

## **OUTLOOK FOR U.S. DAIRY**

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The U.S. dairy industry enters 2009 with the domestic economy in the throes of the worst economic downturn since 1982. Although retreating in 2008 from 2007's record levels, the all milk price remained well above prices in recent years. Despite relatively high milk prices, producers already felt the squeeze as feed prices rose. Corn prices received by farmers topped at \$5.29 a bushel in the second quarter of 2008 and Decatur soybean meal prices reached their zenith during the summer of 2008 at \$367 per ton. The USDA benchmark 16 percent protein mixed ration stood at nearly \$10.00 per cwt in the spring and summer quarters before sliding below \$9.00 per cwt in the fall quarter. The higher feed prices pushed the milk-feed price ratio below 2.0 in the second and third quarters of 2008, rebounding slightly to hover near 2.0 for the remainder of the year.

### **Outlook for 2009: Falling Returns Force Herd Retrenchment**

The outlook for 2009 is for feed prices to moderate from last year; however, assuming no significant herd reduction early in the year, milk prices are expected to plummet to their lowest levels in years. The all milk price is expected to be its lowest since 1978. Low milk prices will push the milk-feed price ratio into the 1.5 range, a record low, and leave producers with the worst profit outlook in years. Producers are likely to continue to face severe profit pressures during most of 2009, although some relief could come by the end of the year. Consequently, cow numbers are forecast to decline in 2009 to an average 9.050 million head in the fourth quarter of 2009. Current USDA forecasts are based on the assumption that there is no liquidation aid of any kind either in the form of another CWT buyout or any Government buyout program. The forecasts suggest that herd liquidation will be most pronounced in the second half of the year as poor returns earlier in the year force producers to retrench. Milk yields will likely continue to rise fractionally in 2009 because liquidation would be of the least productive animals helping to boost the average productivity of the remaining herd. Further complicating the supply reduction effort is the ample supply of replacement heifers available at the beginning of 2009 and at attractive prices. The number of replacements available is 47.3 per 100 cows, down only slightly from the 47.7 available at the start of 2008 but still near an all time high. Replacing less efficient cows with younger ones could boost productivity per unit of feed and overall yields foiling efforts to rein in supply.

## **Demand Weakens in 2009**

With high production relative to demand in 2008, year-end stocks had climbed. The central problem is that domestic demand is insufficient to absorb the added production in the near term. The high prices of 2007 and 2008 came as commercial exports rose sharply and domestic commercial use continued to advance. In 2009, domestic commercial use will likely continue to advance, albeit slowly. The economic slump has adversely affected restaurant sales as consumers scale down to less expensive restaurants or eat more at home. Retail sales of premium and value added products, especially cheese, have suffered as consumers appear to be “trading down”. In previous years, growth in commercial use grew in response to rising incomes. In 2009, commercial use will continue to grow as falling prices stimulate sales. The ample supply of dairy products should encourage retail “promotions” and restaurant “value” items that will appeal to cash strapped consumers. Low prices appear to be having some effect on volumes. According to the NASS weekly *Dairy Product Prices* report, cheese, butter, NDM, and whey posted double digit volume increases for the four week period ending the first week in February over the corresponding period in 2008.

## **International Demand Weakens as Competition Stiffens**

U.S. exports of cheese, butter, and NDM rose to record levels in 2008, not because total global imports changed that much from 2007 but because reduced supplies from Australia, New Zealand and the EU allowed U.S. products to fill the gap. International demand for U.S. exports pushed domestic prices for milk and dairy products into the stratosphere in 2007. The relatively high prices carried over into 2008 and partly offset record high grain prices faced by producers. A number of factors provided the foundation for the strong exports seen in 2007 and much of 2008. First, world stocks of dairy products were low. Dairy stocks in the major trading nations declined from 2006: butter by 44 percent, cheese by 5 percent, whole milk powder by 28 percent, and skim milk powder stocks by 13 percent. Another factor was the severe drought that engulfed much of Oceania which limited dairy product supplies for exports from Australia and New Zealand. At the same time that export supplies were tightening, strong world economic growth, especially in Asia, strengthened import demand. Also, high petroleum prices prompted increased dairy product imports by oil exporting countries. U.S. prices remained below world prices for most dairy products until late 2008 and the trade-weighted value of the dollar made U.S. dairy products an attractive buy.

