

The KDM Dairy Report – Feb 17th, 2012

What's Bullish:

- The Daily Dairy Report this week noted that U.S. dairy cow exports reached an all-time high in 2011. Citing statistics from the Dept of Commerce, dairy cow exports totaled 73,639 head in 2011, nearly double the 37,356 head in 2010 and 4½ times the 16,209 head in 2009. Turkey was the largest importer, with nearly 50,000 going to that country.
- Dairy cow slaughter for the week ending 02/04 totaled 63,400 head, up 4,300 head during the same period last year.
- Weakening producer returns should begin reducing the herd size by the end of the year, according to USDA.

Futures Month	Class III 02/17	Class III 02/10	Change	Dry Whey 02/17	Dry Whey 02/10	Change	Cheese 02/17	Cheese 02/10	Change
Feb-12	\$16.07	\$16.08	(\$0.01)	64.50¢	64.50¢	0.00¢	\$1.540	\$1.544	(\$0.004)
Mar-12	\$15.68	\$15.63	\$0.05	57.50¢	57.00¢	0.50¢	\$1.538	\$1.535	\$0.003
Apr-12	\$15.63	\$15.80	(\$0.17)	51.85¢	53.75¢	(1.90¢)	\$1.570	\$1.575	(\$0.005)
May-12	\$15.92	\$16.12	(\$0.20)	49.25¢	51.00¢	(1.75¢)	\$1.611	\$1.620	(\$0.009)
Jun-12	\$16.10	\$16.46	(\$0.36)	48.48¢	49.75¢	(1.28¢)	\$1.643	\$1.672	(\$0.029)
Jul-12	\$16.40	\$16.65	(\$0.25)	47.93¢	47.25¢	0.67¢	\$1.665	\$1.700	(\$0.035)
Aug-12	\$16.52	\$16.73	(\$0.21)	47.25¢	47.28¢	(0.02¢)	\$1.682	\$1.712	(\$0.030)
Sep-12	\$16.53	\$16.80	(\$0.27)	46.25¢	46.25¢	0.00¢	\$1.695	\$1.730	(\$0.035)
Oct-12	\$16.54	\$16.83	(\$0.29)	44.00¢	45.00¢	(1.00¢)	\$1.705	\$1.722	(\$0.017)
Nov-12	\$16.39	\$16.62	(\$0.23)	45.00¢	46.00¢	(1.00¢)	\$1.695	\$1.721	(\$0.026)
Dec-12	\$16.40	\$16.66	(\$0.26)	45.00¢	45.95¢	(0.95¢)	\$1.692	\$1.730	(\$0.038)
Jan-13	\$16.20	\$16.50	(\$0.30)	40.00¢	40.00¢	0.00¢	\$1.714	\$1.721	(\$0.007)
12 Mo Avg	\$16.20	\$16.41	(\$0.21)	48.92¢	49.48¢	(0.56¢)	\$1.646	\$1.665	(\$0.019)

- Fluid Milk & Cream Review reports competition between cheese plants for farm milk contracts with dairy producers is heating up again in the Central region, with procurement premiums reportedly running above \$2/cwt in some areas.
- CWT announced Monday the acceptance of 36 requests for export assistance to sell 6.2 million pounds of cheese and 4.5 million pounds of butter to customers in Asia, Central America, the Middle East and North Africa. Product will be delivered from February through June, 2012. To date in 2012, CWT has assisted member cooperatives to export 23.2 million pounds of cheese.
- Exports: The Foreign Ag Service reported on a range of dairy exports for the 2011 calendar year. Exports of butter and milkfat totaled 140.3 million pounds, up 12% or 15.2 million pounds from the twelve month comparable period in 2010. Butter and milkfat exports accounted for 7.8% of butter production in the U.S. Exports of cheese and curd from the United States totaled 494.5 million pounds, the highest export total on record and a 29% increase over 2010. The exports account for 4.7% of total cheese production in the U.S.
- International: Though milk output in Oceania is well above year-ago levels, manufacturers and handlers of dairy products are indicating that stocks are basically fully committed to contractual and known needs. Manufacturers are also stating that the positive milk flow at this time is providing some cushion to the supply/demand balance, but also state that significant uncommitted stocks are not expected to be generated.

What's Bearish:

- Milk Production Report: January milk output in the U.S. surged 3.4% higher than a year ago. The large increase, no doubt helped by a temperate winter, was also due to 13,000 head added during the month, and a jump in milk per cow from 1,790 to 1,835. We start 2012 with 76,000 more head than last year. Only one of the top 23 milk producing states was lower (Vermont), and just by a fraction. Gains were led by UT up 8.6%, CO up 7.8%, AZ up 7.0% and CA up 6.6%. WI registered a 3.7% gain.
- Cash Market: Blocks gained 1¼¢ to settle at \$1.48¼/lb on 13 trades, but barrels were down ½¢ to \$1.48/lb on 3 trades and butter fell 1¼¢ to \$1.41½/lb on 10 trades. Grade A NFDM declined 4¼¢ on just unsold offers, settling at \$1.29¼/lb.
- Livestock, Dairy & Poultry Outlook Report: USDA lowered their 2012 Class III price forecast by 45¢/cwt from last month to \$17.05 avg for the year. Higher than expected milk per cow observed in Q4 of 2011 will likely continue through 2012. In addition, the mild winter is expected to benefit milk production, especially in Q1. As a result, milk production in 2012 is projected to be 1.4% above 2011 output.
- Dry whey prices are starting to see larger drops reflected in the weekly NASS survey. Dry whey fell 2.3¢ from last week's survey to average 64.1¢/lb. Butter decreased 4.9¢ to average \$1.50/lb, 40-lb block cheddar lost 2.8¢ to \$1.53/lb and 500-lb barrels gave up 1.2¢ to average \$1.53/lb.
- Fluid Milk East: The mild winter of 2012 continues to prompt increased milk production and adds to manufacturing milk supplies in the Northeast and Mid-Atlantic regions. Class I demand continues to be at levels below expectations for most balancing plants. Milk is moving into the Mid-Atlantic region from the Southeast and the Midwest at discounted prices. Florida's milk production continues to rise in spite of tighter hay supplies and declining pasture conditions, caused by the continuing drought. Class I demand has declined, increasing export spot loads this week to 133, up from 91 last week. The Southeast region also continues to see additional milk production increases. The additional milk supply has prompted the utilization of a few auxiliary manufacturing facilities.
- Fluid Milk Central: Central region milk handlers report farm milk pickups are steadily growing, running slightly ahead of the usual timing of seasonal increases. Spot loads of milk from the East are clearing into the Central region to find processing room. Some Central spot loads cleared as low as \$4 below Class.

