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MCT COMPASS

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Inflation, Recession in Focus

At this time last year, most of the U.S. population had been okayed for COVID vaccines, restaurant traffic was picking up, and people were starting to travel more. Giddy to be out and about with money in the bank, consumers spent readily. This unbridled spending exacerbated global supply chain issues and ramped up inflation. The U.S. stock market, while starting to slow, was still logging gains, and robust dairy demand led to record-high U.S. exports. This euphoria, however, was not equally felt by farmers who were dealing with severe drought in the United States and Canada and flooding in Europe, which eventually sent feed costs soaring.

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Ongoing supply chain disruptions, strong consumer spending precipitated by COVID relief payments, a labor shortage, periodic lockdowns particularly in China, and increased COVID restrictions began to propel prices—for everything from milk to air fare—skyward. When Russia invaded Ukraine, fuel and fertilizer markets further exploded, and overall inflation hit levels not seen in 40 years. To slow the rate of inflation, the Federal Reserve began raising interest rates in March. By May, consumer spending had turned negative and financial analysts were uttering the word "recession" with frequency.

Dairy producers stung by sky high feed, fuel, fertilizer, and labor prices tightened their belts another notch, further delaying expansion plans and driving milk production into negative territory in Europe and Oceania and slowing year-over-year gains in the United States. Signs soon surfaced that reduced supply and the resulting rising prices were starting to chip away at the edges of dairy demand. One participant in *MCT Compass'* July survey of economists put it aptly: "The increased costs of inputs for producers and living costs for consumers has everybody nervous."

To get a sense of where markets might go from here, MCT Compass interviewed and collected midyear forecasts from its panel of five dairy economists: Bill Brooks, analyst with Stonehart consulting and an ag instructor at Northwest Missouri State University; Bob Cropp, retired economist from the University of Wisconsin; Sara Dorland, managing partner at Ceres Dairy Risk Management; Monica Ganley, analyst with the *Daily Dairy Report* and principal of Quarterra; and Mark Stephenson,

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Ken's Corner

by Ken Meyers
President , MCT Dairies Inc.

The mood has changed. Once euphoric, consumers have turned cautious. Pandemic relief has dried up, and people, once flush with cash, have taken out their charge cards, paying substantially more for goods than they were a few years ago. That will slow.

While COVID is less threatening than it was now that nearly 70% of Americans are fully vaccinated, new variants continue to remind everyone that the pandemic is not over. Even grocery stores, while better stocked than a year ago, occasionally have intermittent problems with empty shelves, indicating that the supply chain has not yet fully recovered.

Inflation is still red hot, but gas prices are falling, which puts money directly into consumers pockets. Instead of spending $80 to fill the tank, they're paying $60, leaving $20 for a pizza or the ice cream shop.

Globally, producers continue to struggle with high costs, and year-over-year milk production in the top exporting regions is down 1.7 percent year-to-date through April. However, the weaker milk supply could offset any demand setback, supporting milk prices at levels high enough to keep dairies in business.

If a recession is shallow and consumers keep their jobs, life and the dairy industry could finally be headed back to status quo. **MCT**

...demand teeters

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dairy economist at the University of Wisconsin. We then added their forecasts to CME futures settlement prices for July 17, 2022, to create a consensus forecast. Despite the pending likelihood of recession and demand pullback, this year's panel expects milk and dairy product prices to remain relatively healthy for the rest of the year before dropping in 2023. Their average Class III price forecast for second-half 2022 is $21.56/cwt., but the 2023 consensus drops to $19.60. As for Class IV, the consensus forecast for second-half 2022 is higher at $24.54, with the 2023 average falling to $21.86.

While inflation's mark on dairy demand was virtually unfelt earlier this year, "demand began to shudder in early July as calls for recession grew louder," said another. "If we get a soft landing and inflation declines, dairy markets could level out."

In 2021, U.S. dairy exports hit a new high, and 2022 exports are tracking close to those levels. "Demand has been good, but questions remain about what will happen to demand in price-sensitive countries," one panelist said.

The United States remains well positioned to take advantage of any gaps in supply caused by production pullbacks in Europe and New Zealand, which will provide some support for U.S. prices through the downturn. **MCT**

Consensus Forecast

	Cheese	Class III	Butter	Class IV	Whey	NFDM
July	2.1171	20.96	2.95	23.26	0.53	1.78
Aug	2.1073	20.18	2.90	22.85	0.50	1.73
Sept	2.1203	20.51	2.87	22.91	0.49	1.70
Oct	2.1307	20.93	2.84	23.16	0.50	1.70
Nov	2.1400	20.93	2.77	23.39	0.50	1.69
Dec	2.0513	20.47	2.63	23.06	0.51	1.68
2H 2022 Avg	2.1104	21.56	2.83	24.52	0.50	1.71
2023 Avg	1.9882	19.60	2.45	21.87	0.50	1.61

What the experts say...

Bill Brooks: Higher borrowing costs seem to be the Federal Reserve's main tool to slow inflation. Unfortunately, production problems around the world for foodstuffs and artificially constrained energy production could limit the effectiveness of the Federal Reserve's efforts to rein in inflation. Increased inflation will cause dairy demand to slow, either through reduced consumer expenditures or through shrinkflation, which limits the volume of product consumers get with their dollars.

Bob Cropp: I'm not sure the Federal Reserve will get inflation under control in 2022. Slowing it down some is very possible, but it will take 2023 for the Fed to tame inflation. The challenge for the Federal Reserve is getting inflation under control without causing a recession. Any slowing of the economy with increased unemployment and lower wages would impact dairy demand. But offsetting this demand hit would be lower prices for dairy products as inflation comes under control.

Sara Dorland: European milk production likely peaked in 2020. Given shifting jet streams, which can cause oppressive heat, and Europe's aggressive environmental regulations to combat climate change, European animal agriculture, including dairy will likely never be the same. Dairy farm numbers, cow numbers, and milk collections in Europe will likely continue to decline through this decade.

Monica Ganley: It seems output concerns will continue to be an issue through the balance of the year. Even with most of the world experiencing historically high milk prices, increased operating costs are leaving producers with slim margins. On the demand side, I'm a bit pessimistic about consumer purchasing power and the impact inflation will have on consumers' appetite for dairy products. An economic slowdown will negatively impact dairy demand.

Mark Stephenson: The Fed won't get inflation under control this year, and inflation is shining an even brighter light on income distribution. Folks who have been living close to the poverty line are now finding that they can't afford the most basic items like rent and food. Dairy demand could come under additional pressure from the folks who are rebalancing their grocery baskets. In addition, rising dairy prices worldwide will cause a pushback in demand for dairy products.