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Livestock, Dairy, and Poultry Outlook

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Sheep and Lamb Inventory Increases for Second Straight Year

NOTE: Due to uncertainties as to the length of bans on trade in ruminants and ruminant products because of the discovery of BSE in the United States and Canada, forecasts for 2006 assume a continuation of policies currently in place among U.S. trading partners. For this month's report, the following conditions are assumed: 1) The recent suspension of beef imports is temporary pending resolution of Japan's concerns. 2) A framework for the reopening of South Korea to imports of U.S. beef has been announced but regulations are still being written to incorporate the requirements. Thus exports to South Korea are not included in these forecasts.

Sheep/Lamb: The January *Sheep and Goats* report by the National Agricultural Statistics Service (NASS) indicates that all sheep and lamb numbers increased in 2005 for the second straight year. On January 1, 2006, the inventory totaled 6.23 million head, up 2 percent from a year earlier, and nearly equal to that of 2003. Despite concerns about over-finishing, first-quarter demand is expected to be boosted by the upcoming religious holidays early in the second quarter of 2006. Slaughter lamb prices for the first quarter of 2006 are expected to stabilize between \$93 and \$95 per hundredweight (cwt).

Cattle/Beef: The NASS *Cattle* inventory report released January 27, 2006, confirmed that the national cow herd and cattle inventories are in the second year of an expansion phase of a new cattle cycle. While heifers for beef and dairy cow replacement were both up 4 percent, the real increase in 2006 heifer inventories was in the implied number of heifers to be bred this summer and later. Whether these heifers are actually bred in 2006 will

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Tables will be released on
February 28, 2006

The next newsletter
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depend on pasture and forage conditions this spring and summer, and some may have been placed in feedlots since January 1, 2006 because of deteriorating soil moisture conditions and forage supplies below January-February 2005 levels. Despite declining poultry and hog prices, beef prices at both wholesale and retail levels remain relatively high. However, beef price strength may be dampened by deteriorating prices for other meats and poultry, low packer margins, and shrinking wholesale-to-retail price spreads.

Beef Trade: Cattle imports showed strength in the fourth quarter of 2005, reaching 788,000 head, bringing the 2005 total to 1.815 million head. Imports from Canada resumed in July 2005, and total cattle from Canada during 2005 were 558,000. The cattle import forecast for 2006 was left unchanged at 2.175 million head. Beef imports dipped somewhat in the last quarter of 2005, totaling 797 million pounds. Beef imports during 2005 were down slightly from 2004, as Australia and New Zealand both reduced their shipments. Beef imports during 2006 are also forecast to fall slightly on a year-to-year basis, totaling 3.5 billion pounds. U.S. beef exports in the fourth quarter of 2005 reached their highest level yet after the December 2003 BSE case, totaling 220 million pounds. Japan reopened its market to U.S. beef, though it has been temporarily halted due to a shipment containing prohibited materials. Taiwan has reopened its market, and South Korea is putting regulations in place to do so, as well. U.S. beef exports for 2006 are forecast at 905 million pounds, about 36 percent of the record level set in 2003.

Dairy: The January 1 inventory showed almost 4.3 million dairy replacement heifers, up almost 4 percent from a year earlier and more than 6 percent from 2 years earlier. The larger-than-expected rise was triggered by the very high replacement prices of 2004 that encouraged unusual measures to keep as many heifers as possible.

Hogs/Pork: The first month of 2006 presented a mixed picture for the U.S. pork and hog markets. Supply side signs were strongly positive in January, but in line with most expectations, while cautionary flags are beginning to emerge on the demand side.

Poultry: Higher broiler meat production in the fourth quarter of 2005 and a weakening in overall export demand caused stocks of broiler products to increase significantly, putting downward pressure on prices for most broiler parts. The lower prices have caused production estimates for 2006 to be reduced and ending stock estimates to be increased. Turkey production is expected to grow slightly in 2006 as strong prices in 2005 encourage growers to expand. Lower cold storage turkey holdings at the end of 2005 are expected to keep upward pressure on turkey prices through 2006.

Poultry Trade: The volume and value of U.S. broiler exports in 2005 increased from last year by 8 percent and 21 percent, respectively. The strongest markets last year were Russia and Mexico, which together accounted for 42 percent of total exports. Impacts of avian influenza were felt by the U.S.—reducing foreign consumer demand and thus partially responsible for a relatively low fourth-quarter performance. Broiler exports in 2006 are expected to increase. Like broiler exports, turkey shipments and value have increased from 2004 to 2005, mainly due to the positive impact of Mexico's growing economy on consumer demand. Turkey exports are expected to increase slightly in 2006.

Sheep and Lamb Inventory Increases for Second Straight Year

The NASS *Sheep and Goats* report shows the inventory of all sheep and lambs increased in 2005 for the second straight year. Even though inventories were up in 2005 for the second year, inventory totaled 6.23 million head—about equal to that of 2003. Conditions favor a likely 1-2 percent increase in inventory during 2006, with increases mainly in the market lamb category. Among the top five sheep-producing States, increases were in Texas (2 percent), Colorado (7 percent), and South Dakota (3 percent). The areas that experienced the largest percentage increases in inventory were regions in the Southeast, Delta States, and Appalachian where herd size are generally smaller. These include Tennessee (17 percent), Missouri (15 percent), Oklahoma (14 percent), Pennsylvania (10 percent), and Virginia (10 percent). In addition to California, the second-largest sheep-producing State which saw a 3-percent drop, States in the Corn Belt, and Northeast also saw declining inventories. Inventory increases were fairly well distributed throughout the rest of the country.

Retention and replacement of lambs have led to a corresponding increase in the breeding sheep inventory. Texas had a 30,000-head increase in breeding sheep and lambs, a 20,000-head increase was seen in Colorado, and a 15,000-head increase in Utah. The replacement lamb inventory was 2 percent above a year earlier, slowing from the 10-percent increase that occurred in 2004. Increases in replacement lambs were highest in Colorado (6,000), Iowa (5,000), Michigan (5,000), Minnesota (5,000), and New Mexico (5,000). While most of the States saw a net increase in breeding inventory from replacement lambs, some States registered a net loss. Though Iowa, for instance, had a 5,000-head increase in replacement lambs, they had a 5,000-head decline in its breeding inventory, suggesting that none of the replacement herd was used for herd rebuilding. In 2006, breeding sheep inventory is expected to stabilize as retention and replacement continue to slow.

The increase in ewe lamb retention for the past 2 years has resulted in a decrease in the supply of market lambs. On January 1, 2006, market sheep and lambs were down 1 percent from the same period last year. As retention and replacement slows, and the breeding herd stabilizes, the number of market animals is expected to increase. These increases may not begin to affect the market before early 2007. As a result, supplies are expected to remain fairly tight throughout 2006. However, the expanding severe drought conditions, especially in Texas and New Mexico could result in premature stock liquidation and increased domestic production in 2006.

