

The KDM Dairy Report – December 16th, 2016

What's Bullish:

- Spot Market: Blocks gained 9¢ for the week to settle at \$1.80/lb on 23 trades, while barrels jumped 12¼¢ to close at \$1.70/lb on 30 trades. Grade A NDM picked up 4¼¢ on 28 trades to settle at \$1.02/lb, a new high for the year and highest since Oct 2015. Butter finished the week 12½¢ higher on just 6 trades, to close at \$2.19/lb.

Futures Month	Class III 12/16	Class III 12/09	Change	Dry Whey 12/16	Dry Whey 12/09	Change	Cheese 12/16	Cheese 12/09	Change
Dec-16	\$17.32	\$17.10	\$0.22	39.750¢	39.250¢	0.50¢	\$1.795	\$1.776	\$0.019
Jan-17	\$16.95	\$16.68	\$0.27	42.475¢	41.300¢	1.18¢	\$1.738	\$1.713	\$0.025
Feb-17	\$17.14	\$16.88	\$0.26	43.125¢	42.175¢	0.95¢	\$1.750	\$1.737	\$0.013
Mar-17	\$17.35	\$17.01	\$0.34	43.600¢	41.025¢	2.58¢	\$1.762	\$1.742	\$0.020
Apr-17	\$17.48	\$17.00	\$0.48	43.875¢	42.250¢	1.63¢	\$1.775	\$1.745	\$0.030
May-17	\$17.50	\$17.05	\$0.45	44.125¢	42.250¢	1.88¢	\$1.775	\$1.753	\$0.022
Jun-17	\$17.55	\$17.25	\$0.30	44.125¢	41.750¢	2.38¢	\$1.781	\$1.769	\$0.012
Jul-17	\$17.62	\$17.48	\$0.14	43.550¢	41.750¢	1.80¢	\$1.792	\$1.786	\$0.006
Aug-17	\$17.66	\$17.60	\$0.06	43.750¢	42.100¢	1.65¢	\$1.803	\$1.802	\$0.001
Sep-17	\$17.75	\$17.65	\$0.10	43.750¢	42.500¢	1.25¢	\$1.796	\$1.804	(\$0.008)
Oct-17	\$17.63	\$17.47	\$0.16	43.750¢	42.000¢	1.75¢	\$1.793	\$1.787	\$0.006
Nov-17	\$17.44	\$17.30	\$0.14	44.900¢	41.800¢	3.10¢	\$1.777	\$1.765	\$0.012
12 Mo Avg	\$17.45	\$17.21	\$0.24	43.398¢	41.679¢	1.72¢	\$1.778	\$1.765	\$0.013

- Fluid Milk Northeast: Colder weather and snow has been common across some areas of the region. Farm milk output show minimal gains as wintery conditions slow production. Class I milk sales are good. Milk production volumes in the Mid-Atlantic states are mostly steady. Manufacturers' milk intakes are sufficient but below expected levels as some comment on volumes coming into their plants.
- Fluid Milk Southeast: Milk handlers in the region note balanced milk production. Strong Class I pulls should continue into next week. With little surplus milk available, manufacturing milk supplies are minimal to none. Bottling sales are slightly higher. The fluid cream market is firmer than market participants anticipated and supplies have been somewhat tight.
- Fluid Milk Central: Current farm milk production is slightly higher, following seasonal patterns. However, the winter storm Decima is expected to pass throughout the Midwest during the end of the week. Some dairy operators are anticipating a reduction in milk yields due to the upcoming wintry weather. A few Class III processors are looking for extra milk loads in order to support the active regional cheese production. Bottlers are decreasing milk orders as schools get close to the holiday break. Nevertheless, demands from retailers and food service are fair to good.
- Butter West: Cream is becoming more readily available as some Class II manufacturers wind down ahead of the holiday season. Butter makers continue to transition to bulk butter production or advance print production for the spring holidays. However, domestic butter demand is solid. Though manufacturers expect it ease back a bit over the winter holidays, some suggest demand may stay seasonally strong for some time. There has also been relatively good international demand for butter.
- Dry Whey Northeast: Prices are higher at the top of the range on a firm market. The market undertone is unchanged. Production levels are steady. Most of the eastern producers have little or no product to offer on the spot market. Inventories are in balance to tight, with some sold-out for several weeks.
- Dry Whey Central: Prices moved higher this week. Manufacturers report solid demand and dry whey is moving well through contracts. A lot of the 2017 contracts are now in place. However, a few buyers are delaying purchases, opting to work through inventories and waiting to see what direction the market takes after the first of the year. The overall market tone is firming.
- Dry Whey West: Prices are steady to higher, increasing on the top of the range and bottom of the mostly price series. Manufacturers report inventories are committed and tight through the end of the year. Dry whey production is steady, but some industry contacts suggest manufacturers are making more whey protein concentrations in lieu of dry whey. Export demand has been good and contracting for 2017 is progressing well.
- NDM East: Prices for low/medium heat nonfat dry milk increased in the mostly series on f.o.b. spot sales. Nonfat dry milk production is steady to slightly lower due to stagnant milk output in areas of the region and good Class I sales. Most Eastern low/medium heat NDM inventories are closely balanced.
- NDM Central: Prices are steady to higher in the range and higher through the mostly series. This week, spot markets saw a noticeable surge in trades. New NDM production trades at a premium in some cases. The market undertone is firm.
- NDM West: Prices for low/medium heat nonfat dry milk are mostly higher, mirroring upward movements on various indices. The market undertone is unsteady for some buyers/end users, but firmer for many manufacturers. According to some industry participants, higher international SMP pricing is boosting domestic prices. Inventories are steady to higher, but are highly committed thru the end of the year. In addition, some processors are holding stocks instead of selling, anticipating stronger prices in the short term.
- Cheese Northeast: Cheese output in the region is steady at moderate levels. Milk supplies are adequate with less surplus volumes available to local cheese plants. Process and mozzarella cheeses are holding at good levels, as fast food outlets and other restaurants are enjoying good business over the holiday shopping season.
- Cheese Midwest: Cheese makers report orders are still strong. Some manufacturers anticipated a slowdown in orders this week, but that has yet to be fully realized. A few cheese processors say they are slightly behind on orders or have been able to draw down on cheese stocks somewhat. Inventories for barrels remain a little long. Milk supplies are generally well balanced right now and extra spot loads are not widely offered.
- Cheese West: Cheese makers say they continue to fill holiday orders and some additional block demand. Domestic retail demand is solid. Cheese production is active with good volumes of milk flowing into cheese vats. Block cheese manufacturing is in good balance with current cheese demands and inventories are steady. Inventories for barrel cheese are a little long.
- CWT has accepted 13 requests for export assistance to sell 2.518 million pounds of Cheddar and Monterey Jack cheese, and 440,925 pounds of butter to customers in Asia, the Middle East, North Africa and Oceania. The product has been contracted for delivery in the period from December 2016 through March 2017.

