

Dairy Margin Watch: December



Dairy margins were flat over the second half of December with limited movement in the milk and feed markets to close out 2018. While nearby margins continue to reflect losses through Q1, deferred margins are holding up better, with both Q2 and Q3 at or near the 70th percentile of the previous ten years, and Q4 just beneath that level. The forward curve continues to reflect optimism over improving fundamentals for milk supply and demand, with deferred futures holding a \$3.00/cwt. premium over spot prices based on the September Class III contract. Thawing U.S-China trade relations are behind some of that optimism as a recent phone conversation between President Trump and Premier Xi reported that tangible progress is being made on some of the more sensitive issues that have blocked previous rounds of talks as negotiating teams prepare for new meetings next week in Beijing. Excess cheese production continues to weigh on nearby futures, as cheese output through October exceeded 2017's record-breaking volume by 2.5% while U.S. milk production is only up 1% from 2017. This preference for directing milk production towards cheese is also being reflected in monthly Cold Storage inventories, as USDA reported November butter stocks at a three-year low of 153.7 million pounds versus November cheese inventories of 1.35 billion pounds which were up 7.5% from a year ago. While the October to November draw of cheese inventories was larger than average, overall cheese inventories remain abundant which will put additional emphasis on demand improvement in 2019. Our clients continue to make strategic adjustments on existing positions by adding flexibility to milk hedges and allowing increased opportunity if prices begin to recover.



The Dairy Margin calculation assumes, using a feed price correlation model, that for a typical dairy 62.4 lbs of corn (or equivalent) and 7.34 lbs of meal (or equivalent) are required to produce 100 lbs of milk (includes dry cows, excludes heifers not yet fresh). Additional assumed costs include \$0.90/cwt for other, non-correlating feeds, \$2.65/cwt for corn and meal basis, and \$8.00/cwt for non-feed expenses. Milk basis is \$0.75/cwt and non-milk revenue is \$1.00/cwt.

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