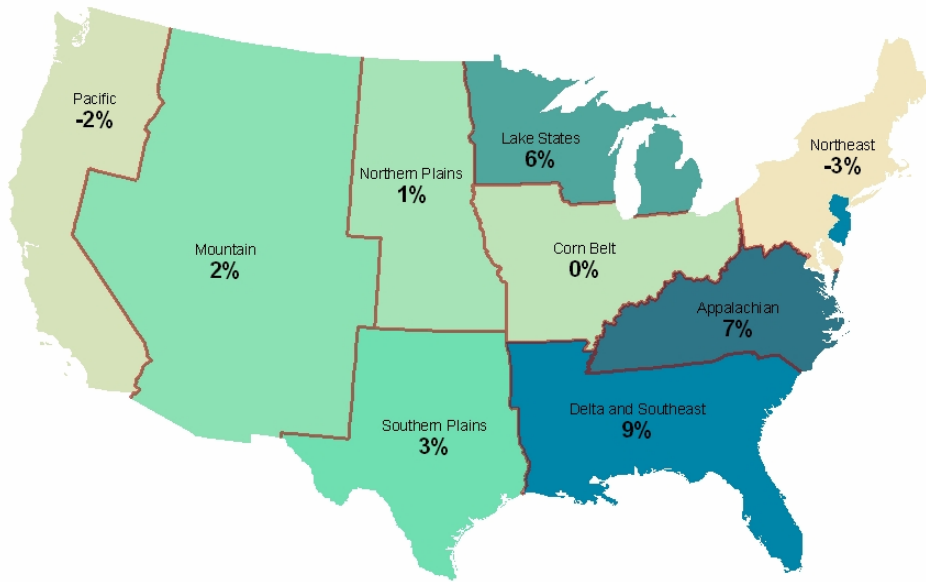
Tight supplies throughout 2005 kept prices strong, and slaughter lamb prices were at an all-time high in the first quarter at \$106.10 per cwt. San Angelo lamb prices tapered off during the rest of 2005 primarily due to seasonal demand fluctuations, averaging \$97.76 per cwt for the year. The seasonal reduction in demand resulted in lambs possibly being held longer than normal, causing increased slaughter weights and average dressed weights above 70 pounds. Average dressed weights above 70 pounds often signal a movement toward an over-finishing problem that often results in even further reduction of slaughter lamb prices. Historically, average dressed weight at slaughter has been negatively correlated with prices. This was evident in 2001 and early-2002 when the slaughter lamb prices dropped sharply, averaging near \$70.00 per cwt. This phenomenon could be repeated if

average dressed weights continue to drift beyond 70 pounds. However, despite the looming concern about over-finishing, seasonal demand related to the religious holidays early in the second quarter is expected to boost first-quarter slaughter lamb prices into the \$93-\$95 per cwt range.

Lamb and mutton production continues to be tight, due in part, to increased retention of replacement ewes. Commercial lamb and mutton production totaled 188 million pounds in 2005, down more than 3 percent from 2004. First-quarter 2006 lamb and mutton production is expected to be 49 million pounds, equaling the same period in 2005. Production is expected to be maintained by heavier animals since offsprings from the past 2 years' replacement and retention are not expected to affect the market until early 2007.

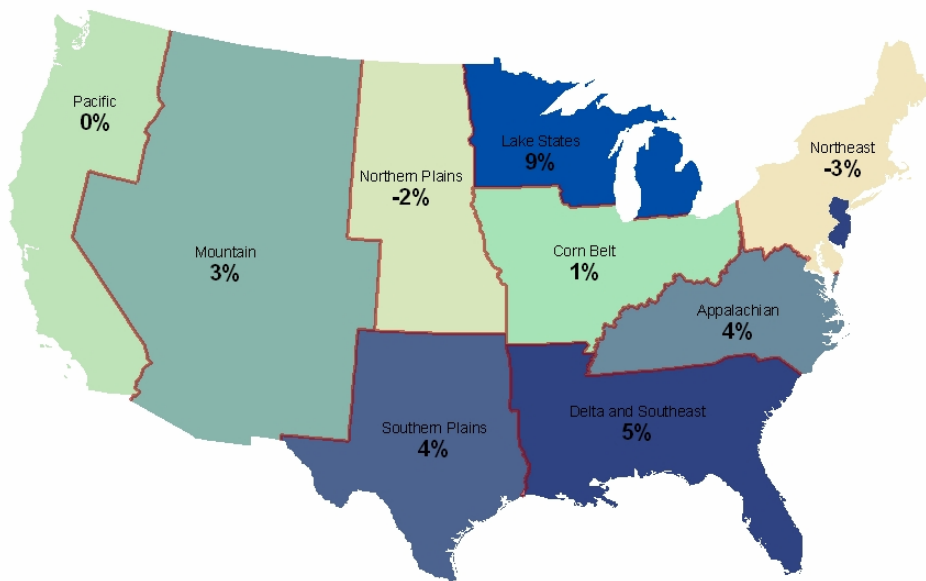
Imports in December were unusually strong at 21 million pounds, causing lamb and mutton imports for 2005 to be unchanged from 2004. Fourth-quarter 2005 imports were 48 million pounds and imports for the first quarter of 2006 are expected to equal the first period in 2005 as strong imports are expected for the upcoming holiday season. Imports in 2006 are expected to increase by about 4 percent in order to satisfy the fairly stable domestic demand.

Change in U.S. All-sheep Inventory by Farm Production Regions,
January 1, 2005 to January 1, 2006



Source: U.S. Department of Agriculture, National Agricultural Statistics Service (NASS).
Compiled by Economic Research Service.

Change in U.S. Breeding sheep Inventory by Farm Production Regions,
January 1, 2005 to January 1, 2006



Source: U.S. Department of Agriculture, National Agricultural Statistics Service (NASS).
Compiled by Economic Research Service.

National Cow Herd Expands for Second Year

The *Cattle* inventory report released January 27, 2006, by NASS confirmed that the national cow herd and cattle inventories are in the second year of an expansion phase of a new cattle cycle. All cattle and calves, at 97.102 million head, were up by 2 percent over the revised January 1, 2005, estimate. Cows and heifers that have calved, at 42.311 million head, were up a modest 1 percent over 2005 inventory estimates. The 2005 estimates were revised downward for almost every category of cattle and calves, including the 2004 calf crop estimate. While heifers for beef and dairy cow replacement were both up 4 percent, the real increase in 2006 heifer inventories was in the implied number of heifers to be bred this summer and later, which was up over 6 percent after removing the heifers expected to calve this year. Whether these heifers are actually bred in 2006 will depend on pasture and forage conditions this spring and summer, and some may have been placed in feedlots since January 1, 2006, because of deteriorating soil moisture conditions and forage supplies that are below January-February 2005 levels.