What's Bearish:

- Weekly cold storage numbers indicate butter stocks at USDA-selected storage centers increased 16% (2.7 million lbs) over the period 12/01 through 12/12. Cheese stocks over the same period declined a seasonal 1%.
- Fluid Milk Southwest: Although rain showers associated with the winter storm Decima are present in some areas of California, farm milk output continues improving. Milk volumes are heavy and sufficient to keep balancing plants busy. Most educational institutions are reducing Class I requests as the upcoming holiday break is near. According to some industry participants, rains are helping newly planted forage crops to germinate. In Arizona, milk production is on the rise as cooler temperatures continue boosting cow comfort. Milk components are steadily improving. Milk intakes in New Mexico are more than sufficient to cover manufacturing needs. Also, some milk intakes are clearing into processing plants out of the state. Sales into Class I and Class II are lower this week.
- Fluid Milk Pacific Northwest: Milk production is seasonally strong. Industry contacts report plenty of milk is available for most processing needs. Bottling demand is steady to lower as educational institutions wind down prior to winter breaks. A lot of the milk freed up from fluid containers is finding its way into cheese vats. Milk production in the mountain states of Idaho, Colorado and Utah is robust. Cheese makers, in particular, are not having any trouble getting enough milk for processing. Some industry contacts report there are a few loads of milk available within the region at or slightly below Class III prices.
- Butter Northeast: Churning activity is light to moderate as cream supplies are exceptionally tight. However, cream volumes are likely to increase into next week, thereby encouraging heavier butter production. Holiday needs are now filled, although a few last minute immediate shipments are expected. Producers indicate demand is fair as the market is showing hesitancy in placing large orders in anticipation of additional price weakness. Cream buyers are also watching butter market prices and waiting for lower multiples. The market has a softer undertone.
- Butter Central: Most of the holiday butter production has been finished in the region. Cream availability for churning is higher as cream loads moving into Class II are waning. However, churners are not eager to buy spot cream loads, as their internal cream supplies are adequate. At this point, some manufacturers are switching butter supply from print to bulk. Inventories are starting to build into cold storage.

Recommendation:

Class III futures finished the week solidly higher, especially in the first half contracts. While we've seen some pull back from mid-week highs, support appears to be close by. NDM broke to new highs for the year while cheese and butter all finished higher in this week's spot market. Barrels, while still more plentiful than blocks, appear to be less burdensome than in recent weeks. Domestic demand is lasting beyond the typical holiday period, catching some off guard. There might not be much of a pull-back after the holidays. Why? There is a growing appreciation for production hurdles in the EU and Oceania that we've covered multiple times in this report. Meanwhile, export demand is on the rise. Many cheese plants are sold out through the rest of the year and now in to the first part of 2017. Domestic demand is strong. Optimism about a better and more quickly growing economy under a Trump administration has the stock market at or near all-time highs. When people's 401ks and retirement portfolios jump in value, consumer confidence grows. There's also been chatter that Russia may drop its ban on Western dairy products as a show of reconciliation with the new administration. Russia needs to lift the ban, if only because their own dairy industry cannot meet internal demand. The rally in the first half of 2017 has been particularly impressive. Just one month ago, the average settled at \$16.08 but finished today at \$17.33. Current spot prices work out to about \$17.25 Class III, putting it well over \$17.50 when factoring in NASS weekly survey premium. With January beginning its calculation period next week and closing at \$19.95 today, should cheese hold or go higher, that contract will need to rally to close the current discount to spot. Cheese prices may not have a lot of upside left from here in the near term, but equally, with stocks sold out and an inability to keep up with demand, there seems to be little chance for a dramatic fall either. We continue to be bullish in the long term and would not sell heavily. However, if Q1 contracts approach or exceed \$17.60, we would consider selling there. A reminder too that producers should not fall asleep on grain/feed costs. At current prices we believe there is more upside risk than downside. Producers should look to lock in their input costs, especially considering we are in a rallying milk market.

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