

By Cameron Thraen, State Specialist, Dairy Markets and Policy, The Ohio State University Extension, The Agricultural, Environmental, and Development Economics, The Ohio State University

In the last installment of Buckeye Dairy News (BDN), I discussed the ebb and flow of the U.S. dairy herd. To recap, I showed a chart with the growth and decline of the number of dairy cows in the United States over the time period January 1998 to September 2009. The chart showed the dramatic increase in that number over the period January 2004 through July 2008 and equally dramatic decline through September 2009. The new chart, which can be viewed each month on my webpage <http://aede.osu.edu/programs/ohiodairy> shows the latest. Dairy cow numbers declined only 7 thousand head from October to November 2009. This is a dramatic slowing in the draw-down after declining an average of 34 thousand head each month over the preceding 5 months. The current USDA estimate puts the national herd at 9,091,000 head. This may be only a pause in the contraction or it may reflect the easing of the financial pain as milk prices have strengthened and input costs have fallen even more, resulting in positive gains in income over feed and other operating expenses (this chart is also available on my website).

My comments in this issue of BDN center on the chart shown below. Chart 1 shows the time path for (1) the Class 3 milk price (line) and (2) the annualized rate of change in milk production (bars) for the United States over the period January 1998 through November 2009.

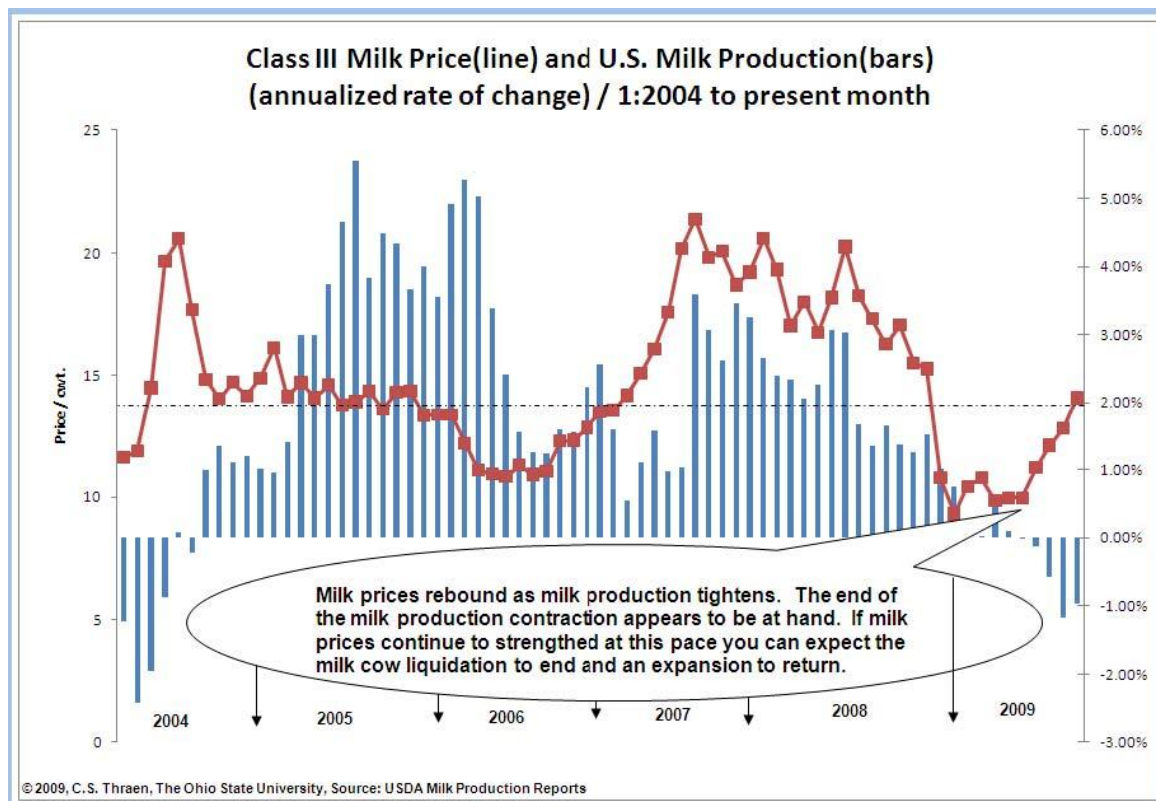


Chart 1. United States: Class 3 milk price and annualized rate of change in milk production 2004-2009.

The chart visibly shows the inverse relationship between the rate of growth in milk production and the market clearing price. At the start of the period, early 2004, the U.S. milk production was contracting, growing at a negative rate, and the Class 3 milk price was increasing to peak at over \$20 per cwt. The high milk price (and all other milk prices determined by this price) drew in more resources (mainly cows) and production growth returned to the positive, eventually reaching the 4 to 5% rate by mid 2005. Even before this period, while growth was well under 2% annualized rate, the Class 3 price declined to the \$14 to 15/cwt level. The pattern of high(low) growth of U.S. milk production and low(high) milk prices continue over the decade.

Now consider the latest period shown in Chart 1. Milk production in the United States started to decline well before the infamous cheese price collapse of January 2009. The annualized rate of growth started its downward movement back in late 2007 and with the exception of two months in 2008, has been on a decline over the last 2 years. Contraction, as measured by negative annualized growth, occurred only in the months of August through November 2009. The slow rate of growth in U.S. production helped push the Class 3 milk price up from \$10 to 14/cwt. The annualized rate of growth in milk production, while negative for November 2009, is showing the first sign of moving back toward expansion. If this indicates that the financial distress is easing for the nation's dairy farms, this is good news. However, if this also forecasts that the contraction in the U.S. dairy herd is over, this may not be good news for the milk price and ultimately net returns to milk production. With aggregate domestic and international demand still weak, a too rapid return to positive growth in U.S. milk production will mean a weaker U.S. milk price in 2010.

The current Chicago Mercantile Exchange (CME) futures market is forecasting a Class 3 milk price for the coming year, January through December 2010 at \$15.60/cwt. The December 17 issue of the USDA Livestock, Dairy and Poultry Outlook has the Class 3 milk price in the \$15.15 to 15.95/cwt range. The USDA price forecast is based on a continued decline in the U.S. milk cow numbers, falling to an average of 8.97 million head for 2010. This is a level last experienced in the United States in December 2003. If U.S. milk cow numbers continue to slide, milk prices for 2010 will remain above \$15/cwt, and with some modest growth in international demand, could even reach the \$16/cwt level by mid 2010. At that time, it might be a good decision to use the CME futures market to lock in these better prices or use the CME options market to put a floor under the milk price. Also, consider learning more about the Livestock Gross Margin Insurance product available to dairy producers. Each of these provide a management tool to which can assist in avoiding a repeat of 2009.