As published in

Nutrition Line

Dairy demand questionable for balance of 2011

After launching his career with Cargill Investor Services in the livestock pits on the floor of the Chicago Mercantile Exchange, Dave recognized the potential of the emerging milk and butter futures market and joined Downes–O'Neill LLC, now a division of FCStone group, in June of 2002. As Senior Broker, he plays a critical role in assisting dairy producers, processors and end-users in managing their Class III and Butter price risk. Dave has authored articles for such publications as The Progressive Dairyman, Dairy Field and Cheese Market News among others and is often called on by Dairyline Radio and Brownfield Ag Radio for his market opinion. Dave earned a B.A. degree in Economics from Loras College in Dubuque, Iowa.

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I'll be the first to admit that August is typically a very slow month for commodity markets. Normally the dog days of summer serve as the quiet before the storm of fall market volatility. But the "norm" has been largely defeated with this summer's $2.00 cheese market.

So far this summer, the news seems constant and bleak. Daily discussions seem to haplessly jump from drought to downgraded debt ratings to a host of other global macro-economic maladies that leave many people lurching for the Maalox in lieu of afternoon lemonade.

Unfortunately, the usually insulated dairy markets have not avoided the uncertainty.

For U.S. cheese prices, there were several contributing factors promoting a $2.00 lb. market since early June. For one, domestic demand remained somewhat robust through mid-year as $4.00 gasoline took several months to impact spending habits. International demand too remained strong well into mid-year as the U.S. dollar continued to spur global commodity interest. Perhaps most important, however, was that U.S. cheddar cheese production capacity was compromised.

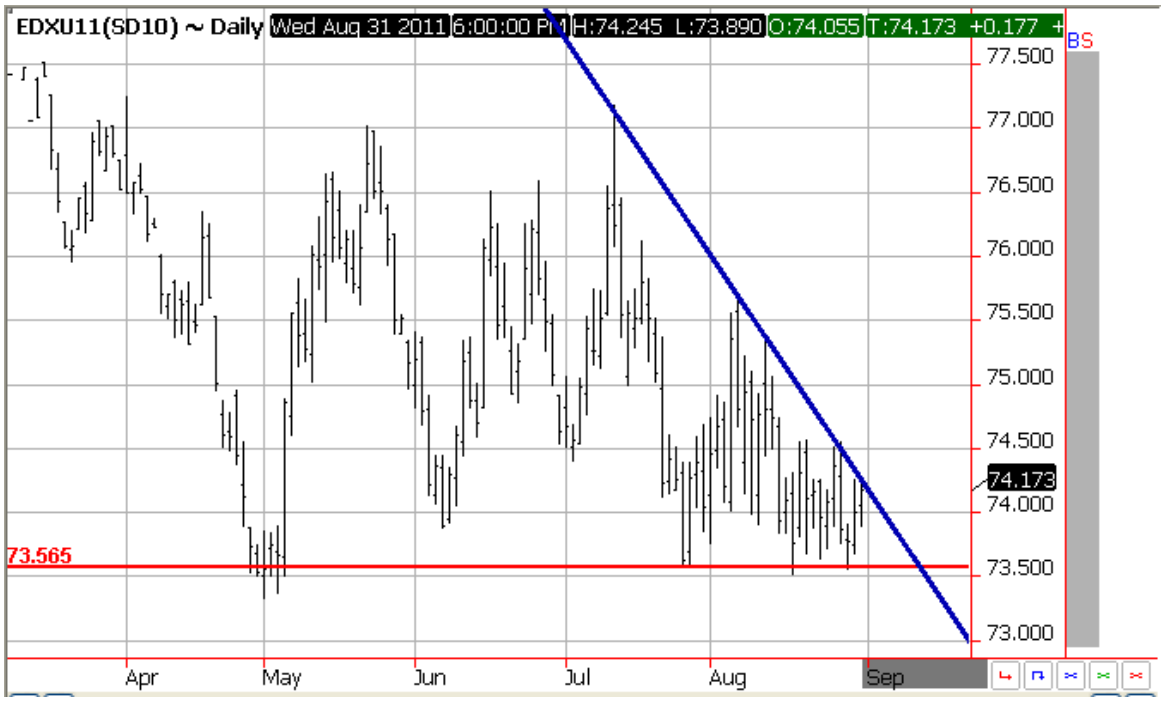
Problems in plant operations, lofty dry whey prices, milk pull from butter/powder plants and milk pull to other types of cheese all had a hand. In addition, Mother Nature topped off the bullish cocktail with oppressive heat and humidity which has stunted milk production growth in the upper Midwest. But that all appears to be changing.

As the upper Midwest weather cools and New Zealand ramps up for their peak milk producing season, demand will be the name of the cheese pricing game through year-end. Market participants are clearly focusing on international dairy price weakness of late and weighing our ability to compete globally at higher price levels. They're also following closely the good, bad and unthinkable of Europe and China's economic growth potential.

Few, however, are considering the very real possibility that any U.S. dollar strength would potentially jeopardize export sales and higher dairy prices from Q4 well into 2012.

We in the commodity world have leaned hard upon Mr. Bernanke's weak dollar policies presented to Americans for quite some time now. And while there doesn't seem to be much reason today to doubt a pro-business, low-interest rate environment to be augmented by another round of currency-deflating money-printing by the U.S. Federal Reserve, be careful not to lean to hard.

Although bullish dollar news is in short supply today, there is potential for a significant rally of the U.S. dollar – and in short order. The dollar boat is profoundly tilted with market bears and it's getting ready to tip. From a technical perspective, the market is at a very pivotal point and should the dollar soar as I expect, there will be another round of pressure for commodity prices.



U.S. Dollar Weekly Index

Looking ahead, few end-users of cheese will disagree that buying cheese at a $1.70 lb. price level is much more palatable that $2.00. Remarkably, 2012 Class III futures have remained perched at approximately that level since late July despite the recent cheese price and the nearby futures volatility.

Value-buying from commercial hedgers underpins the market as they understandably want to avoid the pain felt this summer. While that would normally be a good thing for proactive, risk management-minded dairy producers because prices tend to rise when buyers get worried – the $7.00/bu corn and $300/ton hay you're paying make it difficult to bring home profits today.

Higher prices are just now being passed along to U.S. consumers. And with little promotion occurring for the next several months, demand may be on shaky footing. Add a stronger U.S. dollar to the mix and more demand destruction abroad and the justification for high-priced milk (and corn, hay and meal) dissipates and lower prices ensue once again.

So while it is difficult to find and capture profit margin for your dairy, be vigilant. Educate yourself and when opportunity arises, use tools to manage your dairies profitability.

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