

The KDM Dairy Report – December 7th, 2018

SPOT MARKET	11/30	12/7	Change	Trades
Cheddar Blocks	\$1.3600	\$1.3500	(\$0.0100)	3
Cheddar Barrels	\$1.3150	\$1.2225	(\$0.0925)	8
Butter	\$2.2425	\$2.2075	(\$0.0350)	10
Grade A NDM	\$0.9050	\$0.8850	(\$0.0200)	6
Dry Whey	\$0.4350	\$0.4375	\$0.0025	13

Futures Month	Class III 11/30	Class III 12/07	Change	Dry Whey	Dry Whey 12/07	Change	Cheese 11/30	Cheese 12/07	Change
Dec-18	\$13.98	\$13.76	(\$0.22)	44.875c	45.625c	0.75c	\$1.411	\$1.377	(\$0.034)
Jan-19	\$14.40	\$13.98	(\$0.42)	42.800c	45.050c	2.25c	\$1.462	\$1.410	(\$0.052)
Feb-19	\$14.72	\$14.41	(\$0.31)	39.750c	42.175c	2.43c	\$1.513	\$1.468	(\$0.045)
Mar-19	\$14.99	\$14.81	(\$0.18)	38.300c	40.525c	2.23c	\$1.552	\$1.520	(\$0.032)
Apr-19	\$15.37	\$15.21	(\$0.16)	37.900c	40.000c	2.10c	\$1.589	\$1.565	(\$0.024)
May-19	\$15.56	\$15.46	(\$0.10)	37.400c	38.700c	1.30c	\$1.617	\$1.597	(\$0.020)
Jun-19	\$15.73	\$15.71	(\$0.02)	37.100c	38.000c	0.90c	\$1.634	\$1.626	(\$0.008)
Jul-19	\$16.05	\$16.00	(\$0.05)	37.250c	39.000c	1.75c	\$1.668	\$1.658	(\$0.010)
Aug-19	\$16.30	\$16.25	(\$0.05)	37.000c	38.250c	1.25c	\$1.688	\$1.684	(\$0.004)
Sep-19	\$16.52	\$16.49	(\$0.03)	37.350c	38.025c	0.67c	\$1.710	\$1.704	(\$0.006)
Oct-19	\$16.42	\$16.39	(\$0.03)	38.000c	38.000c	0.00c	\$1.702	\$1.699	(\$0.003)
Nov-19	\$16.33	\$16.33	\$0.00	37.675c	38.000c	0.33c	\$1.695	\$1.695	\$0.000
12 Mo Avg	\$15.53	\$15.40	(\$0.13)	38.783c	40.113c	1.33c	\$1.603	\$1.584	(\$0.020)

What's Bullish:

- Dairy cow slaughter for the week ending 11/24, totaled 50,900 head, up 5.2% vs. the same period a year ago.
- Fluid Milk Northeast: Milk output is mainly flat in the region, with some manufacturers not at capacity. There is little to no milk leaving the Northeast at this time. Mid-Atlantic milk output is flat to slightly lower. Balancing facilities are clearing lower milk volumes this week, due to other Classes' immediate needs. There is capacity in many operations currently.
- Fluid Milk Southeast: Milk production is level to lower this week. Some market participants communicate being short on milk for Class I due to the bottlers' strong orders. Florida milk output is increasing at a steady pace, but some market participants report some facilities might be a little short on milk this week.
- NDM Northeast: Spot NDM prices remain strong. Domestic interest is fair, but export interest to Mexico is active. Stocks range from fully committed and light, to readily available.
- NDM Central: Trading activity was steady to busier on the spot market, as Mexican buyers are showing increased interest. Some traders suggest Q1 2019 contracts are in the works and/or wrapping up at +\$.90. Contacts in the Midwest suggest newly produced loads are tight. The current NDM market tone is firm.
- NDM West: Prices increased this week. The market tone is stable with firm underpinnings. Sales in the domestic market are stable as buyers refurnish their stocks for the holidays while demand from Mexico remains solid.
- Foreign Cheese:
- CWT accepted 33 offers of export assistance to sell 4.028 million lbs of Cheddar, Gouda and Monterey Jack cheese, 1.340 million lbs of butter, and 705,479 lbs of whole milk powder. The product will be delivered during the period December 2018 through May 2019.
- International: Milk production in Western Europe is varied by location. In some of the major milk producing countries, official reports of September milk production lagging last year's volumes have not improved much. In some areas, milk production is slowly moving up from the seasonal low but is still not breaking out of 2017 volumes. A factor that is causing concern is lower feed stocks and the lower quality of stocks available. The recent drought or dry conditions led to heavier use of existing feed and poorer crop harvests. A result is that the dairy industry heads into winter with less, and poorer quality feed than is desired. Concern for the possible outcome in milk production is evident.
- International: Cheese supplies are tighter in Europe. Brisk end of year holiday demand persists, keeping retailers replenishing coolers. Cheese inventories are being drawn lower to keep up with sales interest. Demand is also strong from restaurants, as people have increased dining out at this festive period of the year. The demand trifecta is completed by stronger export interest, due both to the typical preference for European cheese from some destinations, as well as recent weakness of the euro.
- International: Skim milk powder prices in Europe have firmed, with pricing is higher than one year ago. Many buyers of SMP used within the EU are regular long-term users. They want to have supply assurance while attempting to impose some price certainty. Recent declining milk availability in Germany, France and Netherlands has increased uncertainty as to new production SMP short term supplies and prices. Thus, these buyers have been actively concluding deals for SMP in recent weeks to cover needs for the next few months.
- International: October milk output in Australia fell 5.7% vs. a year ago, putting YTD (July-Oct) production down 4% compared to last season.
- This week's GDT auction saw the dairy price index increase 2.2%. It was the first increase in the last 13 auctions.

