

Dairy Situation and Outlook

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2010 & the Dairy Industry

2009 was the most difficult financial period for dairy producers since the early 1970's. Milk prices were very low early in the year along with feed costs that had not declined to amounts that left cash for other expenses. The 2009 Class III price averaged \$11.35, \$6.09 less than 2008.

I will next discuss the cause of the 2009 milk price drop. During the previous 10 years dairy product use had averaged near 2%. In years where milk production was above 2% milk prices declined. But the 2009 price decline occurred due to domestic and export demand reduction. Seven of the first 10 months of 2009 milk disappearance was less than the same month 2008. Fluid milk sales in 2008 were -0.9% and total cheese consumption was up only 0.4%, less than the increase in population, because the per capita consumption dropped 0.7 pounds. For the first 10 months of 2009 NDM export dropped 40%, cheese exports were 24% less and the largest export category, proteins, was 1% less. The total export loss for 2009 is estimated to 5 billion pounds or 3% of the domestic milk production.

Milk production during the first 7 months of 2009 was either the same as or higher than one year ago. Those months had up to 1.8% or higher year over year increases. And those same months in 2008 had milk production increases of 1.8% to 3.3%. This large milk production increase following a year of large increases led to very large cheese stocks for 2009. The total natural cheese stock report for Nov 09 was +17.4% from one year earlier. And the Nov 08 report was larger than Nov 07. A draw down in cheese stocks did occur during 2009 but much later than the previous years. After the middle part of 2009 butter stock also were larger than the previous year. Cheese production for Dec09 did fall, by 0.1%, compared to one year ago.

Dairy product stocks matter in milk prices. Large stocks hold down Class III milk prices. A change of 10 cents in cheese price changes the Class III price by \$0.97 while a 10 cent change in butter price only changes the Class III price by 5 cents. Dry whey prices have a large impact on Class III prices. A 10 cent change will change Class III prices by \$0.58.

So what do we estimate for 2010 demand? USDA is projecting an increase in export sales, from about 7% to 9% of domestic production. That would not quite reach the 2008 sales of 10.8% but would almost equal 2006. USDA projects domestic demand to increase by 0.3% while Dr Bob Cropp, U of WI, estimates an increase of 0.8-1% greater commercial disappearance. Which one is more correct will depend on the ability of the US and World economy to right itself.

Cow numbers need to decline further to strengthen short-term milk prices. Some of the reduction will be due to financially stressed dairy operations that exit. Lost equity will slow expansion. One commentator lamented a generation of lost equity due to the dairy industry crisis. However the inventory of dairy heifers on Jan 1 2010 was 4.52 million, up from one year ago at 4.41 million. We can increase the dairy herd rapidly if milk prices were to rise. The Jan 10 Milk-Feed price ratio was 2.45 with a corn price of \$3.45. This ratio does not yet indicate expansion is expected. A Milk-Feed price ratio of 3 indicates expansion so we are not at that point.

Much of the 2009 dairy herd reduction was in the West. The two charts below explain.

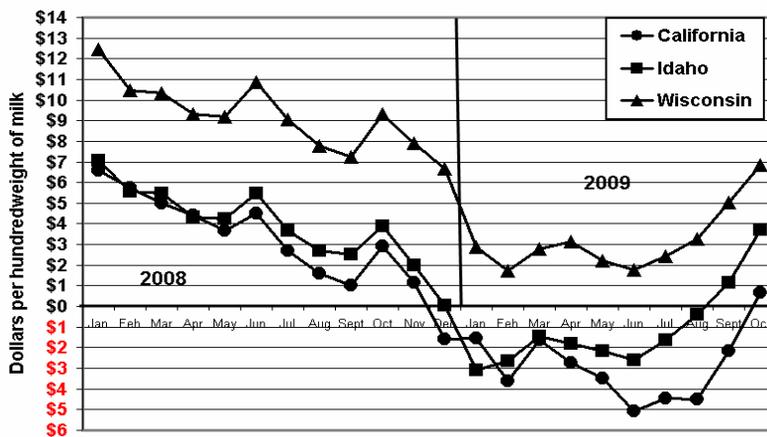
State	2007 Average	2008 Average	2009 Average (Jan-Sept)
CA	17.56	16.17	10.09
NY	19.24	18.07	12.07
WI	19	18.63	11.95

Source: Dr Robert Cropp, U of WI

The following chart is from the Dec 09 Milk production report. The important Midwestern states have maintained milk production while most of the West has lost total milk production. The third chart showing returns over feed cost explains why milk production has held better in the Midwest. We produce much of our own feed here. And we produce much of the feed that goes to western dairy herds. Thus their cost of feeding tends to be higher. Western dairy herds have compensated for this feed cost advantage by higher milk production per cow and reduced fixed costs.

State	Milk Cows(1000)	Milk/Cow	Total Milk
AZ	168	1995	-10.9
CA	1764	1860	-4.6
CO	116	1930	-11.1
ID	550	1840	0.4
NM	318	2015	-3.2
TX	411	1795	0.1
UT	83	1765	-2.7
WA	243	1945	1.9
MI	354	1895	2.4
NY	610	1675	-0.3
PA	538	1620	0.7
VT	134	1545	-2.4
IN	169	1660	1.8
IA	215	1750	3.6
MN	469	1650	3.2
WI	1259	1700	4.3

Returns over feed costs: All Milk Price minus ERS total feed cost



Source: USDA, ERS, courtesy of Dr Robert Cropp

Milk production is expected to rise for 2010 compared to 2009. But only by 0.7% for the year. Milk prices will be higher than last year, however probably not as much as Dr Cropp had anticipated in early Jan 2010. Class III milk futures have declined recently. Large stocks of cheese still overhang the market. Economic recovery seems to be elusive in the US. Recent jobs numbers are not showing strengthening employment yet. A double dip recession may take place in 2011 after the Bush take cuts expire. Increased tax rates are likely to restrain consumer spending when they become aware of the situation. 2010 is a year where dairy producers need to heal financially as best they can. And be prepared for a possible double dip recession.

Source: Dr Robert Cropp