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MCT COMPASS

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Supply Recovery Likely Delayed

As the industry turns its attention to 2020, early data suggests that the new year could be just as volatile as 2019 as the U.S. economic engine continues to blaze ahead, new trade deals take effect, and global milk supplies remain flat. While several factors could temper prices in 2020, it seems that prices, on average, could remain well above those over the past five years for most dairy products, and that, no doubt, will be welcome news to dairy producers.

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World economic news turned positive in late 2019, and fears of a global recession in early 2020 have been waived off for now. Most economists point to the resolution of outstanding trade disputes as a reason for the economy sidestepping a recession. The United Kingdom resolved its three-year Brexit cloud of uncertainty with a December vote that resoundingly supported a divorce from the European Union. In addition, the United States House of Representatives passed the U.S.-Mexico-Canada Agreement (USMCA) with just a day left in the 2019 session and sent the legislation to the Senate for an early 2020 passage. During the same week, the United States and China agreed to a phase-one trade understanding in which both groups appear to be stepping back and unwinding tariffs. Just ahead of the holiday week, China announced it would repeal most of the retaliatory tariffs from nearly all U.S. dairy products as well as from a host of other U.S. agricultural items. Into the end of the year, extremely low unemployment and positive consumer confidence also encouraged consumer spending, including on dairy products.

Seasonally, dairy demand could soften somewhat at the start of the year as consumers moderate purchases, but the adjusted price level at the beginning of 2020 will likely be considerably higher than at the start of 2019. In January 2019, CME block and barrel Cheddar cheese prices averaged $1.4045 and $1.2379/lb., respectively, compared to a January 2020 cash-settled cheese futures forecast of $1.8270/lb. Similarly, nonfat dry milk (NFDM) averaged $1.0075/lb. in January 2019, or 22% less than

Continued on page 2

Ken's Corner

by Ken Meyers
President, MCT Dairies Inc.

This year has ended on a very good note. Not only are consumers feeling flush, but dairy demand and milk prices are also starting the year off from a relatively strong level. With many producers still needing to shore up their financials before taking full advantage of today's improved outlook for milk prices and others still having difficulty finding labor, a full supply response likely will be delayed, supporting prices well into the new year.

To help with the labor shortage, investments in robotics could become more commonplace in time, but most U.S. dairy operations are still waiting for the technology to become more cost-effective or for income to climb to sustainable levels that can support the investment.

However, if enough producers take advantage of the new Dairy Revenue Protection insurance program, which allows them to lock in milk prices five quarters in advance, milk production longer term could begin to climb and remain elevated well after markets have signaled an oversupply of milk—delaying the next inevitable pullback.

For now, though, the 2020 forecast looks rather rosy, with the U.S.-China trade war moving toward resolution, the USMCA awaiting Senate passage, U.S. stock markets at or near all-time highs, and demand for dairy products as robust as ever. MCT

Prices Quietly Ring in 2020

Not surprisingly, markets were quiet during the year-end holidays. The ascent of the NFDM and SMP markets slowed, and in some cases, turned lower as news of a weaker Algerian tender and a poor performance at the last Global Dairy Trade auction of 2019 weighed on buyers' enthusiasm. The recovery in CME spot barrel prices at the end of the year was short-lived as sellers returned to the market. Spot butter prices trended higher as well after reaching the low-$1.90 range in early December trading. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Dec	1.8750	1.8500	19.12	1.9750	16.70	0.3325	1.2175
Jan	1.7650	1.6375	16.78	1.9325	16.70	0.3350	1.2375
Feb	1.6900	1.6375	16.95	1.9025	16.62	0.3350	1.2425
Mar	1.7225	1.6575	16.95	2.0025	17.00	0.3375	1.2375
Apr	1.7600	1.6900	17.22	2.0750	17.29	0.3350	1.2375
May	1.7775	1.7375	17.60	2.0250	17.14	0.3400	1.2450

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

...persistent strength

Continued from page 1

current CME futures forecasts. Butter and whey have been the laggards. At the beginning of 2019, CME spot butter averaged nearly $2.25/lb. compared to a January 2020 cash-settled butter futures forecast of nearly $2.05. Whey powder took the brunt of both the U.S.-China trade dispute and the African swine fever outbreaks in China, which resulted in a 25% projected price decline over the same period.

A few late-year contributors to higher prices could persist into 2020, including slowing global milk output and depleted government stockpiles of skim milk powder (SMP). In late 2018, Northern Hemisphere milk production slowed due to harsh weather conditions, poor feed quality, and deficient on-farm margins. Supply-side issues accelerated at the onset of 2019 as producers throttled back milk production. Despite slowing output, market prices remained depressed. The EU Intervention program served as a backstop, supplying ample amounts of heavily discounted SMP. But those stocks have largely been consumed and prices have increased. With Intervention SMP gone, the market price will quickly reflect supply and demand imbalances.

While the end-of-year price hikes are easily explained, the delayed response from farms remains puzzling—and this could be what sets the pending supply recovery apart from previous ones. Compared to the 2013-14 dairy price run-up, more extensive environmental regulations are in play today that could keep farms from adding cows, especially on the U.S. coasts, in parts of Europe, and throughout New Zealand. With environmental regulations increasing, most farms are having to do more with less. In the future, advancements in genomics and adoption of new technologies could help farms become more productive with fewer cows, but for now, fewer cows could keep milk production from expanding in the coming year. Moreover, with decades-low unemployment in the United States and a smaller unauthorized workforce, those U.S. dairy producers who want to expand could be limited by available labor.

With dairy demand expected to remain buoyant well into the new year, the 2020 wild card will be milk production. Then as higher prices eventually make their way through the system, the question becomes how much will the world's food manufacturers and consumers be willing to pay before seeking alternatives. **MCT**

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