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MCTCOMPASS

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Markets Tip Toward Surplus

Two worlds collided this month when expectations for futures prices reconciled with the stark reality of physical markets. For weeks, markets have discounted the swelling domestic milk supply and have instead focused on USDA orders and the strong pull from overseas markets. While both commercial and government demand was able to absorb the growing milk supply through much of 2020, the scales have now started to tip toward surplus, which could account for the recent sharp price declines.

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When it comes to overseas markets, two countries—China and New Zealand—command attention. Both markets helped to support prices at the end of 2020 and into 2021, but concerns have been mounting that a slowdown is inevitable. Last year, China imported less skim milk powder (SMP) and whole milk powder (WMP) relative to 2019, down 2.8 percent and 5 percent, respectively, after adjusting for leap day. Despite slower exports, Chinese demand was steadfast given the pandemic's impact on the supply chain in early 2020.

Reports surfaced that Chinese companies increased safety stocks in second-half 2020 to avoid future disruptions to the country's food supply. The Chinese government also recommended that people should consume more dairy to maintain health, a campaign that likely boosted demand and elevated imports. But China's WMP imports slowed considerably in fourth-quarter 2020, raising concerns that dairy purchases could moderate soon. When China reduces WMP buying, no other country can absorb the slowdown.

In New Zealand, weather concerns helped to lift WMP and SMP prices to their highest levels of the past five years. While hotspots remain on both the North and South islands, pasture conditions are not as bad as last year, and recent rainfall has modestly improved soil moisture conditions. In more normal times, the current situation would not be able to sustain New Zealand dairy product premiums. However, in a pandemic with countries under pressure to avoid supply-chain disruptions, sufficient uncertainty could force buyers'

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Ken's Corner

by Ken Meyers
President, MCT Dairies Inc.

USDA has pumped billions of dollars into the dairy industry over the past several years, and markets are clearly starting to demonstrate what happens when governments intervene. No doubt, many producers and processors have welcomed both trade mitigation and pandemic relief, but in reality, the support has likely only postponed the inevitable.

The nation's milking herd is at levels not seen since at least 1995 and output per cow has continued to improve, breaking 2,000 lbs., on average, for December—the first time ever it has exceeded that level for December. For months, weather has been mostly conducive to milk production, plus both cow numbers and yields indicate producers have had enough cash to feed optimal rations, keep most of their cows milking, and expand the national herd—and that has resulted in surplus milk and dairy products.

At the same time, faltering foodservice demand has led to a build-up of dairy products that could take years to work down. Pumping more money into the industry will only result in more of the same. The best course of action would be to move product overseas, either as humanitarian aid or commercial exports. However, for exports to pick up, prices will likely need to remain at current levels or decline further. **MCT**

Indecisive Markets Retreat Again

Spot dairy markets surged on news of additional USDA food boxes and Section 32 purchases in early January. But reports that showed building surpluses and a burgeoning milk supply in December caused markets to retreat to pre-announcement levels. Overseas demand remains supportive to milk and whey powders; however, spot markets, which likely raced ahead of export values, caused prices to retreat again in late January. Despite recent sell-offs in both the spot and futures markets, forecasts for second-half 2021 futures prices remain relatively stable. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Jan	1.7375	1.5175	16.16	1.3925	13.53	0.4575	1.1350
Feb	1.6250	1.4525	15.67	1.4300	14.00	0.4825	1.1725
Mar	1.6500	1.4625	15.67	1.5225	14.31	0.4775	1.1625
Apr	1.7100	1.4950	15.99	1.5500	14.31	0.4575	1.1475
May	1.6600	1.5100	15.88	1.5225	14.14	0.4275	1.1425
Jun	1.7700	1.6225	16.23	1.5800	14.32	0.4250	1.1350

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

... New Zealand strengthens ties with China

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hands into accepting price premiums, especially given the renewed and expanded New Zealand-China Free Trade Agreement. The agreement, which was extended for another decade, further solidifies ties between the two nations. In addition, milk production growth in New Zealand has stagnated, and that could limit future output gains and the amount of product available to world markets. A greater focus on China could also cause New Zealand to retreat even further from other regions, providing an enhanced opening for EU and U.S. dairy products.

Until this week, government and overseas demand worked to lift dairy price forecasts across all categories. Year-to-date exports through November 2020 eclipsed those for the same period in 2019. Domestic foodservice demand remains lackluster, but USDA food boxes and Section 32 purchases have shored up the imbalance, keeping markets mostly balanced and prices primed to move higher on any announcement of further USDA buying. However, well-intended bureaucrats may have overshot their effort to support dairy prices and instead encouraged massive supply expansion in some regions, while helping other regions to hold production near unchanged.

At the end of January, USDA announced that for the second consecutive month, U.S. milk production grew more than 3 percent above 2019—a level of growth not seen in years—and the dairy herd bulged to sizes not seen in decades. This helps explain the growing disparity between U.S. dairy product prices and those in New Zealand and Europe. Abundant U.S. milk and dairy product supplies could undercut the market's desire to push prices higher on stronger demand at least through midyear.

While demand from many countries has been good given the pandemic, in some cases, it was not as strong as in 2019. And while USDA was able to shoulder lost foodservice demand when year-over-year milk production was near unchanged, future demand could struggle to keep up with today's robust production growth. Fundamentals suggest lower prices ahead, but governments have deep pockets, and Uncle Sam has been omnipresent in dairy markets since 2019. With a single announcement, prices could rocket higher again—and that could be why sellers are reluctant to seek coverage. **MCT**

 MCT Dairies, Inc., 97 Main St., Chatham, NJ 07928 (973) 258-9600 fax: (973) 258-9222 www.mctdairies.com. For more information, email **info@mctdairies.com.**