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MCT COMPASS

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Signals Imply Higher 2019 Prices

In 2018, CME Cheddar blocks passed the $1.70/lb. level just six times compared to an average of 71 times in the prior two years. As a result, the Class III milk price averaged $14.61/cwt. last year, the lowest annual average since 2010, and $1.56 lower than 2017's average. But there are signs that market prices could mount a recovery in 2019.

Given prospects of growing commercial disappearance of dairy products in the United States and Europe, the pace of milk production expansion will likely not be able to keep up.

Supply-side expansion, or contraction, tends to be one of the first, and most significant indicators of market direction. During second-half 2018, combined milk production growth in Argentina, Australia, Brazil, the EU-28, New Zealand and the United States slowed to just 0.5% more than the prior year. In January, milk production from these countries fell 0.1% behind the prior-year's pace. Given prospects of growing commercial disappearance of dairy products in the United States and Europe, the pace of milk production expansion will likely not be able to keep up with robust demand. In fact, Germany's ZMB forecasts that EU-28 2019 stocks will decline by 1.6 million metric tons (MT) of milk equivalents. That compares to an average build of 1.3 million MT over the prior four years, a significant reversal of recent trends.

Slowing milk supplies tend to precede the second signal of recovery—stock depletion. It has been more than four years since the world last managed markets without significant government stockpiles of dairy products, primarily milk powder. Typically, as milk production slows, markets rely on stocks as a stopgap. However, as of Feb. 28, EU-28 Intervention skim milk powder stocks (SMP) of 4,331 MT were down 99% from the prior year. On the other hand, after accounting for working inventories, expanding stocks reflect a surplus,

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Ken's Corner

by Ken Meyers
President, MCT Dairies Inc.

Reading market signals can be challenging, even in the best of times, but this year presents two major obstacles to market forecasting. Looking at historical price patterns is an ideal place to begin, and according to the past, SMP and cheese prices look poised to continue their recent run-ups once the Northern Hemisphere's seasonal milk production peak has passed. That's good news for the milk production sector, which has been managing through poor margins for four consecutive years.

Contracting world milk production, coupled with the depletion of world SMP stocks, provides a solid foundation for a global milk price recovery, but two major issues threaten to derail—or perhaps curtail—the level of price appreciation that can be expected later this year. First, the global economy is teetering on the brink of a recession, which could slow global demand for dairy products. And second, the United States' ongoing trade disputes with China and Mexico, and to a lesser extent with Canada, continue to hamper the efforts of U.S. exporters to grow sales.

These issues aside, U.S. dairy producers have been culling their herds at a breakneck pace, and the number of licensed dairy herds fell nearly 7% last year to 37,468 from 40,199 in 2017, according to USDA. And if the past in an indicator, that type of bleeding can't continue without seeing a significant contraction in U.S. milk supply. **MCT**

Seasonal Decline Ahead

Throughout March, CME Cheddar block and barrel prices appreciated 12¢ and 18.25¢, respectively.

MCT Forecast							
	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Mar	1.5600	1.4650	14.99	2.2800	15.74	0.4125	0.9650
Apr	1.5150	1.4575	15.03	2.2550	15.63	0.3975	0.9600
May	1.5200	1.4275	14.72	2.3025	15.72	0.3875	0.9550
Jun	1.5425	1.4800	14.86	2.3975	16.14	0.3900	0.9625
Jul	1.6525	1.5775	15.58	2.4950	16.81	0.3975	0.9925
Aug	1.6975	1.6400	16.51	2.5000	17.17	0.4125	1.0175

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

With barrels increasing at a faster pace than blocks, the block-barrel price spread narrowed to 13.75¢. Anecdotal reports suggest that cheese is available off market and that further price gains could be challenging—at least for now. At the same time, spot butter and nonfat dry milk prices have flattened and, in recent weeks, turned negative, causing the difference between Class III and IV prices to close. As milk seasonally increases, prices could ease. **MCT**

...surpluses no longer offer safety

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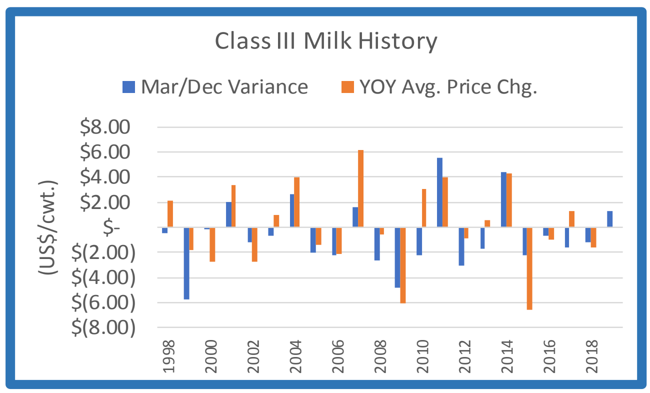
relative to demand and are marked by periods of lower prices. That was typical of milk powder and even cheese prices through most of 2018. While it could take several more months for private companies to consume their purchased SMP, the safety of surpluses is really no longer in play. As a result, higher prices will likely be needed to ration demand until it once again finds equilibrium with supply.

The last signal could be a market reflection of the first two. Since 1996 when federal order reform was implemented, in years in which the March Class III price settled higher than the previous December, the average value was at least 24% higher than the prior year. That happened in 2001, 2004, 2007, 2011, and 2014. Futures markets have been expecting the March 2019 Class III price to settle above $15/cwt., which would be higher than December 2018's Class III price of $13.78. If this pattern were to hold, it could result



in an average Class III price closer to $18/cwt. this year. However, given the ongoing trade disputes that continue to upset U.S. efforts to export cheese and whey, that level of appreciation could be challenging. However, considering 2018's low average Class III price, the past pattern could very well resurface to send prices higher later this year. **MCT**

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