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MCT COMPASS

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Can't Keep Good Cows Down

USDA's most recent Milk Production report that highlighted the department's first estimates of July 2010 production illustrates the tenacity and resilience of U.S. dairy producers. After weeks of media coverage of hot and humid conditions east of the Rockies, most analysts were expecting a modest year-over-year gain in U.S. milk production. After all, the Midwest experienced one of the mildest summers last year, when milk per cow was also exceptionally strong.

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Instead, USDA reported a jaw-dropping 2.9% increase in U.S. milk production driven by a 3.3% gain in milk per cow, which offset the 0.5% decrease in the U.S. dairy herd in July vs. July 2009.

At the beginning of the year, the U.S. dairy herd stood at 9,087,000 head, down 225,000, or 2.4%, from January 2009, and milk per cow was 1.7% greater for a net 0.7% decrease in total production. Over the next six months, the difference in the U.S. dairy herd narrowed to just 42,000 head vs. the prior year, and milk per cow since April 2010 has exceeded 3.0%, compared with the same period a year earlier, much higher than the historical growth rate of 1.7%.

California produces more milk than any other state, accounting for about 21% of total U.S. milk production. The economic downturn that began in 2008 and continued through 2009 resulted in a 60,000-head decrease in California's dairy herd. Exceptionally low milk prices in 2009 prompted dairy producers to feed lower-cost rations, which reduced output per cow. A year later, more favorable feed costs and higher milk prices convinced producers to feed higher-quality rations to increase milk per cow. California has posted steady gains in milk per cow this year, culminating with July's extraordinary year-over-year gain of 7.2%. Granted, California experienced a mild summer, which also contributed to cow comfort and greater output per cow. Looking toward 2011, this rate of growth is unlikely to continue without producers adding more cows.

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Ken's Corner

by Ken Meyers
President , MCT Dairies Inc.

Dairy markets could be at a crossroads. The U.S. economy is on the verge of entering into another recession, but economic contraction is far from certain. Despite a higher savings rate, consumer spending in August rose a modest 0.4%, the first increase in four months. The rise in spending could indicate employed consumers are finding balance between paying down debt, saving, and spending.

However, there is no guarantee that increased spending will continue, and in a consumer-driven economy, continued frugality does not bode well for either the economy or growth in overall dairy demand. It appears consumers are as resolute in their new spending habits as dairy producers are in producing milk.

Whether the world market can absorb the unexpected onslaught of U.S. milk production at the same time milk and dairy products begin flowing from Oceania will depend on demand pulls from China, Russia, and India. Stronger demand for whole milk powder from China and increased orders for butterfat from India and Russia could keep markets stronger than anticipated. **MCT**

Butter's surge...

Despite growing cheese inventories and strong milk production, U.S. dairy product markets remain stable for powders to higher for cheese and butter. There is clearly a global butterfat shortage. CME spot butter prices have gained 34 cents in the past month and are now at a level not seen since December 2004. Butter prices likely will be knocked off their lofty perch sometime in the next few months, as seasonal demand subsides. And Oceania production will reach our shores in December. **MCT**

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV	Whey**	NFDM**
Aug	1.6365	1.6015	15.15	1.9898	15.67	0.3584	1.1578
Sep	1.6620	1.6370	16.10	2.2000	17.10	0.3615	1.1500
Oct	1.5750	1.5500	15.60	2.2575	16.70	0.3710	1.1450
Nov	1.5330	1.5100	14.75	1.7000	14.50	0.3800	1.1350
Dec	1.5100	1.4850	14.60	1.6200	13.85	0.3800	1.1150
Jan	1.4650	1.4425	14.15	1.4500	13.15	0.3780	1.0850

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

cow numbers creep up...

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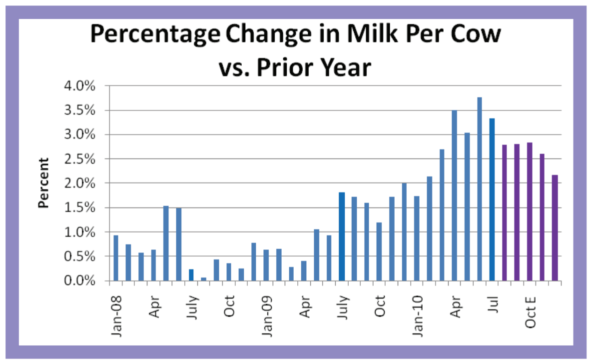
A second factor contributing to greater milk per cow is the upgrading of the U.S. dairy herd. Strong beef prices have resulted in higher cull cow prices for dairy producers. In many cases, producers can sell "Old Elsie" for $1,000 and replace her with a "New Elsie" for less than $1,400. The opportunity to continue to upgrade the dairy herd is expected to continue into 2011 as strong beef prices persist and the supply of replacement heifers remains ample—in part due to the use of gender-selected semen.

Extremely low milk prices and the Cooperatives working Together (CWT) herd retirement programs resulted in a 225,000-head decrease in the U.S. dairy herd in 2009. However, as milk prices approached $14.00/cwt., producers in some parts of the country began adding cows. Since January 2010, the U.S. dairy herd has increased by 58,000 head. Most notable was a 10,000-head gain in May, followed by a 14,000-head increase in June, and then a 20,000-head gain in July.

In the 1990s and into the 2000s, California posted several annual gains of 50,000-head or more in its dairy herd. Since January, California's dairy herd has actually decreased by 10,000 head to 1,750,000 cows. Idaho's dairy herd has increased by 16,000 head followed by Arizona with a 10,000-head increase and Washington and Oregon with 6,000-head gains. Further herd increases, albeit more modest, are prevalent in Minnesota, Wisconsin, Michigan, and Kansas.



The combination of greater milk per cow and cow numbers leads to just one thing—more milk, especially during the last quarter of 2010 and into the first half of 2011. However, posting additional gains in milk per cow above the stellar gain experienced in 2010 may be difficult to replicate. **MCT**

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