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MCT COMPASS

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Look out below!

As 2012 comes to an end, the universe has obviously dodged the Mayan calendar's doomsday, world-ending prediction, but the United States still faces a fiscal cliff, and the likelihood that U.S. agriculture policies and regulations will revert to 1949 legislation has increased. What does this mean for the dairy sector? The simple answer is short-term chaos.

The agriculture sector faces its own version of the fiscal cliff if a U.S. farm bill is not passed or extended by Jan. 1. If nothing is done, laws and policies governing agriculture revert to the Agricultural Act of 1949. According to the Act: "[T]he price of whole milk, butterfat, and the products of such commodities, respectively, shall be supported at such level not in excess of 90 per centum or less than 75 per centum of the parity price therefore as the secretary determines necessary in order to assure an adequate supply."

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What exactly is parity? Parity refers to the 1910-14 "golden era" of agriculture when commodity prices were particularly high. USDA's monthly Agricultural Prices report notes that the November 2012 parity price for all-milk is $52.10/cwt. And 75% (per centum) of $52.10 is $39.08. Because milk is a perishable product, the all-milk support price is converted into support prices for more-storable products, Cheddar block and barrel cheese, butter, and nonfat dry milk (NFDM). Current support prices for Cheddar 40-lb. blocks and 500-lb. barrels are $1.13 and $1.10/lb., respectively. The butter support price is $1.05/lb., and NFDM's is 80 cents. These product prices translate into a theoretical all-milk support price near $9.80/cwt. for milk containing 3.5% butterfat.

For the secretary of agriculture to support milk prices at not less than 75% of parity, the secretary would need to almost quadruple the current dairy product support prices. In other words, the support price for 40-lb. Cheddar blocks would be near $4.52/lb., and support prices for butter and NFDM would be about $4.40 and $3.20/lb., respectively.

Historically, manufacturers have been hesitant to sell product under the voluntary support price program

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Ken's Corner

by Ken Meyers
President , MCT Dairies Inc.

Congress has done it again. The country is tenuously balanced at the edge of the fiscal cliff trying to retain its footing, and market analysts for everything from crude oil to equities are busily trying to pencil out their 2013 price forecasts. This year, milk prices have grabbed the national spotlight.

When the average consumer's holiday dinner conversation reverts to the possibility that milk prices will double next week at the same time taxes increase, it's obvious that the industry and the media have caught the attention of the country's legislators.

However, the odds that the retail price for a gallon of milk will actually double are much lower than news reports suggest. Politics aside, milk supplies in November and December were quite strong, and with the holiday demand season now over, softer farm milk prices are expected to collide with poorer-quality feed supplies and higher prices for purchased feeds. This likely will result in a contraction in the U.S. milk supply during the first quarter of 2013, which could, in turn, result in higher milk prices for producers, manufacturers, and possibly even consumers this spring.

Thus regardless of whether Congress is able to end gridlock in Washington anytime soon, farm milk prices in the first half of 2013 are expected to be stronger than in first-half 2012. **MCT**

Lower Output, Lower Stocks...

Short term, dairy markets have ample supplies of product; however, the longer-term outlook is less certain. Cheese and butter markets in excess of $2.10/lb. and $1.95/lb., respectively, in October contributed to very high milk checks in November and December. As the year comes to a close, cheese and butter markets have fallen by more than 35 and 50 cents, respectively, and that will translate into lower milk checks during Q1 2013. Butter stocks as of Nov. 30 totaled 127.1 million pounds, up 36% vs. 2011's low level and 14 million pounds higher than the five-year average. American cheese stocks, which totaled 581.2 million pounds as of Nov. 30, are tighter, down almost 12 million pounds vs. last year. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Dec	1.7475	1.7300	18.60	1.5575	17.85	0.6575	1.5465
Jan	1.7450	1.7100	18.20	1.5600	17.70	0.6565	1.5575
Feb	1.8000	1.7750	18.60	1.6250	18.10	0.6400	1.5650
Mar	1.8500	1.8250	19.10	1.7000	18.50	0.6375	1.5725
Apr	1.8750	1.8500	19.30	1.7450	18.75	0.6200	1.5775
May	1.8850	1.8650	19.40	1.8000	19.00	0.6150	1.5800

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

Don't bank on it..

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(due to packaging requirements, risk of USDA graders rejecting product, delayed payments, etc.) and have instead unloaded surplus product at lower-than-support prices to clear the market. But at prices twice the level of current market prices, some manufacturers would likely offer product to the government.

However, failure of Congress to pass a new farm bill or extend the current one doesn't mean farm-level milk prices will automatically rise to $39/cwt. or that the price of a gallon of milk doubles as we ring in the New Year. Why? Because Federal Order milk prices are calculated from the National Dairy Products Sales Report (NDPSR) prices and California prices are priced off CME spot prices—not government support prices.

If manufacturers were to sell Cheddar, butter, and NFDM under the support price program, resulting sales prices would be included in weekly NDPSR prices but would most likely only represent a small volume of the survey. For example, typically close to 16 million pounds of butter, 60 million pounds of NFDM, and 80 million pounds of cheese are included in the NDPSR prices each month. Therefore, sales to the government would have to displace commercial sales to have a significant impact on milk prices at the farm level or at retail.

Contrary to media reports from the *New York Times* to CNBC that have warned that retail milk prices could double in early January, the regulated price of milk used in fluid milk beverages in January 2013 will be $2.43/cwt., or nearly 17 cents per gallon, lower for 2% milk than in December, according to USDA's Federal Order price announcement. The significant price decline is due to the cheese market falling from $2.11 in November to $1.76/lb. in December.

Most dairy producers won't feel the financial pinch from the 35-cent drop in cheese prices, which translates into at least a $3/cwt. decrease in milk prices, until mid-January. At that time, producers are expected to respond to lower milk prices by reducing their herds, which in turn will slow milk production. Slower output due to supply and demand fundamentals, not government programs, is expected to buoy milk prices into Q2 2013. **MCT**