

Dairy Situation and Outlook, December 18, 2008
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Dairy product prices have taken a nose dive towards year's end. As of December 18th CME cheddar blocks were \$1.345 per pound and barrels at \$1.405 per pound. CME butter was \$1.20 per pound. Cheddar blocks have not been this low since November of 2006, barrels since March of 2007 and butter since February of 2008. Dry whey has been trading \$0.15 to \$0.17 per pound and nonfat dry milk around \$0.83 per pound. If prices remained at these levels the Class III price would be about \$11.25 and Class IV about \$10.20. As of December 17th, Class III futures were settling below \$13.00 January through April, below \$14.00 May through July and only peaking around \$14.50 for November and December. The average for the 12 months in 2009 was just \$13.54. This compares to an average Class III of \$18.04 for 2007 and an estimated 2008 average of \$17.45. Class IV prices are even more depressed. Class IV futures are settling below \$11.00 January through March, below \$13.00 April through July and peaking at around \$14.00 for November and December. The average for the year is \$11.45 compared to \$18.36 for 2007 and an estimated \$14.75 for 2008.

This level of milk prices will cause major financial stress in the dairy industry. While feed prices have declined from their highs of last spring and summer, return over feed costs will be much lower in 2009. But, hopefully markets have over reacted and some recovery will take place. Butter and cheese prices normally do decline in December after holiday orders are filled. Buyers are now only purchasing butter and cheese as need arises and not accumulating any extra inventory. There is the concern that the troubled economy will continue to negatively impact sales of milk and dairy products. Restaurant traffic is important for cheese and butter sales. The restaurant traffic index has been much lower and outlook for 2009 is not promising. One bright spot could be beverage milk sales. With lower retail prices and increased meals at home beverage milk sales could improve. Some evidence already exists with October beverage milk sales 0.7% higher than a year ago.

Exports of butter, cheese and nonfat dry milk were strong through August, but have weakened considerably since and contributing to falling butter, cheese and nonfat dry milk prices. The world economy has weakened, the supply of dairy products on the world market has increased and the U.S. dollar has strengthened.

With slow domestic sales as well as exports stocks of dairy products are increasing. October 31st stocks compared to a year ago were up 3.1% for American cheese, 1.6% for total cheese, and 18% for nonfat dry milk. However, butter stocks were still 24% lower. October cheese production was up from a year ago with cheddar cheese up 3.8%, all American cheeses up 6.5%, but Italian cheeses down 1.4% resulting in the production of all cheese up 2.0%. Butter production was down 0.3% but nonfat dry milk production was up 21%. Since skim milk powder is primarily produced for export its production was down 18.1%.

With this farm level milk prices we can expect milk cow numbers to continue to decline and increases in milk per cow to remain below normal increases. Milk cow numbers increased month

to month from May of 2007 through July of 2008 when numbers totaled 9.284 million head. Cow numbers declined August and September only to increase again in October and November. November cow numbers at 9.276 million head were still 0.9% higher than a year ago. But, in recent weeks cow slaughter has been much higher. The sixth round of CWT herd retirement will also remove about 61,000 cows beginning mid January. We can expect cow numbers to decline in 2009, at least through the first half of the year. Milk per cow, which has been increasing less than 1.0%, was up just 0.2% in November with an increase of 2.4% resulting in an increase in total milk production of 1.1%. Milk production was 2.4% higher than a year ago for the first half of the year, but from July through November production was up just 1.4%. For the year production will be up about 2%.

Comparing November production to a year ago, production was down 0.3% in California and Arizona, but up 4.9%, 5.5% and 11.3% respectively in Idaho, New Mexico and Texas. Relatively high feed costs and much lower milk prices appears to be impacting cow numbers in some West, Southwest and Southeast states. For example, cow numbers were down 1.2% in New Mexico and 4.8% in Florida. Milk production continues to do quite well in the Upper Midwest due to more cows and increases in milk per cow. Milk production was up 1.4% in Wisconsin, 2.0% in Minnesota and 2.3% in Iowa. In the Northeast, New York and Pennsylvania had 0.3% and 0.4% fewer cows respectively, and with milk per cow just 0.3% higher in New York and 4.4% lower in Pennsylvania, there was no increase in New York's total milk production and Pennsylvania had a 4.8% decrease.

Looking ahead into 2009 total milk production may increase no more than 1%. Normally this would mean relatively favorable milk prices. But, a depressed domestic economy and lower dairy exports spells much lower milk prices in 2009. Farm milk prices will likely improve for the second half of the year, but stay well below 2007 and 2008 prices. Hopefully the market has over reacted in the down direction and final prices will not end up as what is currently shown by Class III and Class IV futures.

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