in a relatively short period of time.

That's what I call volatility. And while many of us would like to see prices stabilize at a comfortable level for sellers, buyers, and consumers, any reprieve from volatility is likely to be short lived.

As U.S. dairy and other markets become more globally oriented, outside influences such as rapid growth in developing countries, a sovereign debt crisis in Europe, revolution in Libya, or a labor strike in Brazil play a growing role in the prices of U.S. dairy products.

The past year has provided a great example of the globalization of the dairy market. Increased demand for U.S. dairy products on the world market was the direct result of three outside factors: growing demand from the developing world; production problems in New Zealand; and a drop in the value of the U.S. dollar compared with key currencies like the yen and euro.

Probably the only certainty that I can offer in these uncertain times is to expect continued volatility in both world and U.S. dairy markets. **MCT**

Floor could be forming...

Dairy markets are in flux. All eyes are on New Zealand as its production season gets underway.

Recent globalDairyTrade (gDT) auctions suggest moderately lower prices on dairy commodities vs. the prior year. November-January 2012 delivery prices are: Cheddar cheese, $1.86/lb.; skim milk powder, $1.55/lb.; and the butter equivalent of anhydrous milkfat, $1.55/lb. However, some prices are not being matched by global competitors, suggesting a floor has been reached. **MCT**

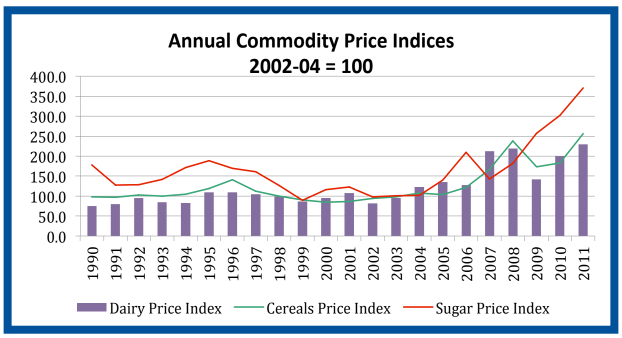
MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Aug	1.9725	1.9570	21.65	2.0880	20.05	0.5695	1.5630
Sep	1.8450	1.8150	19.15	2.0550	19.70	0.5875	1.5250
Oct	1.8600	1.8600	19.20	2.0300	19.25	0.5800	1.4925
Nov	1.8200	1.7900	18.95	1.9800	18.55	0.5400	1.4350
Dec	1.7450	1.7150	18.10	1.8500	17.75	0.4950	1.3775
Jan	1.7100	1.6800	17.05	1.7500	16.60	0.4600	1.3250

** CME prices.*
***NASS prices.*

Prices trend higher...

Continued from page 1



the lowest price to the highest price during the year is a simple way to look at volatility. For example, in 2011 the monthly average CME spot Cheddar block price ranged from a low of about $1.51/lb. in January to roughly $2.11, a difference of 60 cents and the highest since 2007's 77.5 cents. The largest variation in monthly average CME block Cheddar cheese prices of 86.25 cents was posted in 2004.

Economists often note that agricultural commodities are subject to greater price variation than other markets because agricultural production varies from season to season caused by natural "shocks" such as weather and disease. Take for example the 2011-12 U.S. corn crop. Millions of acres went unplanted due to floods, and flooding wiped out millions of planted acres. In other areas, corn did not reach the appropriate stage before tasseling, causing the cob to develop prematurely. As a result, both acres harvested and yield per acre are expected to be significantly lower than the past two marketing years.

The relatively long production cycle in agricultural commodities also contributes to price volatility within the sector. It is difficult for producers of most agricultural commodities to respond immediately to price changes. Even though, unlike crops, milk is harvested every day, it takes two years for a young female calf to enter the milk herd. As a result, it is still difficult for the dairy sector to respond to a significant price increase in a timely manner.

How countries respond to rising food prices can also contribute to price volatility. For example, during the 2007-08 period, India and Argentina imposed export taxes on dairy products to help ease domestic consumer milk prices. By insulating their own consumers, these countries effectively created greater instability in the international markets. **MCT**