

Dairy Situation and Outlook, January 19, 2009
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Farm milk prices were favorable for the past two years, 2007 and 2008. The Class III price for 2008 averaged \$17.44, \$0.60 lower than 2007, but the second highest on record. However, the Class IV price averaged only \$14.65, \$3.71 lower than 2007. As a result, the average U.S. all milk price was \$18.79, \$0.79 lower than 2007, but the second highest on record. With high feed and energy costs dairy producers needed these higher prices. Unfortunately, 2009 is starting out with dairy product prices and milk prices at levels not experienced since the depressed period of 2000 to 2003. Prices were forecasted to be lower in 2009, but no one forecasted prices this low.

Cheese prices have fallen below the support level of \$1.13 per pound for cheddar blocks and \$1.10 per pound for cheddar barrels. As of January 16, on the CME barrel cheese was \$1.09 per pound and 40-pound blocks \$1.07 per pound. CME butter was \$1.1125 per pound, close to the \$1.05 support price. Western nonfat dry milk is at or near the \$0.80 per pound support price trading in the \$0.80 to \$0.82 per pound range. Western dry whey is in the \$0.13 to \$0.14 range which is below the cost to make it and resulting in a negative “other solids” price being paid to dairy producers. The CCC has been purchasing nonfat dry milk under the support program since October 2008 and started purchasing butter the week of January 5th. Cheese purchases are expected to begin, and if so, this will be the first time since April – May of 2003 that all three products—butter, cheese and nonfat dry milk were being purchased under the support program.

December, 2008 Class III was \$15.28. The January Class III price will be about \$4.50 lower around \$10.70. The December Class IV price was \$10.35 but could fall below \$10.00 in January to around \$9.80. Class III futures drop below \$10.00 for February and March, don't reach \$11.00 until June and only peak out at \$13.70 for December. If prices no higher than this materialize, there will be considerable financial stress in the dairy industry. Feed and energy costs have declined some, but not nearly as much as milk prices.

Market fundamentals don't support prices staying this low. The market likely over reacted in the down direction and price improvements will be experienced, especially by the second half of the year. But, 2009 prices will average well under those experienced in 2008. Milk production may increase less than one percent as cow numbers decline and milk per cow remains below normal increases due to relatively high feed prices and unfavorable returns over feed costs. But, the down turn in the U.S. economy and the world economy will dampen milk and dairy product sales in the U.S. and U.S. dairy exports. In 2008, U.S. exported nearly 10% of its milk production on a total solids basis—about half of its nonfat dry milk, 40% of dry whey, 3% of cheese and 12% of butter. But, by the end of December exports dropped dramatically and are forecasted to decline perhaps as much as 25% to 30% below 2008 levels in 2009. World prices for dairy products have declined to levels making exports without subsidies more difficult. World demand has softened due to the economic down turn in key importing countries, the melamine issue in China and increased exportable supplies from U.S., New Zealand, the EU and others.

Cheese production had picked up with November American cheese production 4.8% higher than a year ago. Cheddar production, however, was up just 2.3%. But, production of mozzarella was 4.9% lower as well as lower production of other Italian cheeses netting just a 1.3% increase in the production of all cheeses combined. Butter production was up 2.2%. More milk is going into the production of nonfat dry milk which can be more easily stored or sold to the CCC under the price support program. November nonfat dry milk production was up 34.8%. Yet stocks of dairy products are not burdensome. November 30th stocks compared to a year ago were up only 2.2% for American cheese, up only 1.9% for all cheese and 16.2% lower for butter.

Domestic sales of beverage milk, cheese and butter should be helped by lower wholesale and retail prices in 2009. More at home eating should be a positive for beverage milk sales. And with milk production increasing no more than one percent milk prices ought to strengthen as we move through the year. Milk production ended the year at still a relatively strong level with December production estimated 1.4% higher than December a year ago. This brings total milk production to 189.699 billion pounds for 2008, an increase of 2.2%, or adjusted for leap year, an increase of 1.9%. December milk cows were estimated to still be 75,000 head or 0.8% higher than a year ago. In fact cow numbers increased 8,000 head November to December. But, with the expected drop in milk prices cow numbers ought to decline as we progress into the year. Increases in milk per cow remain low at just 0.6%.

December milk production compared to a year ago for some key dairy states was: California down 0.8%, Idaho up 1.7%, Arizona up 5.6%, New Mexico up 6.1%, Texas up 13.7%. A decline of 1.2% in milk per cow in California and 2.7% in Idaho explain the decrease in California's milk production and the slow down in Idaho. In the Northeast milk production was down slightly, 0.1% in New York, down 2.8% in Pennsylvania and 1.9% in Vermont due to each state experiencing less milk per cow and fewer cows. The Upper Midwest experienced increases in milk production with production up 2.3% in both Wisconsin and Minnesota and up 1.4% in Iowa.

In summary, milk prices were very favorable for 2007 and 2008. But, 2009 will start the year with milk prices very depressed and at levels that don't allow for favorable returns over feed costs. While prices will be well below those of 2007 and 2008, prices should strengthen as the year progress as milk production slows and sales of milk and dairy products improve in response to lower wholesale and retail prices. But, 2009 is shaping up to be a challenging year for dairy producers.

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