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MCTCOMPASS

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Mighty Dollar Weighs on Dairy

Exchange rates today are affecting international dairy trade significantly more than they have in nearly 20 years. With the September inflation rate up 8.2% from a year ago for all products before seasonal adjustment, most pundits expect the Federal Reserve to hike rates by 0.75% each month through the end of the year. That would continue to strengthen the U.S. dollar and create a meaningful headwind for U.S. exports into next year by restricting buying power in developing nations and making U.S. dairy products more expensive than those from Europe and New Zealand.

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Inflation, today's higher cost of borrowing, and signs of an impending recession have buyers apprehensive about demand prospects in early 2023. Reflecting this negative market sentiment, the Global Dairy Trade (GDT) index on Oct. 18 dropped to levels not seen since January 2021. While combined milk production through August for Oceania, the EU-27, Argentina, Brazil, and the United States lagged the same period last year by nearly 1%, demand has started to drop at an even faster pace, resulting in pockets of excess milk and dairy supplies that have started to weigh on prices. Within a matter of weeks, Europe's strategic dairy stockpiles have become surpluses seeking markets. Combined with stocks that have been building in China and at the U.S.-Mexico border as well as rising daily milk intakes in France, Germany, and the United States, this new surplus has caused a downshifting in market sentiment. Buyers do not want to pay to carry expensive dairy products into uncertain markets. With the three-month treasury bill at its highest level since before the Great Recession, working capital is substantially more costly for organizations.

While the cost of money is increasing for businesses, it is also moving higher for consumers. Many consumers have taken advantage of the pandemic to reduce credit card debt and increase savings. However, future spending

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Ken's Corner

by Ken Meyers
President, MCT Dairies Inc.

Interest rates are still historically low. The U.S. economy continues to hum along, and unemployment remains below historical averages. Yet talk of a global recession continues to escalate.

A recent study by the World Bank suggests that if central banks around the world raise global policy rates by 2 percentage points above 2021 averages, global gross domestic product (GDP) could slow to 0.5% next year. That would equate to a 0.4% contraction in per capita terms, meeting the technical definition of a global recession. That would not be good news for dairy.

The study argues that while tamping down inflation is critical, raising interest rates is not the only way to tame prices. Increasing production of commodities, especially food and fuel, could also help. However, that won't be easy. Despite some of the highest milk prices ever, global production has softened. With dairy demand weakening, milk prices will likely decline further discouraging more output.

However, if today's ongoing supply chain issues resolve, Russia ends its war in Ukraine, and production of fossil fuels increases—all daunting challenges—the trickle-down effect could prove extremely helpful in tamping down inflation and preventing, or at least lessening, a recession. **MCT**

Market Sentiment Turns Fickle

In mid-October, dairy markets received a dose of bearish news, including higher-than-anticipated U.S. September milk production, higher year-over-year daily milk intakes in Germany and France, and a disappointing decline in the GDT index. That set off a wave of late-month selling. However, September's Cold Storage report, which showed cheese and butter stocks were lower compared to last year, tempered market pessimism and premiums began returning to the futures market. In addition, China's September dairy imports were lower than the previous year, but the gaps logged in earlier months closed. This late-October news, while far from bullish, seemed to stabilize markets. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Oct	2.0400	2.1750	21.33	3.1875	24.90	0.4875	1.5725
Nov	1.9900	2.0050	20.12	2.8625	22.83	0.4850	1.4925
Dec	1.9525	1.9600	19.63	2.6750	21.65	0.4825	1.4475
Jan	1.9025	1.8975	18.99	2.5700	21.08	0.4725	1.4325
Feb	1.8875	1.8700	18.73	2.6325	21.37	0.4600	1.4330
Mar	1.9025	1.8875	18.94	2.7000	21.85	0.4625	1.4575

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

...consumers feel the pinch

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that involves consumer debt will be more costly than in recent years, and people could be reticent about spending this holiday season, especially with recession concerns and the possibility of layoffs looming. Retailers are also changing return policies, with some going as far as assessing restocking fees to stave off returns. And for consumers looking for a house, mortgage rates will continue to move higher. Rising mortgage rates typically reduce the market value of real estate, which partially offsets total costs; however, today's housing shortfall could support home values. Energy costs will also be higher this winter in Europe and the United States, and winter appears to be making an early arrival, with measurable snow already reported in some northern states as early as mid-October. Even the cost of fast food has been rising. Consumers have noticed that deals at restaurants from Taco Bell to Dunkin' Donuts are evaporating as menu prices increase. With the cost for most goods moving higher this fall, dairy will have to compete mightily for a share of the consumer's wallet.

Overseas dairy prices are starting to tumble. U.S. dairy products are not immune to declines, and price drops at home could be more severe than in Europe given the greenback's strength. On Oct. 13, *Dairy Market News* reported that Western Europe's skim milk powder (SMP) ranged between €3,400 and €3,825/metric ton (MT). With a euro to dollar exchange rate of 0.9835, the SMP price would be equivalent to \$1.52 to \$1.71/lb. The Oct. 18 GDT SMP price fell 6.9% to 3,250/MT or \$1.47/lb. Typically, U.S. dairy prices maintain a discount to European and New Zealand products, thus U.S. prices could adjust lower to remain competitive. Some reports indicate that first-quarter 2023 EU-27 Cheddar cheese prices will near \$2.41/lb. While that's still above U.S. spot prices, it provides a gauge as to where prices could top out. U.S. prices, whether landed in Asia or elsewhere, will need to be competitive against weaker currencies.

Evidence is mounting that dairy product prices could be headed for a reset as the calendar turns to 2023. Today's lackluster demand could be incapable of absorbing the current level of dairy output, thus significantly lower milk prices could cause producers to reduce global production even further. **MCT**

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