What's Bearish:

- Dairy Products Report: Total cheese output in October was 3% higher than a year ago, according to USDA. American cheese increased 0.7%, while butter output declined 0.3% over the same timeframe. Dry whey output increased 8%, most likely a result of higher cheese production.
- Fluid Milk Central: Milk production in the Midwest is up from recent weeks. Declining feed quality has some contacts suggesting milkfat volumes are lower than in recent years, but is still sufficient. Bottling demand is slower than expected this year, and milk loads are not short of most processing needs in the region. Cheesemakers are reporting spot milk prices from \$1 over to \$3 under Class. Cream loosened up a bit this week. Some contacts suggest next week may be the last push for holiday manufacturing. As such, they suggest cream will be more widely available over the next two weeks.
- Fluid Milk Southwest: California milk production is steadily increasing. Temperatures remain favorable for cows, giving a small boost to milk output levels. Processors are able to keep up with dairy product production schedules. In Arizona, milk output is slowing rising, but remains lower than that of last year. Some loads of milk are moving out of state. Balancing plants are running as usual. In New Mexico, adequate milk supplies are available for filling current needs.

- Fluid Milk Pacific Northwest: Milk production remains strong. In some pockets, milk handlers note a slight upturn in production due to favorable weather conditions and availability of good feedstocks. Many manufacturers are running full production schedules and are not having any difficulties getting the milk needed for processing.
- Butter: Churning is active across the country, as seasonal demand continues to be good, but stocks are adequate to meet customers' needs. The amount of cream offers has escalated, and prices are slightly lower than last week. International butter demand is slow due to expensive U.S. butter prices compared to the rest of the world.
- Dry Whey Northeast: Some market participants are purchasing spot loads at lower prices this week. Production is steady to a bit higher, as there are reports of more milk clearing into Class III intakes.
- Dry Whey Central: Some local buyers have said that even with higher freight costs they can get lower prices from Western suppliers. Thus, some Central manufacturers have begun to increase production schedules. While supplies are not overly abundant, buyers are hesitant and/or supplied, thus creating a bearish tilt on the dry whey market tone scale.
- Dry Whey West: Some industry contacts suggest whey supplies are more readily available in the West than other regions. Overall, however, whey stocks are still snug. Whey production took a sizeable jump in October in response to favorable prices.
- Cheese Northeast: Milk availability for Class III is steady to higher, as some cheese plants are receiving more milk loads currently. Cheese sales managers report orders from pizzerias for mozzarella and provolone cheese are good. Moreover, retailers' cheese orders are stable to increased, as customers are actively purchasing cheese from grocers. However, cheese supplies are adequate to fill all contract requests at this time.
- Cheese Midwest: Contacts suggest regional cheese volumes are plentiful overall. They say some buyers are holding off, awaiting the potentiality of further market bears. Some cheese plant managers are still taking on milk at a discount, while others have said regional milk is a little tighter. Reported spot milk prices range from \$1 over to \$3 under Class III. Cheese markets remain stagnant, with many contacts pointing to export declines and high cheese inventories as market agitators.
- Cheese West: Contacts suggest export cheese demand ebbs and flows with the rise and fall of national prices. With U.S. cheese prices lower than a few months ago, there has been some renewed interest from international buyers. However, some foreign cheese prices have declined along with U.S. cheese prices, creating stiff competition in a few markets. Domestic demand has been steady but, here too, there is pressure caused by heavy cheese stocks at all market levels. Industry contacts say there is plenty of cheese in warehouses to meet most end user needs. As a result, buyers have no sense of urgency to make immediate purchases. Instead, they would rather focus their energy on 2019 contracts. Cheese production is heavy and related to plentiful milk intakes. Many manufacturers are running their facilities at or near full capacity to keep up with milk flows.
- International: The October 2018 increase in milk production was the highest monthly increase in the recollection on a number of New Zealand dairy officials. October 2018 New Zealand milk production was up 6.5% from October 2017. October 2018 milk solids also increased 6.5% YOY.

Recommendation:

Last week we highlighted the current record amount of cheese in storage, so this week, our featured graph is our record cheese output in October. Despite low milk prices and hardships on the farm, our warehouses are stuffed full of cheese, and manufacturers, particularly in the West, are still running on full schedules. We're hearing that most holiday buying is done, so this could be problematic in the near term. Futures are concerned as well, with the Jan and Feb contracts taking the bulk of the losses this week. And no wonder. Barrel cheese lost 9¢ while blocks gave up a penny and butter and NDM declined too. The block/barrel average of \$1.29/lb is the lowest it's been since it hit \$1.28 on May 10th, 2016, and it was only there briefly (2 days) before a strong rally. Prior to that, you have to go all the back to March 2010 when we hit \$1.27. Somehow, this time, it feels like we might sit here a while, or go even lower. While cow numbers are coming down, nothing happens overnight. 2019 will be here soon, followed by freshening cows. Q1 could be ugly. Current spot prices work out to about \$12.95 Class III (using Jan whey). Even accounting for basis in our weekly survey numbers, it brings us to just under \$13.50. With the Jan contract beginning its calculation in a week and carrying nearly \$1 premium to spot, more price erosion could happen. Producers should sell Jan and Feb on any rally. On the positive side, assuming we start seeing some \$13 settlements for the next 2-3 months, we believe the dairy herd exodus will pick up speed in a big way. Jun-Dec futures did not lose much this week, and rightfully so. Things will likely look much differently by then. Producers with milk sold in these months should get their upside protected using call options or multiple option strategies.

