

Dairy Situation and Outlook
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Milk prices have held higher through the first half of the year than what was earlier predicted. While dry whey prices have weakened to less than 30 cents per pound cheddar cheese prices near or above \$2.00 per pound has kept Class III prices well above a year ago. The Class III price averaged \$18.22 per hundredweight for the first half of the year compared to \$16.11 for 2007. While butter prices have average near a year ago, lower nonfat dry milk prices resulted in the Class IV price below a year ago. For the first half of the year Class IV averaged \$15.21 per hundredweight compared to \$15.71 for 2007. The higher advanced Class III price has been the mover of Class I prices. This has held the U.S. All Milk price well above a year ago. The U.S. All Milk price averaged near \$19.00 per hundredweight for the first half of the year compared to \$16.63 for 2007.

Dairy farmers have responded to record high milk prices in 2007 and continued high prices in 2008 by adding cows. Milk cow numbers have increased month-to-month beginning with May of 2007 adding an additional 143,000 head as of May of this year. In May, there was 1.6% more milk cows than a year ago. Historically, whenever milk cow numbers increase for a period of time there is downward pressure on milk prices without exception. But, lower than normal increases in milk per cow has held increases in total milk production to a little more than 2 percent. Increases in milk per cow have been less than 1 percent. Part of this is due to reduced use of rBST. Much is placed on high feed costs. But, with current milk prices over \$20.00 per hundredweight returns over feed costs are still favorable. However, May milk production for the 23 reporting states has strengthened with an increase of 3.2% over a year ago and the estimate for the U.S. was an increase of 3.0%. This stronger increase was due to an improved increase in milk per cow of 1.4%. With milk production at this level we can expect some downward pressure on milk prices.

Compared to a year ago, May milk production for the five leading dairy states, which accounted for 53% of U.S. milk production, was up 3.2%. The respective increases were: California 2.8%, Wisconsin 1.8%, New York 4.7%, Idaho 9.2% and Pennsylvania a slight decrease of 0.1% due to fewer milk cows. Other states with relatively strong increases in milk production were: Texas 14.3%, Kansas 9.8%, New Mexico 9.7%, Colorado 9.5%, Arizona 5.2% and Washington 4.7%. Eight of the 23 reporting states had less milk production with the biggest declines in Florida, -7.2%; Oregon, -7.1%; Missouri, -3.2%; and Kentucky, -2.6%. Each of these states had fewer cows except for Kentucky. Milk production declines of 1% or less were experienced in Illinois, Iowa, Pennsylvania and Minnesota.

Much higher than expected cheese prices is the main factor for holding up milk prices thus far. Cheddar cheese has been in the \$1.80 to over \$2.00 per pound range all year. Cheddar cheese prices are used in the product price formula for the Class III price. Cheddar cheese production fell 2.1 percent in 2007 and continued below year ago levels for the first quarter of this year. Most of the additional milk production is going into the production of nonfat dry milk and skim

milk powder. Through April the production of nonfat dry milk was up 15 percent and skim milk powder production up 249 percent. Thus cheddar cheese stocks remain tight with April 30th stocks 7.1 percent lower than a year ago and 1.9 percent lower than the 5-year average for this date. Strong cheese exports is another factor for higher cheese prices. For the first four months of this year cheese exports were up 55 percent and were equivalent to 3 percent of total cheese production.

Exports have also been favorable for butter and nonfat dry milk prices. First four month's butter exports were up 723 percent and equaled 10 percent of butter production. Nonfat dry milk exports were up 77 percent and equaled 62 percent of production.

It is uncertain if cheese and milk prices can hold at these relatively high levels, especially with increases in milk production becoming higher. Milk cow numbers are likely to increase into the 4th quarter. Cow slaughter is running slightly below a year ago and dairy replacements are 3 percent higher. The announcement of the 5th round of CWT will remove some cows by the 4th quarter. Milk per cow may improve some but is likely to remain below normal increases. It now looks like total milk production for the year will be up about 2.0 percent. Commercial use may increase similarly, if exports hold. Relatively high dairy product prices along with higher food prices in general and high gas prices will likely dampen sales. Fluid milk sales declined 0.4 percent in 2007 and continue to run about 0.7 percent lower this year. Lower fluid sales channels more milk into manufactured dairy products. We can expect cheddar cheese prices to fall from their \$2.00 plus per pound level as additional production eventually comes forth and sales slow due to high prices. Cheddar production for the month of April was already 3.9 percent above a year ago. Indications are that cheese export orders may also be slowing in response to high prices.

The bottom line is that we can expect cheddar cheese prices to fall. As a result, by 4th quarter, Class III prices could be in the \$17.25 to \$18.50 range. However, current Class III futures don't reflect these lower prices. Class III futures are in the low \$20s through year's end and in the high \$19s through 2009. Dairy producers may want to take advantage of these prices via of hedging, options or forward contracting. With high feed costs Class III prices much below \$17.00 will cause a lot of financial stress on dairy producers. A major uncertainty where milk prices will end up is this year's hay and crop production. Major flooding in the Midwest will reduce corn and soybean production as well as quality hay. Hay and crop prices are likely to move even higher this winter. To the extent this occurs, we could see cow numbers decline quicker and milk production slowing adding strength to cheese and milk prices towards year's end and into 2009.

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