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The KDM Dairy Report – September 7th, 2018

SPOT MARKET	9/14	9/21	Change	Trades
Cheddar Blocks	$1.6050	$1.6350	$0.0300	0
Cheddar Barrels	$1.4200	$1.3600	($0.0600)	28
Butter	$2.2350	$2.2350	$0.0000	23
Grade A NDM	$0.8750	$0.8725	($0.0025)	16
Dry Whey	$0.5225	$0.5150	($0.0075)	1

Futures Month	Class III 09/14	Class III 09/21	Change	Dry Whey	Dry Whey 09/21	Change	Cheese 09/14	Cheese 09/21	Change
Sep-18	$16.11	$16.14	$0.03	39.825¢	41.000¢	1.18¢	$1.659	$1.655	($0.004)
Oct-18	$16.26	$16.04	($0.22)	42.525¢	44.000¢	1.48¢	$1.653	$1.628	($0.025)
Nov-18	$16.31	$16.37	$0.06	44.100¢	45.275¢	1.18¢	$1.655	$1.655	$0.000
Dec-18	$16.12	$16.24	$0.12	43.975¢	45.675¢	1.70¢	$1.632	$1.640	$0.008
Jan-19	$15.92	$16.02	$0.10	42.750¢	43.600¢	0.85¢	$1.620	$1.629	$0.009
Feb-19	$15.80	$15.88	$0.08	41.500¢	42.325¢	0.83¢	$1.625	$1.628	$0.003
Mar-19	$15.82	$15.95	$0.13	39.850¢	41.000¢	1.15¢	$1.634	$1.641	$0.007
Apr-19	$15.95	$16.08	$0.13	38.825¢	39.975¢	1.15¢	$1.650	$1.659	$0.009
May-19	$15.94	$16.06	$0.12	39.050¢	39.600¢	0.55¢	$1.661	$1.659	($0.002)
Jun-19	$15.99	$16.10	$0.11	38.825¢	38.425¢	(0.40¢)	$1.670	$1.672	$0.002
Jul-19	$16.19	$16.32	$0.13	38.050¢	39.025¢	0.98¢	$1.690	$1.690	$0.000
Aug-19	$16.36	$16.46	$0.10	37.250¢	38.250¢	1.00¢	$1.705	$1.705	$0.000
12 Mo Avg	**$16.06**	**$16.14**	**$0.07**	**40.544¢**	**41.513¢**	**0.97¢**	**$1.655**	**$1.655**	**$0.001**

What's Bullish:

