

MarketView... U.S. Dairy Outlook Brief 2010

by Cameron Thraen, The Ohio State University Extension, State Specialist, Dairy Markets and Policy, Department of Agricultural, Environmental and Development Economics.

Chart 1 depicts the long term relationship between the Class 3 milk price (line, left axis) and the rate of change in U.S. milk production (bars, right axis). The inverse relationship between price and rate of increase in milk production is evident. The dashed horizontal line at 2% shows the annual rate of growth in demand for milk and milk products in the United States. Production expansion higher than this pushes down the milk price, while production expansion at a rate lower than 2% drives up the price of milk. The rapid rise in the milk price beginning in 2007 was caused by slow growth in U.S. milk production and, what is not shown on Chart 1, slow growth in milk production outside the United States. This in turn resulted in additional export demand for milk proteins from the U.S. and the historically high U.S. milk price. The 2008 collapse in U.S. and world demand, coupled with continued U.S. milk production expansion above the 2% line, resulted in the collapse of the farm milk price.

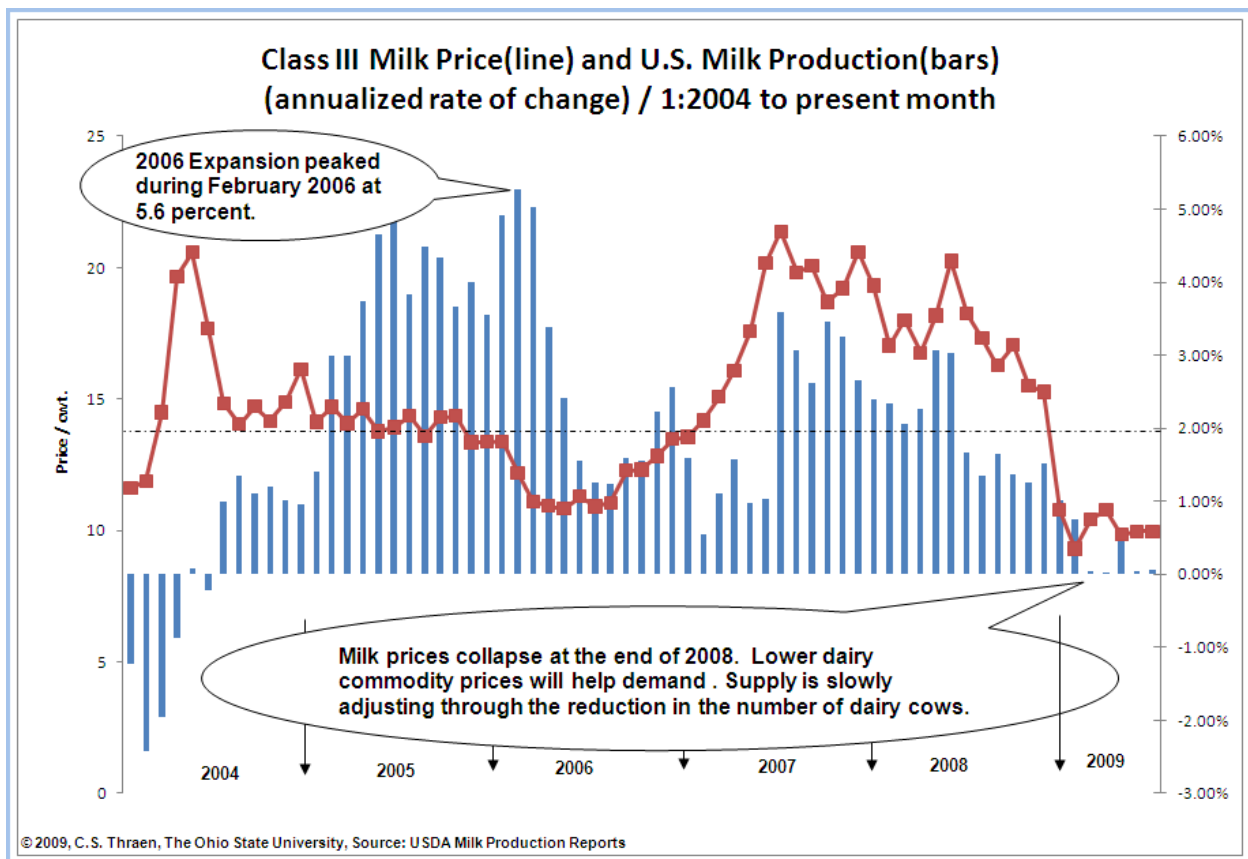


Chart 1.

