Agricultural, Environmental, and Development Economics

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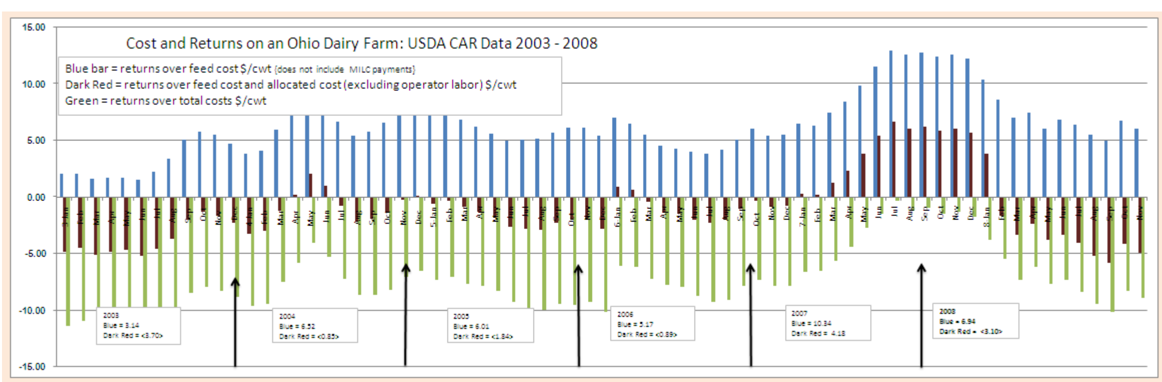
Introduction

In the last issue of BDN I wrote about the coming meltdown in the U.S. dairy market. Now it is here and we are in for it over the next 12 months. I am convinced that the outlook is now no better than 2006 or 2003 for that matter. Why so pessimistic? First and foremost is the prospect for a global economic recovery over the next 12 months. We have become accustom to quick fixes to difficult problems. Over the past couple of decades an attitude developed that on the macroeconomic front we had whipped any economic weakness and downturns would short lived or a thing of the past. This was fueled by a trust and faith in a newly emerging field called financial engineering. Financial engineering married together the fields of economics, finance and advanced mathematics to produce a body of thought which promised ultimate control of any financial product or service with minimal downside risk. Financial engineers assured us that any market position could be made virtually risk free and that the possibility of a complete system collapse was so remote as to be assigned a probability of zero. I think we now see the nonsense in this line of thinking.

What the field actually produced was an arrogant overconfidence in our understanding of and ability to micro-manage financial markets and assets. The financial engineering field produced first the dot com bubble and bust, which was really caused by the demise of the progenitor of FE, the investment hedge company Long Term Capital Management, which precipitated the recession of 2001-2003. Now this time FE has brought us the economic collapse of the last 70 years. The fall-out will last for a decade.

What does this have to do with the U.S. dairy economy you are asking? Well, the excellent returns of the last 18 months are the product of the global speculative economic bubble and that bubble has now burst globally. The world is awash in milk and dairy products while global demand continues to shrink. This can only result in low prices for dairy farmers in the United States over the next 12 months and beyond. I do not see world production declining sufficiently to bring about a balance. U.S. milk prices will struggle to stay above the $13.00 mark. If you have not signed on for the Milk Income Loss Contract MILC program, reauthorized by the 2008 Food, Conservation and Energy Act, I urge you to do so right away. Receiving MILC payments can help offset increased feed and other costs in the coming months. You can learn more about the MILC program by visiting your county Farm Services Agency. You can visit my Ohio Dairy 2009 Website: http://aede.osu.edu/programs/ohiodairy/ for additional information. At this website you will find a chart showing the current and anticipated MILC payments for the current fiscal year. The MILC payment chart can be found at this link: http://aede.osu.edu/programs/OhioDairy/MILC_Center/MILC_Projected_Payments.htm For those inclined to computer spreadsheets, you can download a copy of my MILC Excel Workbook to your computer. http://aede.osu.edu/programs/OhioDairy/MILC_Center/MILC_Center.htm Using this workbook you can setup your own dairy farm data and do what-if evaluations of eligible milk shipments, program start date, payment rate, and anticipated MILC revenue.

NET RETURNS ON OHIO DAIRY FARMS: The latest data from the USDA Costs and Returns database for Ohio shows the severity of the coming financial squeeze on dairy farms. The chart below shows the net return over feed cost IOFC (the blue bars) and the net return over all costs IOTC (green bars: feed, variable, and fixed including capital recovery, and operator labor charges) for the years 2003 – 2008. Income over feed cost (blue bars) beginning in 2007 and holding throughout most of 2008 are excellent. IOFC is even better for those with contracted feed prices, as the USDA data uses current market prices for feed each month. IOFC averaged $6.94 for the period January – November 2008. The IOTC is never good as it always shows a negative value. As it appears now, IOTC averaged for January through November 2008, stands at a *negative* $7.52 per cwt. With only December to be reported for a complete picture in 2008 this may exceed the average of a *negative* $7.74 per cwt. posted for 2006. Given the current dismal macroeconomic outlook, 2009 will see a continuation of the red (green) ink.