Hay production in 2005 declined 5 percent from 2004. Although acres harvested in 2005 were down by less than 1 percent from 2004, yields were down over 4 percent as a result of dry conditions. Alfalfa hay production was up slightly from 2004, while all other hay production was down 10 percent from 2004. The farm price of "other hay" in January averaged \$79.30 a ton, up \$1.30 from December, but up \$6 from a year earlier. After a brief wet spell in fall 2005 that got winter wheat off to a reasonable start, conditions turned dry and have steadily worsened, even since January 1, 2006, the date of the cattle inventory snapshot. Most wheat pasture has disappeared as reflected in large fourth-quarter cattle placements. At present, there is some concern over whether or not there will be sufficient soil moisture to support early growth as wheat and pasture/range emerge from winter dormancy.

Beef Production Rising

Given the breeding categories of the moderate inventory increases, and while beef production will increase about 5 percent this year, steady beef production increases will be held down until 2008. This is when calves from the increased inventories of heifers bred this summer will begin coming out of feedlots. Of course, this scenario depends on normal or near-normal precipitation this spring and summer. Between now and the next substantial precipitation, lower hay stocks and supplemental feeding costs compared with last year will cause producers to critically analyze whether or not to keep cows or retain open heifers that may be borderline producers. Mild winter weather through early February has softened the need for supplemental feeding in some areas, but a turn to more normal late winter conditions would force more cattle on the market.

Most calf and feeder calf prices remain well over \$100 per cwt for medium and large number 1 steers and heifers at Oklahoma City. Although cow prices at Sioux Falls are holding fairly steady in the low- to mid-\$50s per cwt, historically low cow slaughter will continue to support cow prices, even as cow slaughter begins to rise. The 90-percent lean beef, which comes mainly from cull cows and imported beef, is needed to blend with 50-percent lean, which comes from fed cattle.

Near Record Numbers of Cattle on Feed

Increases in inventories of steers and bulls over 500 pounds and calves under 500 pounds indicate increased supplies of cattle available for summer pasture and feedlot placements for at least 2006. Other heifers, the only inventory category not showing an increase over January 1, 2005 estimates, which implies increased retention of heifers for breeding, represents heifers likely to go to feedlots during 2006. The January 1, 2006, cattle-on-feed estimate, 14.132 million head, is the third-highest January 1 number since January 1, 1973, when cattle on feed inventories reached 14.432 million head. The second highest January 1 cattle-on-feed inventory was 14.276 million head on January 1, 2001. These inventory levels imply adequate supplies of fed cattle for most of 2006 and could adversely impact prices when they start coming out of feedlots for slaughter.

Supplies of Choice grade cattle available for slaughter remains tight and below year-earlier levels. The reasons for the lower percentages grading Choice or better are not clear as feeding conditions this winter have been good, with no sapping cold, wet weather. Feedlot performance has been good, no doubt due partially to favorable feeding conditions, which also contribute to the heavier slaughter weights.

Most stocker cattle have been removed from wheat pasture as reflected in the large cattle on feed placements in November and December. There is increasing concern about sufficient soil moisture to support early growth as wheat and pasture/range emerge from winter dormancy. A dry spring, along with the lower hay stocks could cause producers to move feeder cattle into feedlots earlier than they would under normal circumstances.

Feeder cattle from Mexico and Canada continue to move into U. S. feedlots at a rate of about 95,000 and 30,000 head per month, respectively. U.S. rule-making for cattle over 30 months of age and beef from cattle over 30 months of age has begun, but a publication date for the rule is uncertain. At the moment, Canadian producers are moving feeder and fed cattle into the United States, some of which have been displaced in Canada in order to maintain higher levels of cow slaughter to reduce the inventory buildup since May 2003. Otherwise excess cows have little value in Canada.

Uncertainty at Wholesale and Retail

Opposing forces are currently at work in the meat markets. A negative factor is the declining relative price of competing meats as beef prices at both wholesale and retail levels remain strong. Retail Choice beef prices averaged \$4.06 per pound in December, about near to slightly below the previous record price of \$4.07 in 2004 and the record of \$4.09 in 2005, and up nearly 17 percent from the pre-BSE 2001-2003 average of \$3.48 per pound. The retail price of pork averaged about \$2.80 in 2004-2005, up less than 5 percent from the \$2.67 per pound average in 2001-2003. The retail price for broilers averaged about \$1.73 per pound in 2004-2005, up nearly 8 percent from the 2001-2003 average of \$1.60 per pound. Maintaining this price premium will be difficult in the face of deteriorating prices for other meats,

negative packer margins, and shrinking farm-to-retail and wholesale-to-retail price spreads. The retail to wholesale and farm-to-wholesale spreads and live cattle prices typically pressure each other in the opposite direction. The retail-to-wholesale spread has narrowed from \$2.36 per pound in June, when fed cattle were averaging in the lower \$80s per cwt., to \$1.94 per pound in December, with cattle averaging in the mid-\$90s. Even with high cattle-on-feed inventories, Choice-grading cattle remain in relatively short supply as indicated by the roughly 55 to 56 percent currently grading Choice or better, well below last year's 58 percent. The spread between Choice and Select, fluctuating in the \$12 to \$15 per cwt range in the first part of 2006, is currently near \$10 per cwt, still well above the 5-year average. The wide spread is further indication of the strong demand for higher grading beef and relatively short supplies of Choice beef. Over the next few months fed cattle marketings will be increasing, resulting in larger supplies of higher quality beef and adding to price pressure.

Boxed beef prices which were slightly below year-earlier levels in mid-February, but well above the 5-year average, have been declining over the last few weeks. The farm-to-retail price spread has narrowed seasonally, from its spring and summer highs. Most of the decline has been in the wholesale-to-retail spread, but the farm-to-wholesale spread remains relatively low.

Cattle Imports Strong in Fourth-Quarter 2005, 2006 Forecast Unchanged

Cattle imports showed their strongest quarterly performance in 4 years during the fourth quarter of 2005. Fourth-quarter imports totaled about 788,000 head, bringing the 2005 total to 1.815 million cattle. Though imports from Mexico slipped about 8 percent from their 2004 total, the return of Canadian cattle to the United States meant total 2005 imports were up about one-third from year-earlier levels. The 2006 cattle import forecast of 2.175 million head was unchanged from last month.

A seasonal surge often occurs in the fourth quarter because spring calves weaned in the fall provide a significant pool of cattle for export in both Mexico and Canada. In addition to normal seasonal patterns, relatively strong U.S. cattle prices also attracted eligible cattle from both countries. Choice steer prices in the fourth quarter of 2005 were up about 6 percent over year-earlier levels, and feeder cattle prices were up about 4 percent over 2004 levels.

