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# MCT COMPASS

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## How Much is Too Much?

Two widely anticipated government reports were released during the second half of June: Milk Production and Cold Storage. Neither report provided much hope for a milk and dairy product price recovery, which has been hoped for since the beginning of the year. For dairy producers who were told that midyear could bring a recovery, midyear has come but the recovery has not.

The Milk Production report for May, released June 18, showed a 0.2% increase in milk production vs. the prior year. The slowdown in milk production growth is attributed to a 0.5% increase in output per cow and an 11,000-cow decrease to 9.275 million head in the U.S. dairy herd vs. the prior month. That's 43,000 fewer cows, or a 0.5% decrease from May 2008, but still 104,000 head more than May 2007. Twelve of the 23-selected states in USDA's monthly milk production survey posted lower production vs. the prior year and 14 states reported fewer cow numbers. States with the largest herd declines include California with a 31,000-head drop and New Mexico with a 10,000-head decrease.

For the past three decades, U.S. milk production has grown steadily and in the West it grew at a much higher rate. That is no longer the case. Since the beginning of the year, capacity constraints and lack of profitability have resulted in a 2.3% decline, or a 402.2 million pound year-to-date reduction in California's milk production vs. the prior year. In addition, the California dairy herd, which has averaged a 42,000-head annual gain since 1995, is down 31,000 head vs. May 2008.

Meanwhile, milk cow numbers, milk production per cow, and hence total milk production continue to grow in Michigan, Minnesota, and Wisconsin. Together, the three states have 17,000 more cows in their herds that produced 83 million more pounds of milk in May 2009 than the prior year. Additional milk production gains of 2.1% vs. the prior year were posted in neighboring states of Iowa and Indiana.

Based upon information gleaned from the recent Milk Production report, it appears that

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## KEN'S CORNER

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Despite news reports of the financial stress on dairy farms across the country, U.S. dairy producers along with their international counterparts are proving more resilient than expected. After a strong dairy cull during first quarter 2009, the April cull was less than last year. Granted, some producers have held off culling in anticipation of the CWT program. Nevertheless, the latest CWT round is unlikely to take out enough cows to move the dairy product markets in a significant manner. This is likely to have a domino effect this fall as both bankers and dairy producers have counted on a CWT market bounce to move dairy producer balance sheets into the black. This is too tall of an order for the CWT program.

Surplus milk and dairy product markets are not solely a U.S. phenomena. Government support programs in the form of accumulation of dairy product stocks and export subsidies in the United States and Europe are expected to keep a lid on global dairy markets through yearend. In fact, without a significant reduction in supply, there is apt to be more downside price risk in the marketplace prior to a market rebound. We expect Oceania to keep its prices just below U.S. dairy product prices which will limit the competiveness of U.S. exports. MCT

## Slow recovery...

Milk and dairy product markets are weak. Ample milk production, albeit slowing growth, along with building stocks and lackluster exports have contributed to counter-seasonal weak dairy product markets. Despite USDA's approval of sales totaling more than 18.9 million pounds of nonfat dry milk through the Dairy Export Incentive Program (DEIP), weekly sales of nonfat dry milk to the government continue. By the end of July, government-owned nonfat dry milk is expected to equal two month's production. European intervention stocks have already hit this milestone. MCT

MCT Forecast

| | Block* | Barrel* | class III | Butter* | Class IV | Whey** | NFDM** |
|---|---|---|---|---|---|---|---|
| Jun | 1.1370 | 1.0890 | 10.00 | 1.2260 | 10.25 | 0.2705 | 0.8450 |
| Jul | 1.1850 | 1.1600 | 10.15 | 1.2650 | 10.40 | 0.2900 | 0.8400 |
| Aug | 1.3200 | 1.2950 | 11.40 | 1.3200 | 10.60 | 0.3100 | 0.8450 |
| Sep | 1.3700 | 1.3450 | 12.40 | 1.3700 | 10.90 | 0.3100 | 0.8550 |
| Oct | 1.4300 | 1.4050 | 12.75 | 1.4250 | 11.25 | 0.3100 | 0.8750 |
| Nov | 1.4750 | 1.4500 | 13.30 | 1.4500 | 11.60 | 0.3000 | 0.9000 |

** CME prices.*
***NASS prices.*

## *How Much is Too Much?...*

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the greatest amount of economic stress on dairy farms is being felt in the West. Jim Tillison, chief operating officer of the Cooperatives Working Together (CWT) program, confirms this: "All dairy farmers are stressed economically right now. However, the number of cows bid in this round by producers in the West and Southwest is an indication that their financial stress is particularly acute given where their milk prices and input costs are."

CWT has approved the removal of almost 103,000 head beginning in June 2009 and ending in July 2009. According to CWT, 79% of the 103,000 cows will be removed from the West and Southwest.

Assuming that 103,000 head are culled by August and are not offset by new entries into the herd, the U.S. dairy herd would decrease to 9.172 million head. If milk production per cow grows by 0.5%, U.S. milk production would still fall by about 1.2%, or 190 million pounds vs. August 2008. This converts to about 20 million fewer pounds of cheese or nonfat dry milk.

The question is whether this will be enough to cause the markets to rebound. After all, August and September are typically the two lowest milk production months of the year, and conversely, two of the largest demand months as schools and universities reopen and processors scramble to fill milk and dairy product pipelines.

According to USDA's most recent Cold Storage report, there is plenty of cheese in the pipeline. Stocks of American cheese totaled 608.3 million pounds as of May 31, 2009. This is 7%, or 39.8 million pounds more than last year when stocks were considered tight, and the CME spot cheese market traded near $2.00/lb. As of May 31, 2006, American cheese stocks totaled 601.4 million pounds, just 6.9 million pounds less than this year, and the CME spot cheese market traded near $1.20/lb.

Cutting American cheese stocks by 40 million pounds will not be easy given that American cheese production has posted an average monthly gain of 14.0 million pounds vs. last year and exports have slowed. Through April 2009, exports of Cheddar cheese are down 13.5 million pounds.

A 1.2% decrease in milk production will likely cut off the peaks in dairy product production this fall, but strong stocks are likely to overhang the market until the next contraction in the U.S. dairy herd. MCT

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