- Livestock Slaughter Report: About 280,000 dairy cows were removed from the milking herd in August, up 5.3% vs. a year ago, and the highest monthly total for August in more than 12 years.
- Livestock, Dairy & Poultry Outlook Report: As a result of expected tightness in dry whey supplies, which is expected to last into the first part of 2019, USDA has revised the Class III price forecast higher. They now expect a 2019 average of $15.70/cwt.
- Dairy cow slaughter for the week ending 09/08 totaled 57,300 head, up 5.7% vs. the same period a year ago.
- Cheese stocks at USDA-selected storage centers declined 1% (806,000 lbs) over the period 09/01 through 09/17. Butter stocks over the same period fell 5% (2.4 million lbs).
- Fluid Milk Northeast: Milk production is lower as intermittent hot and humid weather conditions continue to take a toll on cow comfort. Market participants report milk clearing into Class I is level to higher. There are reports of active Class II production schedules as some manufacturers are getting ahead of the baking season. Class III milk needs are stable to a bit lower this week. Mid-Atlantic milk output off the farms is lower. Manufacturers' production schedules vary throughout the area as some operations are not receiving enough milk for production needs.
- Fluid Milk Southeast: Hurricane Florence has impacted parts of the region with heavy flooding. There have been reports of power outages and roads closures due to the storm. Some operations are closed at this time. In other parts of the Southeast, where the Hurricane didn't hit as hard, operations are running fairly smoothly. Florida's milk production has leveled off. There are multiple reports of very tight cream availability this week. Milk production is fairly level, yet there have been little to no signs of milk rebounding off the farms. Class I sales are still strong and Hurricane Florence has negatively impacted transportation and manufacturers' production schedules. A few Eastern operations cream needs are very high and have sourced in other regions to buy cream. Condensed skim availability is tight this week as milk volumes are lower. Sale activity is active and market participants report condensed skim spots loads have been hard to come by this week.
- Fluid Milk Central: In most areas, milk volumes remain lower. Bottling remains steady to stronger with schools back in session. Most Class III spot milk loads reported ranged from $.50 to $2.00 over, although some cheesemakers took on loads at Class. Cheesemakers also reported that spot milk offers were lighter this week. Cream has tightened up for Central region processors. Contacts report that cream cheese production in both the Midwest and Eastern regions is taking off ahead of the fall season. Additionally, ice cream manufacturing remains in the mix.
- Fluid Milk Southwest: California milk production is just enough to meet the needs of buyers. Some reports suggest that milk premiums have increased recently. Limited hauling capacities continue to affect the handling of milk volumes in California. Milk supplies in Arizona are manageable even though handlers have to look for alternative ways to redistribute fluid milk loads. Repair and maintenance schedules have disrupted normal activities at some manufacturing plants and caused a decline in daily milk intakes. In New Mexico, farm milk production is flat to increasing following normal seasonal output rates. Bottled milk sales inched up this week as Class I demand is higher. More loads of milk are moving from New Mexico to the Southeast region to fulfill short term needs. However, hauling capacity is limiting the volumes of milk that are being transported to that region.
- Butter Northeast: A strong butter market persists as butter manufacturers gear up for Q4 demand. A few butter manufacturers are maintaining their stock levels by undertaking both micro-fixing and new production to meet their needs. Scheduled plant maintenance activities and the pull from Class II cream needs prompt slightly lower butter output at some plants this week. Industry contacts see retail sales as on pace with the previous year.
- Butter Central: Cream availability has lightened up for butter makers in the region this week. Due to adverse milking weather and cream being pulled toward increased cream cheese production, butter plant managers suggest cream offers dwindled relative to the past two weeks. Butter sales reports continue to be mostly bullish. A number of intake facilities, including butter plants, are or have been closed in the Central region due to flooding or scheduled maintenance. Butter market tones are bullish.
- Butter West: Butter makers say they have adequate amounts of cream and that bulk butter demand has softened. However, retail demand is starting to build, and some manufacturers say retail butter forecasts look strong for the fourth quarter. Inventories are slowly declining as demand surpasses production.
- Dry Whey Northeast: Market participants are regularly purchasing off contracts, the spot market and various pricing indices. Dry whey prices have increased as buyers' demands are stable and manufacturers' supplies are balanced to tight. Dryers are fairly active, but with lower milk volumes clearing into Class III, dry whey inventories are lower. A few manufacturers are very short on stocks and do not have an adequate amount to sell to their contracts. The market tone is firm.
- Dry Whey Central: Prices in the region were steady to higher on an active trading week. Milk is not as accessible to cheese and whey producers, many of whom are on lighter production schedules recently. Balanced to tight are what many contacts report regarding dry whey inventories.