Imports of cattle from Canada totaled 346,000 head during the last quarter of 2005. *Weekly Agricultural Marketing Service* reports suggest that about 40 percent of Canadian cattle coming to the United States since imports resumed in July 2005 were feeder cattle. Canadian slaughter patterns shifted during late 2005 and early 2006, as relatively larger packer margins on cows resulted in higher nonfed Canadian slaughter, coupled with increasing fed cattle exports to the United States. Compared with the third quarter, the difference between U.S. and Canadian prices narrowed during the fourth quarter for both feeder and fed cattle, though in neither case has the differential dropped to pre-BSE levels.

The recent discovery of another BSE case in Canada has not changed the cattle import forecast for 2006, because of import rules involving cattle age limitations. The 2006 forecast also assumes that Canada's imposition of a \$1.65/bushel duty on imports of U.S. corn is in place through the rest of 2006. An internal review by the Canadian Government on this ruling will conclude in late March or April.

Beef Exports Ended Strong for 2005, Several Countries Revise Status for 2006

Fourth-quarter U.S. beef exports totaled 220 million pounds, the highest quarterly total yet since the initial BSE case in December 2003. Mexico remains the top customer for U.S. beef. While Japan reopened its market December 12, 2005, shipments there during the month were still relatively small. Total beef exports during 2005 reached 689 million pounds, up 50 percent over the 2004 total, though still only 27 percent of the record set in 2003 of 2.518 billion pounds.

The 2006 beef export forecast was revised to reflect changes in trade rules by several countries. Most notably, exports to Japan were assumed to be suspended for the remainder of the first quarter, following the discovery of prohibited materials (an intact backbone and spinal cord in a veal rack) in a shipment of U.S. veal on January 20, 2006. The U.S. Department of Agriculture's (USDA) investigation of the incident is underway, and a report will be forwarded to the Japanese Government upon completion.

Taiwan announced in late January that it is reopening its markets to U.S. beef. Taiwan will only accept boneless beef from animals under 30 months of age. The restriction on boneless products does not appear to be a major restriction, as in past years Taiwan's beef imports were over 90 percent boneless products. Taiwan imported about 3-4 million pounds of U.S. beef per month in 2003 and over 8 million pounds per month when it briefly reopened to U.S. beef in 2005.

South Korea and the United States have established a framework for South Korea to reopen its markets to U.S. beef. However, prospective sales to South Korea were not included in the 2006 forecast, as implementing legislation has not yet been finalized. Like Taiwan, South Korea announced that it was only willing to import boneless products from animals under 30 months of age. However, bone-in products were much more significant in the South Korean import product mix; the U.S. Meat Export Federation has indicated that short ribs were the most important cut prior to the ban, accounting for about two-thirds of the U.S. export total to South Korea. South Korea had become a significant market in pre-BSE days, as it imported 587 million pounds of U.S. beef in 2003. Shipments to South Korea will be added to the forecast when trade rules are finalized.

Beef Imports Dip in Fourth Quarter, and 2006 Forecast Also Revised Downward

Fourth-quarter 2005 beef imports totaled 797 million pounds, down 12 percent from the third quarter and down 15 percent from the fourth quarter of 2004. The biggest year-to-year declines from individual countries occurred with Australia, down 20 percent, and New Zealand, down 7 percent. In Australia, record beef and cattle prices during 2005 (owing largely to the absence of U.S. and Canadian competition in the Japanese and Korean markets) have encouraged cattle retention, along with improved pasture conditions. U.S. beef imports from Canada were actually up 3 percent from 2004 to 2005, even with the resumption of Canadian live cattle exports to the United States.

Lower beef imports are forecast for 2006. In particular, Australia is expected to reduce its exports to not only the United States but also its other major markets, Japan and South Korea. Canadian beef exports to the United States should be somewhat constrained by the volume of cattle Canada is expected to send here in 2006. Total 2006 U.S. beef imports are forecast at 3.500 billion pounds, down about 3 percent from the 2005 total of 3.599 billion pounds. Nevertheless, demand for lean beef imports should remain strong, because the U.S. cattle herd is in the expansion phase of the cattle cycle; cow retention and historically low cow slaughter makes domestic supplies relatively tight for lean meat for ground beef and other lean-based products. Uruguay and New Zealand are the other large suppliers of lean beef to the United States. Uruguay's beef shipments to the United States showed another large increase in 2005, reaching 557 million pounds, 38 percent above their previous record set in 2004. Such a large increase is not expected in 2006, however.

Argentina recently had its beef exports interrupted due to a move by its own government to limit beef exports in order to hold down beef prices and inflation. In addition, a new case of foot-and-mouth disease (FMD) was just reported in the northern section of the country. Argentina has averaged about 10 million pounds of

beef exports to the United States per month, although they may currently only ship cooked beef products here due to concerns about FMD. Brazil's problems with the FMD outbreak last fall did not have a large effect on its exports to the United States, as it also was restricted to ship only cooked products here.

Dairy Heifer Supplies Up

The January 1 inventory showed almost 4.3 million dairy replacement heifers, up almost 4 percent from a year earlier and more than 6 percent from 2 years earlier. The larger-than-expected rise was triggered by the very high replacement prices of 2004 that encouraged extraordinary measures to keep as many heifers as possible. Even so, the increase may have been aided by particularly low death losses in 2004. The ratio of replacement heifers to milk cows exceeded 47 on January 1, up from less than 46 a year earlier and easily a record.

Almost 2.9 million heifers are expected to calve and enter the milking herd in 2006, up almost 3 percent from a year earlier. These extra heifers should significantly ease tightness in replacement heifer supplies, allowing for the belated replacement of some marginal cows as well as making it easier to fill new barns. Milk cow numbers in 2006 are now expected to increase slightly faster than thought earlier.

Despite the large heifer supplies, strong demand has kept replacement prices high. January's \$1,840 per head was more than \$200 above a year earlier, and the seasonal decline from last October's record was modest. Some easing of heifer prices is possible this year, but demand for animals to fill new or expanded facilities is projected to stay strong throughout 2006.

Wholesale Prices Slip

Wholesale butter and cheese prices seem caught in the winter doldrums, drifting lower since early January. Increases in milk production remain strong, autumn seasonal declines in commercial stocks were less than expected, but the greatest pressure probably has come from market expectations for the rest of 2006. Traders seem to anticipate large production increases and uncertain demand, making buyers reluctant to seek commitments for later in the year. In addition, this year's date of Easter means holiday buying will be about a month later than in 2005.

Production increases probably will outstrip demand growth, pushing 2006 prices below a year earlier. But, drops in early February cheese prices of 20 cents from a year earlier and almost 40 cents in butter prices might prove to be too large. Slight recovery may occur if production growth slackens as expected and demand stays firm. Even so, prices are not likely to develop very clear patterns until second-half prospects become more settled.

