

Dairy Situation and Outlook
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Milk production is picking up. USDA's milk production report showed August production 3.4% higher than a year ago for the 23 reporting states. The July production increase was revised upwards to 4.0%. Prior to these two months increases were well below 2%. Milk cow numbers have increased from the previous month every month beginning with April and are now 0.6% higher than a year ago. Increases in milk per cow have also improved with August milk per cow 2.8% higher than a year ago.

Growth in milk production is strong in the West and Southwest with the exception of New Mexico. In New Mexico 7.5% fewer milk cows resulted in a 3.6% reduction in August milk production from a year ago. But, August milk production was up 11.5% in Arizona, 4.9% in California, 4.5% in Idaho and 4.1% in Texas. Milk production was relatively strong in the Northeast with New York up 2.3%, Pennsylvania 2.1%, Michigan 9.7% and Ohio 4.1%. The same was true for the Midwest with Wisconsin up 4.5%, Minnesota 5.0%, and Iowa 6.0%. Besides New Mexico, milk production was lower in just 5 other states: Florida 1.3%, Illinois 5.0%, Kansas 6.1%, Missouri 5.9% and Oregon 3.6%.

Farm level milk prices have been much higher than a year ago due to strong dairy product prices. CME cheese prices showed real strength the last half of August and early September, but have declined since. As of August 17th cheddar barrels were \$1.89 per pound and 40-pound blocks \$1.96 per pound. Prices peaked on September 12 with barrels at \$2.1325 per pound and blocks at \$2.1625 per pound. But, as of September 21st, barrels had declined \$0.235 per pound to \$1.90 and blocks declined \$0.345 per pound to \$1.815. A tight supply and demand situation drove cheese prices up. Cheddar cheese production was running well below year ago levels. In July production of cheddar cheese was 4.7% below year ago levels. Cheese sales have been higher than a year ago. The result was tighter cheese stocks. August 31st stocks of American cheese were down 3.1% from a year ago and stocks of all cheese down 1.7%. Nevertheless, cheese prices have now declined in response to relatively strong milk production for the past two months.

CME butter prices did reach \$1.43 per pound early in September, but have since declined to \$1.37 per pound. Unlike cheese, butter production has been higher than a year ago with July production up 21.8%. Butter sales have been higher than a year ago but yet stocks as of August 31st were 21.1% higher. While nonfat dry milk prices are still around \$2.00 per pound dry whey prices have weakened and are now as low as \$0.37 to \$0.44 per pound in the West. Thus, the Class IV price will remain relatively strong in relation to Class III and be the mover of Class I prices for the months ahead.

Based on USDA's report on August milk production we can expect farm level milk prices to decline for the remaining of 2007 and be lower in 2008, but remain relatively high historically.

Record corn production may temper corn prices some, but hay prices will stay higher than a year ago. USDA's latest crop report estimates 2007 alfalfa hay production 2.5% lower than last year and 8.2% lower than 2005. As of August alfalfa hay prices for the U.S. were 26% higher than a year ago with prices up 51% for California and 19% for Idaho. The August milk-feed-price ratio was 3.24 for August but as milk prices ease this ratio will decline as we move through the remainder of the year and into 2008. But, with recent high milk prices, ample supply of dairy replacements and some improvement in corn and protein prices for feeding dairy cows, milk production will continue to improve and slowly lower milk prices. Dairy producers have been responding to high milk prices by keeping lower producing cows longer. While dairy cow slaughter was running 12 to 15% higher the first six months of the year, slaughter has been below year ago for most weeks since.

The August Class III price was \$19.83, but higher cheese prices will increase the September Class III price to \$20.00. Lower cheese and dry whey prices will result in a Class III price near \$18.00 for October and could fall below \$17.00 for December. The Class IV price was \$21.87 in August and will be around \$21.45 for September, but decline to near \$18.70 for December. Looking into 2008, Class III futures, while lower than 2007 prices, still offer good opportunities to protect favorable milk prices. Class III futures start the year above \$16.00, remain above \$15.00 through July and once again go above \$16.00 by August.

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