The rate of growth in U.S. milk production has been slowing for the past 12 months, finally nearing zero in June 2009. Over the first six months of 2009, this reduction in the rate of growth has not been severe enough to halt the decline in the U.S. milk price. While milk cows have been culled aggressively, milk yield per cow has not moderated. Overall production has slowed, but not enough.

Chart 2 shows the long term history of milk yield per cow (right axis) and the number of milk cows for the United States (left axis). The upward trend in milk productivity is evident. Average annual milk per cow grows at a rate of 1.7% per year. Milk cow on farms shows a much more varied history. Beginning in January 2004, the U.S. dairy herd started on an aggressive expansion path. This expansion ran out of steam mid-year 2008 and began a significant downward adjustment January 2009.

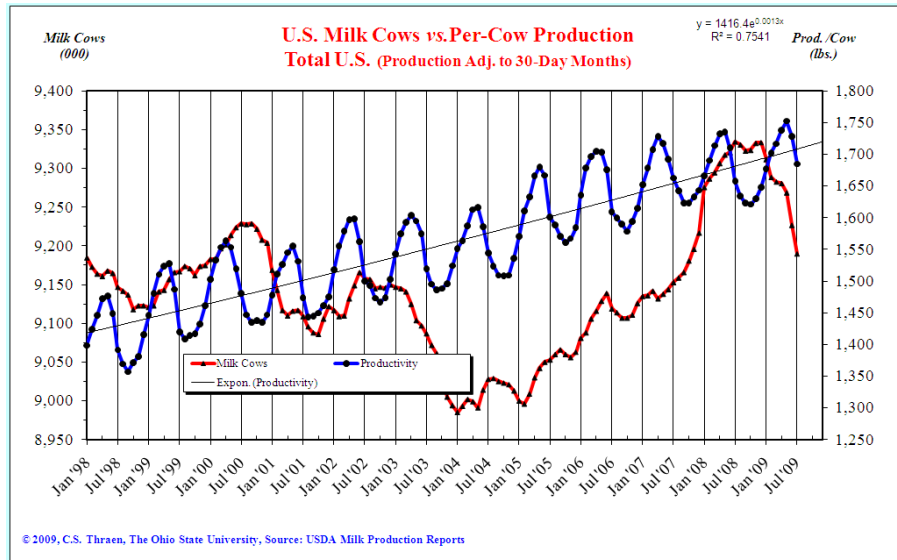


Chart 2.

For milk prices and dairy farm profits to return to a more sustainable level, a painful process needs to take place. The number of dairy cows in the United States must be reduced by a significant amount. The current level, 9,190,000 head is much too high. With the unabated increase in milk output per cow, the adjustment must come from increased dairy cow slaughter. The recent round of the Cooperatives Working Together dairy cow removal program will remove an additional 86,700 head when completed; however, this is not nearly enough. The U.S. dairy cow numbers must decline by at least another 200,000 head. U.S. milk cow numbers must get back to the level of January 2004. This means that a significant number of dairy farms operations will have to exit the industry over the coming months. Today, dairy producers expect the U.S. milk price to return to the \$17 to \$19 dollar range and this is only possible with a U.S. dairy herd below 9 million head.

As the financial pain is spread across the thousands of medium to small dairy operations in the U.S., the political pressure to rescue these operations is mounting. The U.S. Secretary of Agriculture has increased the support prices offered on Cheese and Nonfat dry milk. The U.S. Senate has passed legislation supporting even higher effective support prices. There is pressure to increase payments under the Milk Income Loss Payment program. All of these measures will only serve to extend the pain. The only way to sustained higher prices for U.S. dairy farms is to reduce the number of milk cows and production. The process has started and now it needs to run its course over the coming months.