Nonfat dry milk prices also have softened since the end of December. Production has risen seasonally and also (reportedly) from a year earlier. The heavier supplies have encouraged buyers to minimize purchases in hopes of lower prices. Apparently, sluggish buying applies to both domestic and foreign customers. Even so, international powder markets remain tight. Except for the United States, export supplies remain limited, although quantities are seasonally large in Oceania. Meanwhile, import demand for milk powders has stayed basically strong. Unless international prices slip more than expected, nonfat dry milk prices probably will recover somewhat when buyers start to deplete their stocks.

Pork Supply Side Strongly Positive, Demand Side Less So

The first month of 2006 presented a mixed picture for U.S. pork and hog markets. Supply side signs--estimated slaughter, dressed weights, pork production--were strongly positive in January, but in line with most expectations. And while cautionary flags are beginning to emerge on the demand side--domestic pork demand in particular--foreign demand shows few signs of either relent or decline, with USDA forecasting another year-over-year increase in U.S. pork exports, for the 16th year in a row. But despite beginning 2006 cold stocks at seasonal lows, and packers handling anticipated weekly slaughters of 2 million-plus with nary a whimper, markets appear increasingly focused on domestic demand, and on questions of how higher costs of energy and loans will affect consumers' willingness to buy pork products, at a time when attractively-priced poultry abounds.

Some Background and Context for the Current Market Situation

The key market dynamic of the past 2 years has been the extraordinary jump in hog prices that began in the first half of 2004 (See figure), and the subsequent price reduction from August 2004 through January 2006.

**Monthly live equivalent 51-52 percent lean hog prices,
January 2002-January 2006**



Source: ERS, USDA.

Live equivalent 51-52 percent lean hog prices increased almost 62 percent, from \$36.02 per cwt in December 2003 to \$58.21 per cwt in July 2004, at a time when the U.S. pork industry was producing more pork than ever. The run-up in hog prices has been attributed to increases in the domestic and foreign demand for pork products, deriving largely from the popularity of high protein diets here in the United States, and from the low-valued U.S. dollar and foreign consumers' food safety concerns in markets abroad. While the figure indicates that hog prices have drifted slowly downward since summer 2004, most U.S. hog producers have enjoyed above break-even hog prices for the last 24 months. USDA's 2006 hog price forecast--between \$42 and \$45 per cwt, for 51-52 percent lean, live equivalent hogs--anticipates above break-even prices for most producers this year. But there is some concern now that pork industry profitability may suffer if U.S. consumers, tired of high-protein diets, respond to higher energy prices and interest rates by reducing their consumption of pork products. This is a rational concern since 87 percent of U.S. pork production is consumed here at home, and commercial pork production in 2006 is expected to increase by more than 2 percent over last year.

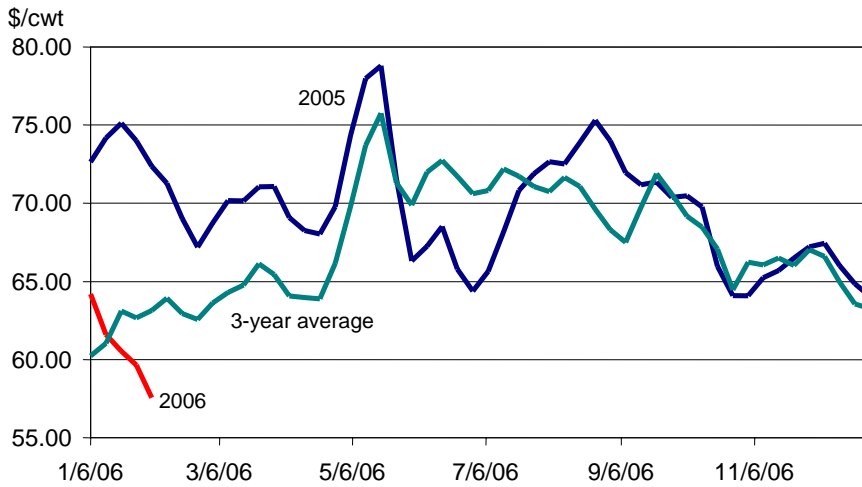
Pork Production in January Estimated To Be Above a Year Ago, Wholesale Values Lower

The USDA *Estimated Hog Slaughter Under Federal Inspection* (FI) in January was 8.84 million head, or 2.1 million head per week, with estimated dressed weights at 204.5 pounds per head--almost 3 pounds above a year ago--and estimated FI production of more than 1.8 billion pounds, more than 6 percent above January 2005. The increased production is consistent with USDA's first-quarter commercial pork production forecast of 5.24 billion pounds. Heavy January dressed weights appear to be a result of ideal growing conditions--cool, not bone-chilling cold Corn Belt temperatures--rather than back-ups at slaughter plants.

Packers paid less for hogs in January. The live equivalent price of 51-52 percent lean hogs was \$41.37 per cwt, 22 percent below January 2005. First-quarter hog prices are expected to average between \$42 and \$44, or about 17 percent lower than a year ago. Packers are likely bidding hog prices lower, not only because of large available producer supplies, but because prices at which they were able to sell pork products are lower than last month and a year ago--a strong indication of softening pork demand. The estimated wholesale value of the composite carcass--the "cutout" was \$61.50 per cwt in January, (see figure), more than 8 percent lower than last month (December 2005), and almost 20 percent lower than a year earlier (January 2005). (For updated information on USDA's calculation of the cutout, see http://www.ams.usda.gov/lsmnpubs/PDF_Daily/LS20060202ACPCO.pdf)

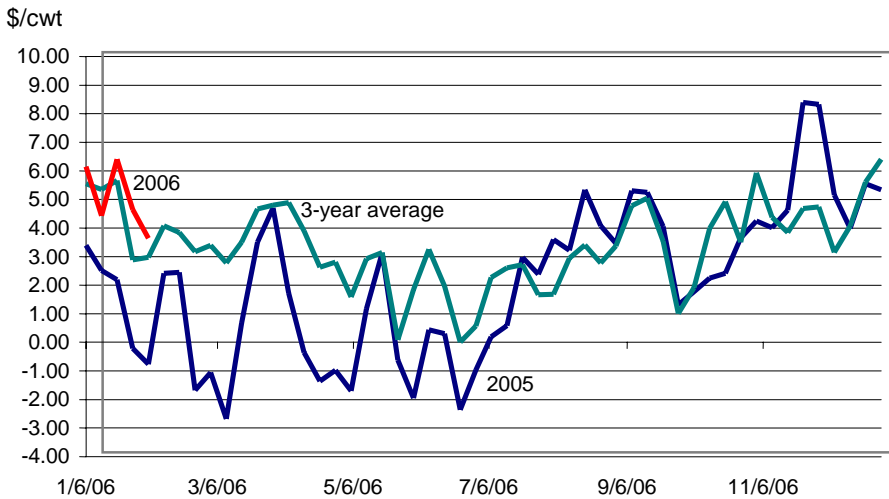
Subtracting the cost of hogs from estimated wholesale values of products yields an estimate of the packers' gross margin (see figure). From the figure, it is clear that current packer margins are strongly positive--above both a year ago, and above the 3-year average of estimated gross margins. But estimated margins are currently strong because hog prices are disproportionately lower, and not because wholesale demand, as reflected in cut-out value, is higher. Again, the lower cut-out (see figure) injects a cautionary note into an otherwise positive outlook picture.