- Dry Whey West: The market undertone is still strong despite concerns about global trade agreements and their potential repercussions on the whey market. Overall, dry whey production is unchanged from a week ago, and according to a number of market participants, stocks are tight. Sales are generally solid.
- NDM Northeast: Buyers are uncertain about prices and are waiting to see where market conditions lead. However, NDM drying time is currently lower as Class I demand is still clearing more milk volumes to school pipelines. In addition, some manufacturers are not receiving enough milk for their production needs.
- NDM Central: Mexican demand continues to outpace domestic interest. Some producers have suggested they are tight and/or even behind on orders. Additionally, condensed skim has tightened in the Central and Eastern regions, so if demand from south of the U.S./Mexican border continues, there is the possibility of continued firmness on the nonfat dry milk market.
- Cheese Northeast: Intermittent hot and humid weather conditions continue to take a toll on cow comfort. Milk volumes clearing into cheese vats are steady to lower, as other Class needs are being met at this time. Mozzarella and provolone cheese production is fairly active. Regular orders have improved with the opening of educational institutions. Fresh cheese supplies are somewhat limited as the demand is keeping inventories stable.
- Cheese Midwest: Cheese sales have slipped for some cheese producers in the Midwest. However, cheese contacts expect a propitious return to positivity near term. They suggest increased sales, new/growing customer bases and more balanced cheese supplies are all favorable for a return to form and in creating less apprehensive buyers. Milk availability is still lower for cheesemakers depending on locality.
- Cheese West: Some cheese manufacturing facilities are working at full capacity to process all the milk available to them. However, cheese inventories, although abundant, are not burdensome. Domestic cheese orders are solid. While some processors say that the current sales fit their expectations for this time of the year, others state that they exceed their expectations. Pizza makers are taking on more cheese since the reopening of schools. International cheese demand is generally good.
- Foreign Cheese: In Germany, milk components remain unusually low and continue to have an impact on total cheese output. Cheese offers are enough to fulfill most end users/buyers' demand, but inventories are at lower levels and are characterized by a young age structure. In general, prices are expected to increase.
- CWT accepted nine offers of export assistance to sell 1.462 million lbs of Cheddar cheese and 8.845 million lbs of whole milk powder. The product has been contracted for delivery in Asia, Central America, the Middle East, and North Africa for the period from September 2018 through March 2019.

What's Bearish:

- Milk Production Report: U.S. milk output in August increased 1.4% vs. a year ago, while cow numbers increased 5,000 head from July. Both numbers were above most analyst expectations.
- This week's GDT auction saw the dairy price index decline 1.3%. The index has now fallen 7 of the last 8 auctions. Cheddar cheese led the way lower, falling 3.5% to a US-equivalent $1.59/lb.
- Fluid Milk Pacific Northwest: Pleasant temperatures are promoting cow comfort and components are improving. Intakes are in good balance with processing. Most manufacturers are running near capacity. Bottling demand is steady. Strong milk production in the mountain states of Idaho, Utah and Colorado is continuing. Warm days and cool nights are helping cows recharge fully. Industry contacts say forages are in good supply.
- NDM West: The market is transitioning from being firm to being somehow unsettled, mainly because NDM supply is surpassing its demand. Some buyers/ end users are taking a wait and see approach, anticipating lower prices for Q4. Meanwhile, NDM/SMP requests from Mexico remain strong as this country has a low farm milk production at this moment. Back to western U.S., large volumes of condensed skim milk continue clearing into dryers. Therefore, NDM inventories are slightly higher from the previous week.

Recommendation:

Another report suggesting bullish fundamentals have the upper hand. But when will prices react? Barrel cheese gave up another 6¢ in this week's spot market, widening the spread with blocks to 27½¢. It's only been wider 3 times in the past, and neither lasted very long. With cheese demand generally strong, it would suggest barrels will need to increase, more than blocks decrease. The tough stories about more dairies in the Midwest under financial stress continue to make news, and it's our perception that unprofitability has hit a much larger swath of operations than just the smallest. Slaughter numbers were very strong in August. Meanwhile, it appears that Canada may offer some concessions to dairy as NAFTA negotiations continue to make headway, and China is once again back at the negotiating table. Class III futures were mostly flat to lower much of the week, but saw decent volume and double-digit gains in most 2019 contracts during Friday's trade. To us, it looks like it could be long-hedging against rising input costs by commercial entities. That's a good sign. It means that they believe this is a good place to cover their inputs as the risk to the upside may be higher than any downside that is left. It will be interesting to see if this trend continues next week. We still recommend dairy operations limit sales/hedging in 2019 as it seems prices are getting set to increase further.