All this ended when the world economy slumped and oil prices crashed. An additional factor is that the partial recovery of production in Australia, New Zealand, and the EU added supplies to a slumping market. Total dry products shipments by the major exporters are forecast to decline only slightly in 2009, but increases from the EU, Australia and especially New Zealand will make the export market extremely competitive. Likewise for cheese and butter, added availabilities from competing

suppliers likely will curtail U.S. exports in 2009. Overall, international demand is likely to remain soft compared to 2007 and early 2008. Those two years were a perfect storm for a sharp run up in U.S. exports. U.S. producers will likely recapture some lost market share in the future but will face keen competition from the EU and Oceania as well as some other emerging nations.

### **In 2009, CCC Purchases Will Limit Increases in Commercial Stocks**

U.S. commercial stocks of dairy products were more variable in 2008 after a slight rise in 2007. On a fat-basis, total stocks began the year marginally above 2007 but moved lower as butter stocks dropped below year earlier levels. Cheese stocks, which began the year lower than beginning stocks a year earlier, moved above 2007 as product production outpaced demand. NDM stocks averaged well above 2007 and climbed rapidly in the last quarter of 2008 as exports slowed. Commercial stocks are expected to end 2009 lower than they began at 9.3 billion pounds (fat basis) and 10.4 billion pounds (skim-solid basis) as later year production declines tighten supplies. CCC removals will keep commercial stocks from building. For the calendar year, net removals of cheese are expected to reach 20 million pounds. Removals of butter and NDM are expected to total 55 million pounds and 575 million pounds respectively. As of February 20<sup>th</sup>, CCC has purchased 4.6 million pounds of butter and 64 million pounds of NDM since the beginning of 2009. For 2009, net removals of cheese are expected to reach 20 million pounds. Removals of butter and NDM are expected to total 55 million pounds and 575 million pounds respectively. This forecast amounts to 1.5 billion pounds of milk equivalent for the year on a fat basis and 6.9 billion pounds on a skim-solid basis. Most of the removals are expected to occur in the first half of 2009.

### **Prices for Milk and Products Will be Much Lower in 2009**

Wholesale prices for dry products in 2008 fell dramatically from 2007 prices. First quarter 2008 NDM prices averaged \$1.36 per pound down from \$1.94 per pound in the fourth quarter of 2007. Prices continued to decline during 2008 to average 90 cents a pound in the fourth quarter. Slowing exports and continued strong production forced some CCC removals of NDM by the end of 2008 as prices neared the support purchase price of 80 cents per pound. Whey prices followed a similar pattern, falling steeply in early 2008 then averaging even lower at 19 cents a pound in the fourth quarter. NDM and whey have been export sensitive products for some time and softness in international markets and large domestic supplies pushed down prices.

What held milk prices up last year were strong performances for butter and especially cheese. Cheese prices ended 2007 near \$2.00 per pound and averaged \$1.90 per pound for 2008. Cheese prices slumped in the fourth quarter of 2008 as the international market weakened and the domestic economy slowed. Butter prices roller-coasted through 2008, averaging \$1.23 per pound in the first quarter then soaring to \$1.58 per pound by

summer. Export sales figured prominently in the butter price spike. Like cheese, butter prices dropped late in 2008 and the bearish price is likely to continue into 2009.

For 2009, the product price outlook is for weaker prices through much of the year. Cheese, butter, and NDM prices will be near support levels during the first half of the year. Some recovery is forecast for the third and fourth quarters of 2009. Cheese prices are projected to average \$1.18 to \$1.25 for the year. Butter prices will average \$1.08 to \$1.18 per pound. For NDM and whey most of the damage has been done. NDM prices will remain below last year in 2009 with prices to average 80 to 86 cents per pound and whey will average 16 to 19 cents per pound. The decline in the dairy CPI from 214.8 in July to 210.0 by December suggests that some of the price declines are reaching the retail level. Further price declines are expected during 2009.

In the face of weak product prices, the 2009 all milk price is forecast to decline from \$18.32 per cwt in 2008 to \$10.95 to \$11.65 per cwt, the lowest since 1978. Class III and Class IV prices will decline dramatically from 2008--by \$5 to \$7 per cwt. Ultimately, any price recovery will depend on bringing milk production in line with lower demand.

Additional information about the 2009 dairy forecasts is available at:

Livestock, Dairy and Poultry Situation and Outlook

[www.ers.usda.gov/publications/ldp](http://www.ers.usda.gov/publications/ldp)

Dairy: World Markets and Trade

[www.fas.usda.gov/dlp/dairy/dairy.asp](http://www.fas.usda.gov/dlp/dairy/dairy.asp)

World Agricultural Supply and Demand Estimates

[www.usda.gov/oce/commodity/wasde/index.htm](http://www.usda.gov/oce/commodity/wasde/index.htm)