Weekly composite pork carcass cutout, 2006, 2005, and 3-year average



Source: AMS, USDA.

Weekly estimated packers' gross margin 2006, 2005, 3-year average



Source: ERS calculations based on AMS, USDA data.

2006 Retail Price Forecast Lowered Slightly

Fourth-quarter 2005 retail prices were \$2.78 per pound, somewhat lower than expected. Prices may be lower due to some combination of increased retail pork supplies and consumers' price sensitivities. USDA's 2006 forecast for retail pork prices was lowered slightly to the mid-\$2.70s per pound, from earlier estimates in the high \$2.70s per pound. The slightly lower retail price forecast derives from expectations of higher 2006 retail supplies, and the effects that tight food budgets may have on consumer pork demand, when attractively priced poultry alternatives are readily available.

Fourth-Quarter 2005 Broiler Production at 8.9 Billion Pounds

Broiler production for fourth-quarter 2005 was reported at 8.9 billion pounds, up 4.3 percent from a year earlier, chiefly the result of climbing average live weights for broilers at slaughter. The number of broilers slaughtered in the fourth quarter was up only 1 percent, while the average liveweight at slaughter was 5.49 pounds, an increase of 2.9 percent from a year earlier. Over the last several months, the percentage of broilers being slaughtered has tended to show gains in the heaviest weight category (over 5.25 pounds) while the number of birds slaughtered have been lower in the lightest weight category (4.2 pounds or below). Most of the birds in the heaviest weight category are cut up for parts, and a large percentage of the birds in the lightest weight category are sold as whole birds. The upward movement in average size has helped contribute to the downward pressure on parts prices and is major reason for lower whole broiler stocks.

Broiler meat production for 2005 was 35.3 billion pounds, up 3.8 percent from 2004. The outlook for 2006 is for continued expansion in broiler meat production, but at a slower rate than in 2005. The production estimate for 2006 is 36.1 billion pounds, an increase of only 2 percent. The 2006 production estimate was lowered by more than 200 million pounds from last month's estimate as processors are expected to slow the growth in meat production in response to declines in most prices in fourth-quarter 2005 and the large build up in stocks.

Cold storage stocks of broiler products at the end of December 2005 totaled 918 million pounds, up 29 percent from the end of 2004. The increase was due to higher stocks of most broiler parts as the poundage of whole broilers held in cold storage fell to 22 million pounds, down 7.6 percent from a year earlier. The majority of the increase in cold storage stocks of broiler parts was the result of a large increase in leg quarter stocks. Stocks of leg quarters alone totaled 176 million pounds, 131 percent higher than at the end of 2004. Cold storage stocks were also significantly higher for breast meat and wings (up 11 and 25 percent), but almost all categories of broiler products showed increases. The lone exception was thigh meat stocks, which declined 12 percent from the same period last year. Due to the rapid build up in broiler stocks at the end of 2005, quarterly ending stock estimates for 2006 have all been increased.

The large increases in leg quarter cold storage stocks are reflective of lower demand for exported broiler products, primarily in Eastern Europe and the Commonwealth of Independent States. This decline in demand for export products, mostly leg quarters, occurred just as production was increasing in the fourth quarter. U.S. broiler meat production was up only 1 percent in third-quarter 2005, but rose 4.3 percent in the fourth quarter. As a result of the impacts of these two factors--lower export demand and higher production--there has been a build up of cold storage stocks and falling prices for most broiler products.

Turkey Meat Production Rises in 2005, Weights Increase

The number of turkeys slaughtered in 2005 was 248 million birds, down 2.7 percent from 2004, but turkey meat production increased slightly (0.7 percent) to 5.5 billion

pounds. The turkey meat production increase was due mainly to average turkey weights at slaughter rising to 28 pounds, up 3.3 percent from last year. Turkey meat production is expected to increase slightly in 2006 as strong prices in 2005 encouraged producers to expand.

The situation for cold storage turkey stocks is the opposite from broiler products. Total turkey cold storage stocks at the end of 2005 were 202 million pounds, down 30 percent from end of 2004. The decline was divided among whole turkeys and turkey parts. Whole bird cold stocks at the end of 2005 were 50 million pounds, down 53 percent and stocks of turkey parts were down 17 percent to 152 million pounds. With a relatively small increase in production, forecast and exports expected to increase slightly, domestic turkey consumption is forecast to decline in 2006. Turkey stocks are expected to remain relatively tight, which will keep upward pressure on turkey prices. However, the upward pressure on turkey prices due to tight stocks and slowly growing production will likely be moderated by the large amounts of relatively low-cost broiler products available for buyers.

U.S. Broiler Exports Increase In 2005

U.S. exports of broiler products in 2005 were 5.15 billion pounds and were valued at \$2.1 billion, up 21 percent in quantity and 8 percent, respectively, from last year. The increase in exports occurred in the first three-quarters of 2005 while shipments fell sharply in the fourth quarter. Fourth-quarter export reductions were likely due to weakening demand as outbreaks of Avian Influenza (AI) spread to areas outside of Asia. Along with the higher volume of exports, the unit value of shipments rose last year as leg quarter prices (the primary export product) was strong, until the end of October. The increase in total exports last year was concentrated in a relatively small number of important markets. The volume of shipments to Russia rose by 9 percent and those to Mexico were up 21 percent. Broiler exports also increased to a number of Asian countries, such as Korea, Taiwan, and Hong Kong/China. Although total broiler shipments to Cuba fell somewhat in 2004, shipments in 2005 totaled 172 million pounds, up 22.2 percent and making Cuba the third-largest market in the Western Hemisphere after Mexico and Canada.

After very strong exports in October, shipments declined in both November and December (766 million pounds, down 16 percent from the 2004), as shipments to countries in Eastern Europe and Central Asia have fallen. These have been partially offset by continued strong exports to Russia and Mexico, the two largest markets. Exports in December were also supported by larger sales to a number of smaller price sensitive markets that were able to make larger purchases due to the large decline in the unit price of leg quarters. Lower leg quarter prices induced countries such as Korea, Romania, Cuba, Guatemala, Angola, and Taiwan to increase quantities demanded.

Exports in 2006 are expected to total 5.4 billion pounds, with exports lower in the first half of the year, but strengthening in the second half. The export forecast is largely contingent on developments in the geographic spread of AI. The impact of AI on foreign demand for U.S. broiler meat will depend on whether the spread of the disease involves relatively isolated incidents involving a small number of birds or if the number of outbreaks are large and if there are additional concerns over human health.