- Fluid Milk West: Milk production trends show that the California milk production is building on a week-to-week basis and that total levels are several percentage points above a year ago. Conditions have been mostly favorable for milk cows. The overall milk supply levels are taxing the processing plants in the state, even more pronounced because there are limited outlets in nearby states for milk and components. Arizona milk output remains strong at the farm level. Processing plants are working at capacity levels on extended schedules to handle the building milk supplies. Handlers are finding few outlets for fluid milk, condensed skim, and cream. Western cream markets remain weak. The overall environment is characterized by heavy supplies and light demand.
- Packed fluid milk sales in December declined 3.9% compared to December 2010, according to Dairy Market News.
- Butter: Churning schedules across the country remain seasonally strong as cream supplies remain readily available to churns. Often, cream continues to move from one region to another to find churning capacity or willing buyers. Often, current churning activity is surpassing demand, thus clearances to inventory continue.
- Dry Whey East: Demand remains sluggish as most baking product manufacturers still consider it too soon to increase production for the Easter holiday. Ice cream production is increasing in some areas, those manufacturers are holding off major purchases in hopes that prices will move lower. Eastern dry whey manufacturers have increased inventories, but remain comfortable and do not feel they are burdensome. Export demand remains soft.
- Dry Whey Central: Central are unchanged to lower on a mixed market, with block sales capturing price discounts from one or two Central manufacturers. Several manufacturers note increasing dry whey production, on a week to week basis, due to steadily increasing volumes of milk available to Class III facilities. Buyer interest is light as downside price risk is a concern.
- Dry Whey West: Contract sales are making up the bulk of this week's transactions, but there are reports of some pushback from buyers. Increased cheese production is resulting in more whey product manufacturing. Lower spot prices are appearing into both export and domestic markets. There are increased reports of brokers lowering prices to move product. Following a lengthy period of tight supplies, there appears to be additional product being offered at lower rates for bulk buyers.
- Nonfat Dry Milk: Prices continue to trend lower and the market tone is weaker. Spot market offerings are being lowered to attempt at stimulating buyer interest. Resale offering prices are being discounted to move holdings. Market activity is very light, with some trade contacts stating the phones are quiet. Domestic interest is subdued because of low interest from cheese producers and because many brokers have holdings that they are not able to move to their customers. Export interest has slowed. Current drying schedules continue to move higher to balance the supplies of milk, while processors are not able to find adequate outlets for milk and components.
- Cheese Northeast: Cheese production has leveled off from recent increases, but inventories are increasing as sales remain sluggish. Cheese makers are increasing the amount of cheese they're putting into aging programs.
- Cheese Midwest: Some cheese manufacturers, already running 7 days a week at nearly full capacity to handle milk volume, are uncertain how they will handle increased milk production if the spring flush brings even more milk. Some manufacturers are uncertain whether exports will sufficiently increase to help move production. Some buyers are uncertain whether cheese prices have reached the lower end of expectations and are holding back from buying on that basis. There is some thought that cheese prices are near the short-term bottom, while other people are equally certain that prices are temporarily holding, before they will then move even lower. Milk supplies remain strong throughout the region. Surplus milk has been reported as occasionally selling at \$4.00 below class in Wisconsin and up to \$5.00 below elsewhere in the Midwest.
- Cheese West: Cheese plants are encountering increased milk or milk solid offerings. Plants are watching inventory volumes and have slowed production schedules in some cases. Sales are reported as moderate in most cases with mozzarella sales slower than hoped.
- Dairy prices at this week's Global Dairy Trade auction sank 3%, the largest decline since last September.
- International: European whey powder markets and prices are weak, according to Dairy Market News. Traders are stating that international sales are slowing, which is often typical when prices are trending lower.
- International: New Zealand milk producers and handlers are adjusting their annual milk output projections to be a little stronger than previously projected and are now setting those levels to be 4-5% ahead of last season. In Australia, the milk flow for this time of the season is stronger than anticipated. Producers and handlers are also adjusting their annual projections to be in the 3-4% higher range. Recent flooding conditions in Queensland and Northern New South Wales are not having an impact on milk output in the Victoria region.

Recommendation:

Spot cheese ended up being a stalemate this week as neither buyers nor sellers could really do anything. With a bearish production report and continued reports of heavy production across the country, upside would appear limited in the near term. Exports are a bright spot, and stocks in Oceania don't appear burdensome, which will provide some support for this market. We would continue to sell rallies in the Mar-Jun contracts as the flow of milk and increasing cow numbers will likely continue in the near term. We would not chase the 2nd half any lower at this point, although a 15.00 x 19.00 fence on 25% of your production would still be ok.

Note: Our offices will be closed on Monday in observance of President's Day. There will be no dairy trading at the CME Group on that day.

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