

## Wide Cheese Spread Structural

The CME spot Cheddar cheese market achieved infamy on Sept. 23, 2019, when the difference between closing block and barrel prices widened to 43.25 cents, resulting in the largest block-barrel price spread since trading began in Chicago. Since Sept. 23, the price difference has tempered to 32.5 cents, still a large chasm by historical measures. To put these figures in perspective, as of Sept. 27, the 2019 year-to-date CME block-barrel price spread averaged 13.8 cents, compared to 11.5 cents for the same period last year and 10.6 cents in 2017. While the average difference between the two Cheddar products has been increasing, about 95% of the time, this year's block-barrel price spread ranged between a negative 1.8 cents and 28.6 cents, illustrating just how gigantic the gap was on Sept. 23.



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The chasm has caused market analysts to ponder how two Cheddar products can travel such different paths, with one continuing to trade near multi-year highs while the other collapses. The answer is complicated. First, demand drivers for blocks and barrels are different. Barrels tend to move to processed cheese uses, while blocks are consumed as natural cheese slices and shreds and exported as commodity cheese. The reopening of schools and the final weeks of grilling season coincide each year, helping lift processed cheese demand in August and early-September. By the end of September, school supply lines are restocked and cheese demand shifts seasonally from sandwiches and burgers to pizza.

These shifts can lift barrel prices in late summer when demand typically outstrips supply. Given the expansion in barrel plant capacity over the past few years, domestic supply is more than adequate, so market tightness tends

to last for just a few weeks, which can lead to an abrupt price decline.

Per-capita consumption of natural cheddar cheese is 11.07 lbs., based on 2017 data, nearly double that of processed cheese. While the food-service industry uses substantial amounts of processed cheese each year,

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### Ken's Corner



*by Ken Meyers  
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After years of predictable CME block and barrel price spreads, the gap between the two cheese prices has not only widened, but it has also reached new levels of volatility. This has affected buying and selling decisions, as well as producer milk prices.

According to National Dairy Products Sales Report data, since 2000, the barrel price has accounted for close to half of the announced cheese price, providing a disproportionate influence on the Class III protein value. Since 2017, the American Farm Bureau Federation calculates that the Class III milk price would have averaged 23 cents per hundredweight higher had blocks been the only cheese price used in the calculation. While that has spurred calls to drop barrels from the price survey, doing so would reduce market transparency.

Another option that's gaining support is to include 640-lb. blocks and/or Mozzarella in the price survey and pricing formulas, which would reduce the impact of barrel cheese on the Class III milk price.

While improving price transparency would be welcomed by the dairy industry, changes to the federal order system are cumbersome and can take years to implement. By the time an adjustment were to be made, the industry likely would have already corrected the structural imbalance. **MCT**

# Cheese and Butter Back Off

After reaching multi-year highs, CME block and barrel cheese prices retreated in late September.

Similarly, butter markets have run into downside pressure, and reports note that Europe could have considerably more product than first reported. Nonfat dry milk and skim milk powder prices, which have long languished in a price trough, have started to increase as Intervention stocks dwindle. That has lifted U.S. milk prices as well as some expectations that milk production could expand at the start of 2020 if margins remain favorable. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Sep	2.0450	1.7500	18.38	2.1725	16.12	0.3700	1.0525
Oct	1.9625	1.7650	18.60	2.2100	16.48	0.3675	1.0750
Nov	1.9150	1.7425	18.36	2.2425	16.81	0.3675	1.0975
Dec	1.8800	1.7225	18.12	2.2075	16.77	0.3725	1.1100
Jan	1.8050	1.6225	17.45	2.1850	16.76	0.3650	1.1200
Feb	1.7575	1.6150	16.94	2.1725	16.73	0.3625	1.1225

\* CME prices.

\*\*NASS prices.

## ...40-lb. blocks insufficient to meet demand

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helping drive demand improvements, these uses are unlikely to close the gap on consumption of natural Cheddar. In years when the United States exports considerable amounts of Cheddar cheese, the availability of 40-lb. blocks to the domestic market is reduced, especially for cheese heading to the Chicago spot market. Moreover, most of the new Cheddar block capacity has been for 640-lb. blocks rather than 40-lb. blocks. Typically, demand tends to outpace the available supply of 40-lb. blocks. In coming months and years, cheese manufacturers will purposefully add 40-lb. block capacity to service this unmet demand, but until that happens, blocks available for spot purchase, especially at the CME, could be limited. As a result, prices could remain somewhat elevated as demand outstrips supply.

Lessor differences between the two products, such as the impact of white whey on cheese-making decisions, have also piqued the interest of market participants. Whey derived from white cheese holds a premium to whey that comes from yellow Cheddar. Simply, white whey does not have to go through a

decolorization process, and buyers, especially those buying for the infant formula market, prefer and pay more for white whey. While makers of Cheddar blocks add color, by definition, barrel manufacturers do not. As a result, some cheese manufacturers elect to make more barrels than blocks because, when considering the value of the coproduct, the combination achieves a superior return. This can result in overproduction of barrels that tend to make their way to the Chicago spot market.

Both the duration and levels of the block-barrel price spreads over the past three years have perplexed the market and made market prediction and hedging more difficult for those buying and selling cheese. As the price spread continues to wildly expand and contract, the market becomes more dependent on price forecasts for block and barrel cheese to determine appropriate values. This has increased volatility, especially over the past few weeks, not only raising the price of cheese but also the associated risk management expenses as option premiums have become more costly and the need for basis adjustments has grown. **MCT**



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