U.S. and International Dairy Market Watch
No group watches the dairy markets more closely than the good folks at the USDA, Agricultural Marketing Service, Dairy Market News. The following is a synopsis of what they have to say about the current conditions in the dairy markets, domestic and international (bolding added for emphasis). You can read the entire report at: http://www.ams.usda.gov/mnreports/dywweeklyreport.pdf Visit my OhioDairyWeb for up-to-date price, futures/options and price forecast information.

OhioDairyWeb 2009 can be found at http://aede.osu.edu/programs/ohiodairy

BUTTER: Butter markets are unsettled as the cash price firmed slightly at midweek and concluded the week at $1.1125. **Within the past two weeks, 375,658 pounds of Western produced bulk butter have been offered to CCC at $1.0500. Last week's clearance of 121,694 pounds was the first to clear to the Dairy Support Program since June 2003.** Buying interest for butter has increased after buyers have reviewed their inventory situation after the end of the year holidays. End users are willing to have normal working inventories on hand at these price levels. Many food service buyers are indicating that traffic flow through their doors has slowed.

CHEESE: Cash cheese prices at the CME Group remained weak and below support prices though prices rallied on January 16. Current CME Group weekly average cheese prices are about 90 cents below the same week in 2008 and more than 20 cents below 2007 and 2006. **CCC has not purchased any cheese under the price support program. Tighter credit is limiting the ability of many buyers to purchase and store extra product.** Current cheese offerings remain heavy on most varieties with a lot of cheese produced late last year still needing a buyer. Cheese production remains seasonally active. FAS reported that Jan – Nov 2008 U.S. cheese exports total 270.1 million pounds, 73.3 million pounds (37.2%) more than the same period in 2007. The exports represent 3% of estimated U.S. total cheese production for the period.

FLUID MILK: Milk production patterns across the country continue to follow trends of recent weeks, although severely cold temperatures in the upper Midwest and Eastern parts of the country could impact output. Early in the week, Class I demand was quite strong, as bottlers continue to fill bottling pipelines after the holidays. Most schools are back in session, thus bottled milk needs for lunch programs have resumed. **Unsettled financial prospects are creating more of a dismal cloud over the industry as lower dairy commodity prices are working into milk price formulas**.

DRY PRODUCTS: Nonfat dry milk markets remain weak as surplus volumes continue to clear to CCC. Spot and index prices have moved lower as more producers are lowering prices to move building stocks, especially those that are not moving NDM to the CCC at $0.8000. Whey markets remain weak. Overall supplies are in excess of trade needs with demand slow. Buttermilk prices are lower to sharply lower.

CCC SUPPORT ACTIVITY: During the week of January 12 - 16, CCC net purchases total 8,328,339 pounds of Western NDM under the dairy price support program. **This brings cumulative NDM purchases since October 1, 2008 to 134,311,251 pounds.** Also during the week, 253,964 pounds of Western bulk butter was purchased by CCC, totaling 375,658 pounds since October.

WORLD DAIRY OUTLOOK: After a euphoric period of record prices and booming exports, dairy exporters now face weak and uncertain markets characterized by a dizzying drop in global dairy product prices. Nonfat dry milk which was priced at over $5,000/MT in mid-2007 can now be purchased for less than $2,000/MT – a startling decline of over 60% in less than a year. **There are a number of factors at play; world economic growth is forecast for 2009 at 1-2%, down from the 3.8% registered during the 2005-2007 period, available exportable supplies in the EU, United States, and New Zealand have increased markedly, and import demand has faltered in the face of high retail prices and economic uncertainty.**

At present, prospects are not favorable with the United States, the EU, and Japan expected to be in a recession, which will likely slow consumption rates for dairy products. For the U.S., this means dairy exports are anticipated to experience a drop in volume and value with U.S. dairy exports currently forecast to fall sharply from $4.0 billion in FY 2008 to $3.1 billion in FY 2009. **There are, however, some positive signs.** The U.S. dollar is expected to remain relatively weak, providing a competitive boost to exports, while oil prices – which have dropped dramatically from a high of nearly $150/barrel to around $40/barrel – are likely to have a stimulative impact on the economy.

INTERNATIONAL MARKETS AND EXCHANGE RATES: A critical factor affecting prices in early 2009 will be the exchange rate between the U.S. dollar and the Euro. SMP prices held steady and increased for most of the first half of the year due to the drought conditions that developed in New Zealand. However, starting in July, EU FOB prices plummeted as a combination of growing (EU) domestic stockpiles drove domestic prices down and the U.S. dollar started to strengthen. The U.S. dollar appreciated from around $1.57/Euro in July 2008 to $1.27/Euro in November 2008 giving EU SMP a significant competitive boost. However, the weakening of the U.S. dollar in early December has meant that EU SMP FOB prices have risen by nearly $200/ton in the space of a few weeks. If the U.S. dollar remains weak, then global prices will likely strengthen once EU intervention stores open on March 1, 2009 as the support price of € 1,746.9 currently equates to around $2,450/ton. This will effectively sideline the EU from export markets until the intervention limit of 109,000 tons is reached or the open period expires at end- August 2009. **This scenario, however, assumes that the EU does not invoke export subsidies which would effectively drive prices down**.

{CsT Note:} As of January 15, 2009, the EU Agriculture Commissioner announced **the reactivation of EU export subsidies beginning February 2009**. This action will place continued downward pressure on international prices.