March 31, 2022

MCT COMPASS

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# Is Dairy Headed Toward Scarcity?

Food is expensive and getting more costly by the day. In February, U.S. food inflation matched overall inflation at 7.9%. While it seems that the number of items in an average-priced grocery sack are becoming fewer and fewer, it could get much worse before it gets better. Using overseas prices as a guide, U.S. cheese, butter, and nonfat dry milk markets could move higher through the rest of 2022. European and New Zealand cheese and butter prices have all surpassed $3/lb. Although domestic prices appear lofty, consumers abroad continue to find value in what in the United States are record-setting prices. Not that many months ago, $25/cwt. Class III and IV milk seemed like a bold call. Today, the math indicates $30/cwt. is possible yet this year if cheese and butter prices make a run above $3/lb.

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For weeks, CME futures pointed to inverted markets, with nearby contracts higher than deferred months. That is typical in a market where demand exceeds supply as it does today. But prices on deferred contracts have since lifted, reflecting a flat market for most of the rest of the year. While buyers were once reluctant to lock in $1.90 and then $2/lb. cheese, suddenly volumes at $2.25 or better seem attractive. Once-hesitant buyers also appear to be embracing coverage in the butter market.

What's changed? Availability. Not only are buyers concerned about total cost, but availability is also now in question as European exporters continue to reduce dairy exports and market participants openly contemplate whether dairy producers will be able to reduce year-over-year deficits given the current situation in Ukraine. In addition, global production is lackluster, with U.S. output down 0.9% in February vs. last year, and New Zealand production off a whopping 8.2%.

Prior to the pandemic and Russia's attack on Ukraine, people took the supply chain and product availability for granted. Anytime and anywhere, most developed nations could obtain food products to meet any

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## Ken's Corner

***by Ken Meyers***
***President, MCT Dairies Inc.***

When the choice is mitigating climate change or keeping people fed, agriculture typically wins. What's occurring in Europe is a perfect example. Without major changes in the food supply outlook, implementation of the Green Deal's Farm to Fork strategy could be delayed. Farm to Fork calls for agriculture's use of pesticides, fertilizers, and land to be reduced by 2030, all of which will adversely impact production.

Still, many Europeans are calling on their governments to push ahead on climate goals so Europe can wean itself off Russian oil and gas. At the same time, others are concerned that pushing ahead on Farm to Fork could negatively impact food production at a time when output from Ukraine and Russia could drop and/or not reach world markets. Together the two countries produce one-third of the world's wheat and barley, 52% of its corn, and more than 50% of its sunflower products.

In a stunning reversal, the European People's Party now wants to delay the Green Deal's Farm to Fork strategy in favor of a food security plan to ensure the world, including the EU's 447 million residents, have plenty of food. While the situation remains fluid, food is almost certain to prevail over the environment if it appears a shortage is developing. **MCT**

# New Dynamic Grips Markets

According to the old adage, as go crude oil and corn prices, so, too, go Class III and IV milk prices. Although there is a relationship between milk prices and input costs, recent trading has been unusual, with dairy prices moving higher nearly in lockstep with corn. In early March, sharply higher crude oil prices and grain and oilseed markets lifted milk and dairy product futures, establishing many new contract highs. At the end of the month, falling crude oil prices once again redirected dairy markets—this time lower. This new dynamic is one to watch. **MCT**

MCT Forecast

| | Block* | Barrel* | Class III | Butter* | Class IV | Whey** | NFDM** |
|---|---|---|---|---|---|---|---|
| Mar | 2.1525 | 2.0475 | 22.84 | 2.7325 | 24.89 | 0.7900 | 1.7975 |
| Apr | 2.1550 | 2.0225 | 22.45 | 2.7325 | 25.53 | 0.7425 | 1.8700 |
| May | 2.1875 | 2.1800 | 23.33 | 2.7400 | 25.83 | 0.7350 | 1.9000 |
| Jun | 2.2050 | 2.1325 | 23.22 | 2.8025 | 26.26 | 0.7375 | 1.9200 |
| Jul | 2.1850 | 2.1325 | 23.12 | 2.9175 | 26.32 | 0.7275 | 1.8700 |
| Aug | 2.2500 | 2.1875 | 23.71 | 2.9150 | 25.89 | 0.7275 | 1.8225 |

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

# ...processors remain challenged

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consumer need. But over the past two years, people have been questioning globalization as store shelves remain under-supplied. Whether hacking of major food processors, unavailable packaging and ingredients, a woefully underemployed labor market, or port disruptions, food processors have been consistently challenged to meet demand. USDA is stepping in by providing massive funds and government-backed loans to improve the integrity of the U.S. food supply chain, but it could take years for these incentives to result in their intended goals.

Traditionally, the domestic market has assumed food processors hold a certain amount of food in reserve to serve its needs. But that has not proven to be the case. When the world market is willing and able to out pay the domestic market, U.S. exporters ship agricultural products overseas. For some nations, adequate food supplies ensure that the current ruling party remains in power. Recall the widespread protests of Arab Spring, which arose from economic stagflation and inadequate food supplies and eventually resulted in several regime changes. At the March G7 meeting, President Joe Biden warned that impending food shortages are “going to be real,” especially in the Middle East and Africa. Currently, high crude oil prices allow oil-producing nations the ability to afford costly products. And on a dollar basis, U.S. dairy is a deal compared to products from Europe and New Zealand.

Given the cost to transport product domestically compared to exporting it at a higher market value, today’s incentives point to increasing exports. The domestic market will need to out pay the export market to keep more product at home. Dairy markets are driven off the incremental volume. Thus, the last pound of cheese or butter can swing a market wildly. If fewer pounds are sold through Chicago, buying frenzies could occur at different points in the year. While an upswing in milk production typically helps offset these price spikes, cows and heifers are scarce today, and dairy producers have been slow to add expensive cows out of fear that prices could capitulate. Therefore, if the calvary doesn’t arrive and food supplies become even more constrained, only the black swan knows how high prices can climb. **MCT**

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