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MCT COMPASS

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Virus to Afflict Market Long Term

Two months ago, the United States was awash with milk. Instead of being sent to plants for processing, surplus milk was poured down drains and fed to calves and heifers. At that time, the world looked particularly bleak, with the U.S. economy on pause while people waited out COVID-19 in isolation in an aggressive attempt to slow the spread of a once-in-a-century disease. Stocks of cheese and butter reached multi-year to all-time highs as foodservice packaging lines sat idle and retail demand overwhelmed capacity. To stem the flow of milk, processors and cooperatives instituted some of the most significant disincentives in modern history, with milk reduction targets reaching 15% to 20% for some.

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Subsequent USDA data show that these types of deterrents, when large enough, can bring about swift change. In May, U.S. milk production broke with trend, dropping 1.1% behind last year's pace. Lower output per cow in May partly drove the correction as producers adjusted rations to manage costs and rapidly cut output to avoid sizeable penalties for overproduction. The national dairy herd also corrected as dairy farms removed a net 11,000 cows from the system; however, today's herd is still 37,000 cows larger than a year ago. Even so, the adjustments likely helped offset lost markets, lifting prices from multi-year lows.

But then the confluence of strong exports, USDA orders, slowing milk production, and the reopening of the U.S. economy in May swiftly moved the market from excess to deficit within a few weeks. Any one of these factors could have provided market relief, but together these independent efforts sent cheese prices soaring. In late June, CME block prices hit a record-high of $2.81/lb. Two months ago, that would have seemed inconceivable. Anecdotal reports suggest that milk supplies in large swaths of the country have remained tight and expensive. Some cooperatives and processors that avoided deterrents this spring have reported that milk supplies have started to recover, but summer heat and humidity

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Ken's Corner

by Ken Meyers
President, MCT Dairies Inc.

The uncertainty of COVID-19 will linger for months, possibly years. Not only has the first wave of the virus worsened, but a second wave of illness could erupt to further impact markets. In a worst-case scenario, by the time the nation's dairy producers fully respond to current market signals by increasing milk production, COVID-19 cases could once again be escalating and federal aid could be exhausted, causing dairy demand to falter again.

That said, predicting the future has never been more difficult. Even looking four weeks out is challenging and trying to predict dairy prices in December is nearly impossible. With foodservice demand not expected to fully recover for months, possibly years, and rolling shutdowns of newly reopened restaurants occurring across the nation, processors need to be more nimble than ever and capable of switching between product mixes and packaging to serve retail, restaurants, and schools.

At the same time, the International Monetary Fund (IMF) projects an 8% contraction in U.S. gross domestic product (GDP) this year and a 4.9% contraction in the global economy—the worst since the Great Depression. If IMF's projections pan out, economic hardship around the world could be even harder on dairy demand than the actual virus. **MCT**

Dairy Product Rallies Peter Out

Butter and nonfat dry milk (NFDM) markets have been muted compared with cheese prices. While some data suggest that butter markets could move higher this fall, prices have been retreating since the beginning of June. NFDM prices continue to hover near $1/lb., and while buyers are reportedly willing to own powder at this price level, most feel product is readily available and thus are in no rush to buy. The gap between Class III and Class IV milk prices could have a profound impact on the All-Milk price in June and July if depooling by cheese plants results in lower prices to farms. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Jun	2.4975	2.2950	20.87	1.8650	13.69	0.3650	0.9200
Jul	2.5575	2.4000	23.53	1.9950	14.98	0.3475	1.0075
Aug	2.2700	2.0975	21.76	2.0025	14.95	0.3275	1.0000
Sep	2.1275	1.9900	19.97	2.0425	14.88	0.3225	0.9725
Oct	1.9250	1.8550	18.41	2.0075	14.68	0.3150	0.9650
Nov	1.8650	1.7375	17.40	1.9550	14.36	0.3200	0.9550

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

...high prices to reverse by fall

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arrived in late June and that could present an uphill battle for recovering milk supplies.

Just like low prices lead to high prices, today's high prices will eventually lead to lower prices. In May, low prices allowed for U.S. cheese exporters to move large, discounted volumes overseas. Low prices also spurred USDA to implement the largest food aid package in modern history. The resulting farm milk prices of $20/cwt. plus will certainly encourage more milk as cooperatives relax base programs and producers put additives back into rations. That should boost production per cow, but how quickly remains uncertain. Even so, a return to production growth seems likely later this year.

In addition, restaurants and retail establishments could soon experience sticker shock as a result of CME spot cheese prices that climbed from the mid-$1.60s in May to over $2.80/lb. in June. High prices will likely curb demand through reduced cheese offerings on restaurant menus and a decreased number of retail promotions. However, these types of changes typically take months to play out before eventually reducing prices.

This summer's markets could be more complicated as USDA orders flood the system, offsetting losses from other sectors. Schools will also be reopening and that will spur a restocking of institutional supply lines and buying over the next couple of months. Prices could remain elevated through summer, but as fall approaches, high prices could begin to work against markets.

The perfect storm that catapulted CME Cheddar block prices toward $3/lb. could reverse by fall. U.S. cheese that's priced $1/lb. above the global competition's has prevented new exports, and imports could also grow—creating a complete reversal of second quarter demand. Domestic demand could also slow in response to higher prices. In addition, USDA funding is finite and buying will be less effective in the second round of aid given today's pricier cheese. Plus, USDA's new fiscal year begins in October, and with 2020 being a presidential election year, USDA buying could soon be put on hold, leaving a large hole in demand. **MCT**

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