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MCTCOMPASS

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Distressed Producers Pull Back

This spring, just when it felt like cheese and milk markets could not roll backwards, they did. While milk supplies are currently far from overwhelming, milk could soon be burdensome given uncertain demand. The global supply-demand picture remains murky, making any sort of conviction about price direction difficult.

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Markets have remained in this morass for weeks, with buyers and sellers unable to find much data to be either bullish or bearish about. As a result, CME cheese and whey markets slowly moved lower throughout in May, returning to 2021 price levels over a matter of weeks. At the end of May, futures were forecasting Class III milk markets would remain in the $16/cwt. range through at least July.

While buyers and sellers have few opinions about market direction, global dairy producers are adamant that the current market price is too low to sustain milk production at the current rate. Dairying has quickly moved from breakeven to unprofitable, and some U.S. dairy producers indicate that margins are as bad as they were in 2009, given higher feed costs and dwindling milk prices. Once spring flush passes, culling will likely pick up as producers look to remove unprofitable cows from their herds—a 180-degree shift from last year when most cows remained in the herd to take advantage of high milk prices.

A consistent refrain from China to New Zealand and from Mexico to the United States is that lower prices are causing dairy producers to slow output and increase culling. This could result in less milk production in the second half of the year as markets move from expansionary to contractionary once again. USDA's April milk production report confirms that sentiment. April output of 19.2 billion pounds is up just 0.3% from last year. Some of the slowdown is weather related. California continues to struggle with milk yields following this winter's excessive rainfall and severe flooding. In addition, the U.S. dairy herd in April rose 0.28% compared to last year, suggesting expansion has started to slow considerably.

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Ken's Corner

by Ken Meyers
President, MCT Dairies Inc.

Today's overall dairy demand picture is positive, but retail food prices are still 23% higher than a year ago and that continues to be worrisome. As consumers funnel more discretionary income toward necessities, economists worry about the health of the overall economy. Most economists as of late-May believed the United States had yet to enter a recession but that a mild recession was still likely to occur this year.

After paying inflated prices for more than a year, tapped-out consumers are reining in their spending and managing purchases in one of two ways. First, they are looking for more value by taking advantage of promotions and sales, and second, they are reducing spending on nonessentials, including dining out.

If the economy worsens and layoffs increase, consumer behavior will continue to shift. A growing number of consumers will start eating at less-pricey restaurants and dine out less frequently. They will also seek out less expensive forms of protein, shifting away from artisan cheeses, for example, to less-expensive commodity styles. While dairy will remain a dietary staple in many countries, consumers in low-income countries will be more likely to shift away from animal proteins and toward more economical proteins, such as legumes, and fortified grains. **MCT**

Markets Flat on Stable Demand

Butter markets have been stable since the start of the year, with little variation in prices. CME spot butter markets climbed to $2.46/lb. before easing. Analysts and market participants expect spot butter prices to remain in the low-to-mid $2.40s for some time. CME nonfat dry milk prices have improved since April but remain vulnerable to pricing pressure. While prices at the Global Dairy Trade auction for skim and whole milk powders lifted in May, demand has remained lackluster, according to various reports. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
May	1.5975	1.5075	15.05	2.4275	18.10	0.3850	1.1575
Jun	1.5850	1.5225	14.89	2.4200	18.18	0.3550	1.1700
Jul	1.7900	1.6975	16.63	2.4350	18.36	0.3375	1.1825
Aug	1.8675	1.8050	17.56	2.4900	18.79	0.3400	1.2075
Sep	1.9775	1.8725	18.48	2.5075	19.08	0.3500	1.2300
Oct	2.0550	1.8975	18.94	2.5375	19.89	0.3425	1.3100

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

...slowing exports free up spot cheese

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Declining milk prices are encouraging dairy producers to slow output, but what caused cheese prices and ultimately milk prices to drop this spring? Since April, CME spot cheese volumes have exploded. Over the last two months, barrels traded 375 times, a volume not seen since 2018. While blocks traded fewer times than barrels, block cheese still traded 172 times. This level of trading brought considerable sell-side pressure to markets. Anecdotal reports suggest that exports have slowed to most areas except Mexico, but robust export volumes to Mexico were insufficient to offset declines elsewhere. This hit some western cheese makers hard, resulting in more cheese being available for the spot market.

Foodservice and retail demand remains uncertain. Reports from processor to processor and region to region vary. At retail, natural cheese performed well in April, with volumes up 0.9% for the 52 weeks ending April 30, compared to the same period a year earlier, according to Circana (formerly IRI). However, sales volumes for processed cheese, a large user of barrels, over the same period were 3.6% less than the previous year. Cheese snack kits performed well, up 11.1% over the same period in April, but processors now report slower sales and building inventories, and more spot cheese is available to the market. At the same time, the U.S. market is preparing for more cheese as a new plant in Texas begins production. The new facility is expected to ramp up production throughout the second half of the year, providing a growing stream of cheese to the market. If demand is steady to higher, the market should be able to readily absorb this cheese, In addition, U.S. cheese is competively priced, which could bolster export demand in the third quarter and beyond.

Since 2018, USDA has demonstrated time and again its willingness to reopen its buying programs when milk prices land in the $16/cwt. range. In the final days of May, USDA announced it would buy 15 million pounds of Mozzarella, 26 million pounds of block Cheddar, and 6.5 million pounds of barrel cheese. While details were still emerging at the end of May, this type of ongoing government intervention could help clear markets and lift prices again. **MCT**

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