

Return to Normal Unlikely

This past year will be one for the record books. The 2022 average Class III milk price will be the second highest behind 2014, and Class I, II, and IV prices will be the highest ever. CME spot butter prices reached a new all-time high and were the primary driver behind this year's record-setting milk prices. Cheese and nonfat dry milk powder (NFDM) prices, while elevated, fell just short of establishing new all-time highs. In the final weeks of trading, though, butter, NFDM, and whey prices were retreating, but cheese remained resilient despite data that suggested a demand slowdown was already in motion. While 2023 milk and dairy product prices could be less than 2022's, most analysts believe prices will not necessarily retreat to their five-year averages. However, a looming global recession, rising interest rates, high inflation, and uncertainty in China all suggest that dairy prices could run into headwinds in early 2023.



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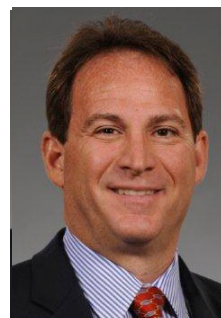
Recall that China's 2021 whole milk powder (WMP) demand was nothing less than stellar as the nation surpassed the record-shattering demand pace it set in 2020 by 35%. The nation's zero-Covid policy and rising internal milk production in 2022, however, took a toll on demand, with imports through November plummeting 18% below 2021's pace. China's imports of skim milk powder (SMP) suffered a similar fate, with volumes falling 24% compared to the first 11 months in 2021. Several factors drove China's decline in purchases, including growing domestic output of raw milk and stronger production of milk powders than in 2021. In April 2022, China's massive and widespread Covid lockdowns disrupted the supply chain, sending milk to dryers. While China's central government has quickly

rolled back aspects of its zero-Covid policy to prevent a severe economic downturn, few are optimistic Chinese demand will rebound in any significant way until at least spring, and possibly later, as the nation grapples with massive outbreaks of Covid and a rising death toll.

Russia's invasion of Europe's second largest country

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Ken's Corner



*by Ken Meyers
President, MCT Dairies Inc.*

As 2022 comes to an end, milk production in the Northern Hemisphere is once again rising, with both the United States and Europe producing more milk than they did last year. But it took months for dairy producers on both sides of the Atlantic to react

to 2022's record-high milk prices.

This is nothing new. Most of the time, just when dairy producers, spurred on by economic signals, have succeeded in increasing milk output, demand for milk and dairy products has started to slow. That's because the same high prices that convinced producers to expand have also worked their way through the supply chain to the consumer. And this year, cash-strapped consumers are contending with the worst inflation in decades.

Milk production will likely continue to grow until farm milk prices retreat, which could happen more quickly next year than the last time milk prices hit record highs in 2014. Back then, most producers enjoyed much better margins due to relatively modest costs for labor, parts, and feed. Today, prices on inputs are significantly more expensive, thus falling milk prices could put the squeeze on margins more quickly, convincing producers to cull their herds. And that could tighten the 2023 milk surplus as each month unfolds. **MCT**

2023 to Bring Reversal of Fortunes

On the precipice of 2023, dairy markets are moving mostly lower. CME butter prices, which are finally

following world prices lower, have dropped into the \$2.30 range for the first time in a year. CME whey

prices retreated to the 30-cent threshold for the first time since September 2020, and spot NDM markets appear set to follow Global Dairy Trade and European prices lower into the beginning of 2023. With 2023 Class III futures in the \$18-19 range and Class IV futures in the \$19-20 range, it appears next year could bring about a reversal of fortunes for dairy producers. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Dec	2.0550	1.8175	19.31	2.6500	21.66	0.4625	1.4600
Jan	1.9450	1.7750	18.34	2.3000	19.74	0.4500	1.4100
Feb	1.8700	1.7150	17.72	2.2850	19.41	0.4550	1.3800
Mar	1.8900	1.7500	18.01	2.3300	19.30	0.4550	1.3450
Apr	1.8800	1.8300	18.46	2.3900	19.68	0.4700	1.3600
May	1.9500	1.9575	19.44	2.4025	19.83	0.4750	1.3700

* CME prices.

**NASS prices.

...war's impact persists

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geographically continues to have a lasting impact on Ukraine and the world. The war in Ukraine sent fuel and energy prices soaring, adding to decades-high inflation that peaked in June and July. Since then, the inflation rate has dropped to 7.1% in November, but it remains high and has spurred the Federal Reserve to implement the most extensive interest rate hikes in recent history, sending the Fed Funds rate from 0.08% on Jan. 3, 2022, to 4.33% by late December. Interest rates that have risen to pre-Great Recession levels have slowed the housing market. Regular conventional gas prices have retreated from just above \$4.84 on June 13 to about \$2.99/gal., according to the Energy Information Administration. Despite declining gas prices, inflation has taken a toll on consumer spending, and many economists are expecting a global recession to further slow growth in 2023.

Dairy tends to be somewhat recession-proof domestically, but the same does not always hold true for overseas markets. A slowdown in overseas demand could cause U.S. dairy products to back up quickly, especially given that U.S. dairy exporters shipped record volumes overseas this year. The good

news for U.S. exporters, though, is that the cost of transporting goods has returned to 2020 levels, which should provide tremendous relief to importers next year. Furthermore, in early December, the ports of Los Angeles and Long Beach reported no backlogs, signaling that the supply chain continues to mend as slowing demand helps relieve multi-year congestion

On the environmental front, the European Green Deal sunrise on Jan. 1, 2023. While the impact to global dairy markets is unknown, most expect the policy shift away from animal agriculture and toward new on-farm practices to result in a dip in European milk supplies. USDA forecasts that Europe's milk supply could drop by 1.3 billion pounds, a 0.4% decline, compared to this year. Half a world away, the New Zealand dairy industry continues to negotiate with the government about a proposed environmental tax to offset dairy's impact on the environment. Regardless of that outcome, many analysts expect production growth from these two exporting powerhouses to slow as headwinds strengthen.

This year was anything but ordinary, and 2023 appears poised to take markets in a new direction—but a normal year appears to be no more than a remote possibility at this point. **MCT**



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