

Dairy Situation and Outlook
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The recovery of farm milk prices continues. The Class III price for October will be around \$12.80 compared to \$9.97 back in July. The Class IV price will be around \$11.60 compared to \$10.15 last July. These higher prices are driven by improvements in cheese, dry whey, and nonfat dry milk and butter prices. On the CME, 40-pound cheddar blocks were \$1.27 per pound mid-September and were \$1.43 as of October 20th. CME cheddar barrels were \$1.275 per pound mid-September and increased to \$1.4225 on October 20th. Western dry whey was selling at \$0.32 to \$0.35 per pound and nonfat dry milk \$1.09 to \$1.22 per pound. Butter, which was \$1.24 per pound mid-September increased to \$1.33.

These improved prices are being driven by both the supply of milk and dairy products, and improved demand. Milk production which dropped slightly below year ago levels in August, (down 0.1%) continues at a lower level. USDA's latest report showed September milk production for the U.S. down 0.7% from a year ago due to 197,000 fewer cows, a decline of 2.1% more than offsetting 1.5% more milk per cow. Milk cow numbers have been declining every month since January. We can expect this trend to continue for the remainder of 2009 and for well into 2010. Most of the decline in cow numbers and milk production continues to be in the West. Compared to a year ago, milk production for September was down 6.4% in California, 2.3% in Idaho, 10.8% in Arizona, 1.4% in Utah, 1.5% in Washington, 7.1% in Colorado, and 0.3% in New Mexico. Texas was the exception with production up 4.9%. In the Northeast milk production was down 1.4% in New York, up 1.0% in Pennsylvania, down 2.5% in Vermont and up 3.7% in Michigan. But, milk production continues to run above year ago levels in the Midwest from both additional cows and more milk per cow. Milk production was up 5.2% in Wisconsin, 3.9% in Minnesota, 5.8% in Indiana, 4.1% in Illinois and even in Iowa.

Significant declines in cow numbers occurred for some Western states. Cow numbers were down 9.7% in Arizona, 8.5% in Colorado, 5.4% in New Mexico, 4.0% in California and 1.3% in Idaho.

With milk production seasonally lower in September and schools in session, which increases fluid milk sales, there is less milk available for manufactured dairy products. Latest dairy product production showed American cheese production for August was up just 1.6% from a year ago. While American cheese production slowed improved pizza sales and cheese in school lunch programs pushed Mozzarella production 5.3% higher. Total cheese production was up 2.6%. Less of the available milk was allocated to butter and nonfat dry milk production. August butter production was down 13.6% from a year ago and nonfat dry milk down 8.3%. Considering the West produces more than 80% of the nonfat dry milk production the decline West milk production explains much of the drop in nonfat dry milk production.

The latest stock report showed as of August 31st ample stocks of both butter and cheese. Butter stocks were 23% higher than a year ago with American cheese stocks and total cheese stocks up

9.5% and 11.9% respectively. These stock levels will decline seasonally during the relatively strong sales period of November and December.

There are signs of improved milk and dairy product sales. Beverage milk sales declined 0.9% in 2008. For the January through August period of this year beverage milk sales, adjusted for calendar year, were up 1.3%. Organic milk sales, which had experience double digit increases for the past three years experience declines during this period of 1.8% for organic whole milk and 3.4% decline for organic reduced fat milk. Cheese buyers have been more aggressive in bidding up cheese prices. Perhaps buyers are anticipating improved seasonal sales, tighter supplies at higher prices later as milk production continues below year ago levels and increased cheese purchases by USDA as a means to help strengthen milk prices. Lower retail prices may be helping to improve sales as well. Compared to a year ago, August retail prices were down 10.4% for dairy products as a group, 20.5% for whole milk, 11.0% for cheese, and 8.5% for butter. However, the September CPI index showed a slight price increase from August to September for whole milk and cheese.

Dairy exports, while well below year ago levels had shown much improvement during June and July. However, August numbers reversed this trend. Nonfat dry milk/skim milk and lactose exports were the exception. August marked the sixth straight month of growth in volume of nonfat dry milk/skim milk powder but exports were still 21% down from a year ago. Lactose exports were 46% higher. August cheese exports fell 24% from a year ago, and butter exports fell 94%. While whey protein exports were 15% higher for the first half of the year, they fell both in July and August mostly due to lower dry whey exports more than offsetting improved exports of whey protein concentrates and isolates. But, compared to August last year, dry whey exports were 23% lower, whey protein concentrates fell 12% and whey protein isolates were flat. World market prices continue to strengthen and the world economy is showing slow recovery. Thus, there is some optimism that dairy exports could improve in the months ahead and for 2010.

In summary, milk prices will continue to improve this year and for 2010. As of October 20th, Class III dairy futures were \$14.64 for December and improved to \$15.42 for July 2010. But, I believe the odds are that prices could do better than this with December above \$15, and \$16.00 or higher by July 2010. MILC payments will decline as milk prices increase and lower feed costs, mostly due to lower hay prices, reduces or eliminates the feed adjuster to the target price. Preliminary September prices for Corn (3.32 per bushel) soybeans (\$9.85 per bushel) and hay (\$110 per ton) means the cost for a 16% dairy ration is \$6.59 per 100 pounds, well below the trigger of \$7.35 for a feed adjustment to the target price. The preliminary MILC payment for September is \$1.24 per hundredweight and payments may disappear by December.

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