Turkey Exports Rise by 29 Percent

Turkey exports in 2005 were 569 million pounds, up 29 percent in quantity and 30 percent in value from the previous year. Most of the increase is due to strong growth in shipments to Mexico. In 2005, shipments to Mexico totaled 354 million pounds or 62 percent of all turkey exports. Another strong market in 2005 was Canada, which imported 28 million pounds of turkey products, a 52-percent increase from the last year. As with broilers, there were also higher exports to several Asia markets, including Japan and China/Hong Kong.

Turkey exports are expected to expand slightly in 2006. Most of the growth will come from continued strong shipments to Mexico. The growth in the Mexican economy is expected to fuel demand for turkey products, especially those used in manufacturing processed turkey sausage products. Shipments to China/Hong Kong, Japan, and Korea together declined over 30 percent from the previous year.

Partially offsetting Asian declines were higher exports to Canada, Mexico, Russia, and the NIS countries. Turkey exports followed much the same pattern as broiler exports, in that the total 2005 quantity of shipments was down year-over-year, but the value of shipments was up sharply.

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Recent Report

Did the Mandatory Requirement Aid the Market? Impact of the Livestock Mandatory Reporting Act, <http://www.ers.usda.gov/Publications/LDP/Sep05/ldpm13501/> compares the mandatory price reporting system developed by USDA's Agricultural Marketing Service in 2001 with the previous voluntary reporting system. The trend toward formula purchases has slowed since mandatory price reporting was implemented, and market forces have likely contributed to an increase in the volume of cattle moving under negotiated purchases.

Market Integration of the North American Animal Products Complex, <http://www.ers.usda.gov/Publications/ldp/may05/ldpm13101/> The beef, pork, and poultry industries of Mexico, Canada, and the United States have tended to become more economically integrated over the past two decades. Sanitary barriers, which are designed to protect people and animals from diseases, are some of the most significant barriers to fuller integration of meat and animal markets.

Related Websites

Animal Production and Marketing Issues, <http://www.ers.usda.gov/briefing/AnimalProducts/>
Cattle, <http://www.ers.usda.gov/briefing/cattle/>
Dairy, <http://www.ers.usda.gov/briefing/dairy/>
Hogs, <http://www.ers.usda.gov/briefing/hogs/>
Poultry and Eggs, <http://www.ers.usda.gov/briefing/poultry/>
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Red meat and poultry forecasts

	2003		2004		2005						2006					
	Annual	I	II	III	IV	Annual	I	II	III	IV	Annual	I	II	III	IV	Annual
Production, million lb																
Beef	26,238	5,838	6,253	6,360	6,097	24,548	5,727	6,192	6,566	6,210	24,695	6,050	6,725	6,825	6,350	25,950
Pork	19,945	5,130	4,897	5,047	5,435	20,509	5,136	5,022	4,999	5,525	20,682	5,240	5,100	5,250	5,625	21,215
Lamb and mutton	199	53	46	46	50	195	49	46	45	48	188	49	52	49	52	202
Broilers	32,749	8,195	8,492	8,839	8,537	34,063	8,571	8,941	8,931	8,850	35,293	8,825	9,125	9,100	9,050	36,100
Turkeys	5,650	1,309	1,366	1,390	1,389	5,454	1,320	1,393	1,375	1,425	5,513	1,335	1,405	1,410	1,425	5,575
Total red meat & poultry	85,476	20,687	21,220	21,858	21,676	85,441	20,964	21,770	22,086	22,221	87,041	21,666	22,579	22,811	22,682	89,738
Table eggs, mil. doz.	6,225	1,556	1,574	1,598	1,637	6,365	1,585	1,580	1,603	1,650	6,418	1,600	1,625	1,640	1,675	6,540
Per capita consumption, retail lb 1/																
Beef	64.9	16.0	16.9	16.9	16.3	66.1	15.6	16.8	17.0	16.0	65.4	16	17.3	17.5	16.1	66.9
Pork	51.8	13.0	12.2	12.7	13.4	51.3	12.3	12.1	12.3	13.1	49.8	12.4	12.1	12.7	13.3	50.4
Lamb and mutton	1.2	0.3	0.3	0.2	0.3	1.1	0.3	0.3	0.2	0.3	1.1	0.3	0.3	0.3	0.3	1.1
Broilers	81.6	20.8	21.2	21.9	20.4	84.3	21.3	21.7	21.6	21.1	85.6	21.7	22.2	21.9	21.3	87.2
Turkeys	17.4	3.6	4.0	4.5	5.0	17.1	3.6	3.8	4.2	5.1	16.7	3.4	3.7	3.9	5.2	16.2
Total red meat & poultry	218.9	54.1	54.8	56.6	55.9	221.4	53.5	55.2	55.7	56.1	220.4	54.2	56.1	56.6	56.7	223.6
Eggs, number	254.7	63.7	63.9	64.1	65.5	257.2	63.3	62.9	63.8	65.4	255.5	63.3	64.2	64.7	65.7	257.9
Market prices																
Choice steers, Neb., \$/cwt	84.69	82.16	88.15	83.58	85.09	84.75	89.09	87.96	81.79	90.27	87.28	89-91	84-90	78-84	80-86	83-88
Feeder steers, Ok City, \$/cwt	89.85	87.98	104.58	116.27	110.19	104.76	104.05	113.36	111.50	114.84	110.94	107-109	99-105	95-101	95-101	99-104
Boning utility cows, S. Falls, \$/cwt	46.62	47.50	54.86	56.25	50.78	52.35	54.18	59.17	55.34	50.64	54.83	51-53	54-56	52-56	51-55	52-55
Choice slaughter lambs, San Angelo, \$/cwt	91.98	100.62	97.06	93.62	95.44	96.69	106.10	98.60	92.90	93.50	97.78	93-95	90-96	88-94	90-96	90-95
Barrows & gilts, N. base, l.e. \$/cwt	39.45	44.18	54.91	56.58	54.35	52.51	51.92	52.09	50.51	45.67	50.05	42-44	45-47	43-47	38-42	42-45
Broilers, 12 City, cents/lb	62.00	73.20	79.30	75.70	68.30	74.10	71.90	72.60	72.10	66.70	70.80	64-66	64-68	66-72	65-71	65-69
Turkeys, Eastern, cents/lb	62.10	62.10	66.60	73.10	77.10	69.70	65.90	67.70	76.50	83.60	73.40	66-68	68-72	72-78	75-81	70-75
Eggs, New York, cents/doz.	87.90	114.90	79.70	66.20	68.00	82.20	64.50	55.90	66.60	75.00	65.50	69-71	65-69	67-73	72-78	68-73
U.S. trade, million lb																
Beef & veal exports	2,518	36	120	138	167	461	130	189	150	200	669	165	235	260	245	905
Beef & veal imports	3,006	873	929	940	937	3,679	831	1,065	906	765	3,567	840	930	890	840	3,500
Lamb and mutton imports	168	62	47	34	38	181	41	52	39	45	177	50	50	40	44	184
Pork exports	1,717	523	546	486	624	2,179	630	699	629	700	2,658	640	725	665	725	2,755
Pork imports	1,185	275	265	291	268	1,099	245	245	257	255	1,002	245	240	260	255	1,000
Live swine imports	7,438	2,210	2,024	2,196	2,075	8,505	1,894	1,951	2,157	2,200	8,202	2,100	2,200	2,200	2,200	8,700
Broiler exports	4,920	1,024	1,008	1,250	1,486	4,768	1,199	1,347	1,315	1,350	5,211	1,175	1,300	1,415	1,515	5,405
Turkey exports	484	83	93	134	133	443	126	147	147	160	580	130	150	155	165	600

