

CHEESE MARKET NEWS®

The Weekly Newspaper Of The Nation's Cheese And Dairy/Deli Business

Volume 30

September 17, 2010

Number 34

GUEST COLUMNIST



CMN Exclusive!



Perspective: Dairy Markets

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Why is butter trading in the \$2.20s?

The butter market has had the perfect set up for higher prices this year. A number of influencing factors have contributed to the 100 percent increase in price since February 2009, including an active export market, Cooperatives Working Together (CWT) assistance and overall global trade. One of the main contributors, though, has been reduction of supply on the farm.

While U.S. milk production has been on a steady rise, butterfat yields have been coming in historically low percentages. Some dairy-farm nutritionists attribute the low butterfat values to the tighter budgets on dairy farms, with lower quality/less-expensive feed going to the herd. While butterfat content seasonally comes off in the summer months, this year's hotter weather catalyzed the reduction as well. In addition, recent culling prices have provided an incentive to replace old cows with younger ones. In turn, the farm receives lower component values and butterfat percentages until the cow is fully mature. As the herds age, component values and butterfat content should rebound.

Not only has the lower milkfat content been an issue domestically but also in other major milk-producing regions around the world such as the European Union (EU). In the EU, the strained butterfat content in milk moved to less cream to the churn, which was one of the reasons that allowed the EU intervention program to

release butter stocks (more than 20,000 metric tons) into a rising market without tampering with the price.

Another factor attributing to the butter market strength has been the weak(er) nonfat dry milk (NDM) market over the last two years. The average National Agricultural Statistics Service (NASS) NDM price since January of 2009 has been \$1.02; the average NASS butter price has been \$1.36 in the same time frame. The lower nonfat (and not-fat solids) prices have led many cheese manufacturers to add nonfat solids to the recipes rather than shedding cream to come up with the appropriate proportion of fat for the cheese. In turn, this reduces the supply of cream in the market, which reduces the supply of cream that can find its way to the butter churn. Now, the reduction of supply that once started on the farm also has moved to the manufacturing side of the equation.

Further, exports — without CWT's assistance earlier this year and with CWT recently — have soared. Tight global supplies of fat combined with a discounted U.S. price compared to the EU and Oceania for the first half of the year allowed U.S. exports to bounce back from 2009 levels. According to USDA data, January through July exports are 260 percent higher than they were last year during the same time period. Additionally, in dairy-producing regions outside of the United States, production

has been strong in whole milk powder, which pulls in a large portion of milkfat (which takes away a large amount of fat that could have been used for butter or butter products). Additionally, various regions around the world such as Russia — which has suffered from drastic reductions in production — increased butter imports from previous years.

In the second half of the year, the timing of the CWT assistance for butter and butter products came at a time of year that is typically a "lag" period before holiday demand comes in. This means that though product has been committed toward the CWT orders, some holiday buying has yet to come to the butter market. Additionally, CWT assisted on a substantial quantity of product, nearly 30 million pounds of butter and anhydrous milkfat.

The U.S. and EU butter prices are very close to parity. Additionally, on Sept. 15, Global Dairy Trade released auction prices of an anhydrous milkfat-adjusted butter equivalent near \$1.92 for November delivery. The auction at the first of September had the price released at \$1.70.

With a pullback of fat content in milk combined with a very strong export market as well as numerous factors leading to a reduction of butter supply, we now sit at a Chicago Mercantile Exchange butter price of \$2.2225 per pound as of Thursday, a 67 percent year-to-date price increase and the highest price since 2004. CMN

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