1/ Per capita meat and egg consumption data are revised, incorporating a new population series from the Commerce Department's Bureau of Economic Analysis based on the 2000 Census.

Source: World Agricultural Supply and Demand Estimates and Supporting Materials.

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Economic Indicator Forecasts

	2004		2005					2006				
	IV	Annual	I	II	III	IV	Annual	I	II	III	IV	Annual
GDP, chain wtd (bil. 2000 dol.)	10,897	10,756	10,999	11,092	11,193	11,234	11,131	11,355	11,449	11,534	11,626	11,487
CPI-U, annual rate (pct.)	3.4	3.4	2.4	4.2	5.1	3.2	3.7	2.0	2.5	2.5	2.4	2.4
Unemployment (pct.)	5.4	5.5	5.3	5.1	5.0	4.9	5.1	4.8	4.8	4.8	4.8	4.8
Interest (pct.)												
3-month Treasury bill	2.0	1.4	2.5	2.9	3.4	3.8	3.2	4.4	4.6	4.7	4.7	4.5
10-year Treasury bond yield	4.2	4.3	4.3	4.2	4.2	4.5	4.3	4.6	4.8	4.9	4.9	4.8

Source: Survey of Professional Forecasters, Philadelphia Federal Reserve Bank, February 2006.
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Dairy Forecasts

	2004		2005					2006				
	IV	Annual	I	II	III	IV	Annual	I	II	III	IV	Annual
Milk cows (thous.)	9,019	9,010	8,996	9,034	9,054	9,050	9,034	9,070	9,095	9,125	9,165	9,115
Milk per cow (pounds)	4,655	18,958	4,807	5,054	4,858	4,818	19,537	4,960	5,140	4,910	4,900	19,910
Milk production (bil. pounds)	42.0	170.8	43.2	45.7	44.0	43.6	176.5	45.0	46.7	44.8	44.9	181.4
Farm use	0.3	1.1	0.3	0.3	0.3	0.3	1.1	0.3	0.3	0.3	0.3	1.1
Milk marketings	41.7	169.7	43.0	45.4	43.7	43.3	175.4	44.7	46.5	44.5	44.6	180.4
Milkfat (bil. pounds milk equiv.)												
Milk marketings	41.7	169.7	43.0	45.4	43.7	43.3	175.4	44.7	46.5	44.5	44.6	180.4
Beginning commercial stocks	9.9	8.3	7.2	9.4	11.2	9.6	7.2	7.7	10.0	11.5	9.6	7.7
Imports	1.3	5.3	1.3	1.1	1.1	1.2	4.6	1.3	1.1	1.1	1.3	4.7
Total supply	52.9	183.3	51.5	55.9	56.0	54.1	187.2	53.7	57.6	57.1	55.5	192.8
Ending commercial stocks	7.2	7.2	9.4	11.2	9.6	7.7	7.7	10.0	11.5	9.6	7.5	7.5
Net removals	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial use	45.7	176.2	42.1	44.7	46.4	46.4	179.5	43.7	46.1	47.5	48.0	185.3
Skim solids (bil. pounds milk equiv.)												
Milk marketings	41.7	169.7	43.0	45.4	43.7	43.3	175.4	44.7	46.5	44.5	44.6	180.4
Beginning commercial stocks	9.5	8.5	8.2	8.4	9.6	8.9	8.2	8.7	9.0	9.9	9.1	8.7
Imports	1.3	4.8	1.2	1.0	1.2	1.2	4.5	1.2	1.1	1.1	1.2	4.6
Total supply	52.5	183.0	52.3	54.9	54.5	53.4	188.1	54.6	56.6	55.5	54.9	193.6
Ending commercial stocks	8.2	8.2	8.4	9.6	8.9	8.7	8.7	9.0	9.9	9.1	8.3	8.3
Net removals	0.0	1.3	-0.4	-0.3	-0.2	0.0	-1.0	0.0	0.2	0.2	0.5	0.9
Commercial use	44.3	173.5	44.3	45.6	45.8	44.7	180.4	45.6	46.5	46.3	46.1	184.5
Milk prices (dol./cwt) 1/												
All milk	16.07	16.05	15.67	14.83	14.97	15.13	15.15	13.85	12.70	12.50	13.20	13.05
								-14.25	-13.40	-13.50	-14.2	-13.85
Class III	15.06	15.39	14.31	14.10	14.08	13.69	14.05	12.40	11.65	11.60	11.70	11.80
								-12.80	-12.35	-12.60	-12.70	-12.60
Class IV	13.19	13.20	12.64	12.38	13.45	13.03	12.87	11.50	11.30	10.95	10.80	11.10
								-12.00	-12.10	-12.05	-11.9	-12.00
Product prices (dol./pound) 2/												
Cheddar cheese	1.610	1.643	1.531	1.507	1.481	1.431	1.488	1.290	1.245	1.255	1.27	1.265
								-1.330	-1.315	-1.355	-1.37	-1.345
Dry whey	0.235	0.232	0.248	0.263	0.287	0.314	0.278	0.330	0.275	0.245	0.235	0.270
								-0.350	-0.305	-0.275	-0.265	-0.300
Butter	1.778	1.824	1.570	1.459	1.646	1.487	1.540	1.250	1.235	1.270	1.270	1.255
								-1.320	-1.335	-1.400	-1.4	-1.365
Nonfat dry milk	0.862	0.841	0.899	0.923	0.957	0.984	0.941	0.915	0.900	0.850	0.830	0.875
								-0.955	-0.960	-0.920	-0.9	-0.935

1/ Simple averages of monthly prices. May not match reported annual averages.

2/ Simple averages of monthly prices calculated by the Agricultural Marketing Service for use in class price formulas. 'Based on weekly "Dairy Product Prices", National Agricultural Statistics Service. Details may be found at http://www.ams.usda.gov/dyfmoms/mib/fedordprc_dscrp.htm

Source: World Agricultural Supply and Demand Estimates and supporting materials.

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