

The Milkweed



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The farmer's milk marketing report

New Dairy Reality: Shortages, Higher Prices & Costs

by Pete Hardin

Are these volatile, up-and-down cash market prices at the Chicago Mercantile Exchange (CME) honest, or contrived?

\$1.95/lb. block Cheddar, then a 25-cent plunge? \$2.05/lb. Grade AA butter? At least butter's price level was more predictable, given low butter inventories for the past year.

Recent volatile dairy commodity pricing events leave the industry stunned. What's ahead in 2005?

Demand for cheese has been very strong since mid-October. Many cheese plants have been unable to fill buyers' orders. Demand for "fresh" cheeses is reported particularly strong. Overall cheese demand during 2004 has been pretty solid.

U.S. butter inventories have shriveled to almost nothing. (See article below.) Seasonal dairy product manufacturing—such as eggnog—must compete for scarce supplies of dairy commodities and farm milk.

Farm milk production has gone backwards in the past several weeks east of the Rocky Mountains. Why?

Dairy replacement heifers are scarce. And 2004's weather caused serious disappointments in both volume and quality of the forage harvest. Forages harvested from many areas alongside the Great Lakes and St. Lawrence Seaway suffer impaired milk-making capacity. Canada—often a source of supplemental forage for U.S. farmers—also suffered serious forage production problems in 2004.

Weather has disrupted dairy and crop production in many areas, although the impact may take several more months to fully appreciate.

Dairy demand is strong. Farm milk output is impaired. The "wave" of milk that some analysts predicted for this fall and winter is not materializing east of the Rocky Mountains.

So what's ahead for 2005???

Predicting 2005 is hazardous, given so many variables that are impossible to predict. The U.S. dairy enters 2005 in a "new reality" that defies many previous assumptions about dairy supply, demand and prices. Global events are also impacting our dairy structure. Elements of this "new reality" include:

Permanent milk shortages east of the Rocky

Mountains. The westward shift of U.S. milk production creates an imbalance in the location of milk vs. the consumption of dairy products. Dairy's processing infrastructure that lies east of the Rocky Mountains will be challenged to maintain volumes. Loss of manufacturing plant capacity—such as in the Northeast—creates terrible headaches for "balancing" weekend, holiday and seasonal milk supplies not needed for fluid processing. Watch for a real scrap as fluid and manufacturing plants compete for scarce milk supplies east of the Rockies.

Higher trucking & plant energy costs. Fuel and energy costs are not just a price issue, but in the future, availability of fuel will be an issue.

Dairy—from farm to supermarket—is intensely reliant upon energy inputs. Perhaps no other sector in the food industry is so dependent upon energy as dairy.

This nation's dangerous reliance on imported energy sources, and an aging petroleum processing infrastructure that's running at near 100% capacity, are catastrophes waiting to happen. Right now, the cost of trucking cheese 3,000 miles from California to the East Coast is about 15 cents per pound. Farm milk manufactured into cheese in the East and sold in the East ought to be worth significantly more, per cwt. than milk processed into cheese in California and shipped East.

Imports more expensive & scarcer. The U.S. dollar has dramatically declined, relative to key dairy exporting nations' currencies (such as New Zealand and western Europe). That fact makes dairy imports—when available—relatively more expensive than a year or two ago. Up to now, some dairy processors had used imports of ingredients—like anhydrous milk fat and Milk Protein Concentrate—to hold down costs of higher-priced U.S. dairy products/ingredients. But the "old" economics of "cheap dairy imports" no longer hold true.

Another fact altering the dairy import scene: China's dramatic increases in purchases of dairy products to improve that nation's diet. New Zealand's dairy industry expects its exports of whole milk (Note: Protein costs for imported MPC are higher than domestic non fat dm milk) powder to increase by 50% to 100% annually for each of the next five years. That massive, compounded growth is shifting New Zealand's product manufacturing strategy some-

what away from MPC and cheese. Forget "cheap" imports in the future. However, U.S. food processors are scrounging Third World cesspools (India, even Haiti) for dairy imports.

Serious heifer shortages: Relatively low U.S. grain costs and predictable higher milk prices mean intense demand for dairy heifers. Sorry ... U.S. heifer numbers are tight. And the Canadian border remains closed, for an uncertain period of time, due to "Mad Cow Disease" concerns. Higher milk prices in 2005 will spur high prices for dairy calves and heifers.

Higher dairy commodity prices and farm milk prices. We'll end 2005 with virtually zero U.S. commodity table grade butter inventories, good cheese demand, and struggling milk production in many parts of the country. While it is impossible to predict the future, it's clear that tight inventories and tight farm milk supplies should propel farm milk prices upwards.

Conclusion: A future unlike the past ...

The Milkweed projects a year ahead like virtually no other the dairy industry has seen. The nation's economy, finance and energy pictures are entering challenging times. Dairy, as an industry that markets consumer products, will feel many of the squeezes that are weighing on consumers.

In a nutshell, the era of "cheap imports" from modern dairy exporting nations is over.

Buckle up: 2005 will be a wild ride for the entire U.S. dairy industry. New realities lie ahead.

November Class III \$14.89; More Increases Coming

USDA announced the November federal order Class III (cheese milk) price at \$14.89/cwt., up 73 cents from October. Meanwhile, USDA said the November federal order Class IV (butter-powder) price had been placed at \$13.34/cwt., up 53 cents from the October Class IV.

Both of these federal order prices will register significant gains for December milk following hefty November gains in Chicago Mercantile Exchange cash trading. The USDA/NASS price surveys that determine federal order prices lag CME moves by several weeks, thus pushing those federal Class III/IV increases into December and, probably, January.

The federal order Class I base price for November is \$14.29/cwt. The December Class I base will rise to \$14.43.

U.S. Butter Inventories Near ZERO

by Pete Hardin

Sometime in mid-December, U.S. commodity butter inventories could be virtually zero.

Strong seasonal holiday demand pulled down already low butter inventories during November. Both USDA's *Dairy Market News* and the Chicago Mercantile Exchange estimated at the end of November that U.S. butter inventories totaled just over 14 million pounds. That's a decline of roughly 50% just during November. One year earlier (11/27/03), *Dairy Market News* had reported 71.5 million pounds of commodity butter. Thus, butter inventories—according to that USDA source—were about 20% of year-ago totals at November's end.

(Note: This data refers to bulk commodity butter. Packaged butter, ready for sale, is not included in any government data.)

Then, early in the evening of December 1, three million pounds of butter were destroyed by a huge explosion and fire at AMPI's butter warehouse in New Ulm, Minnesota. That catastrophe destroyed a significant small percent of the nation's commodity butter. Press reports told of large vol-

umes of melted butter running into the local river during the fire.

U.S. butter production and inventories have been under stress since early in the second half of 2003. According to USDA's "October 2004 Dairy Products Report" (issued December 3, 2004), U.S. butter output for the first 10 months of this year totaled 1.009 billion lbs., a decline of 2.9% from 2003's ten-month total. Butter production in 2004 has been erratic. The first five months of the year saw a 15.6% decline in U.S. butter output, but the second five months zoomed ahead of 2003's totals by 16%.

Butter prices have climbed sharply since late October at the CME, dairy's cash commodity exchange. CME Grade AA butter prices closed at \$2.00/lb. on Monday, December 6. That represents an increase of about 45 per pound since late October X.

During 2004, massive quantities of butter and high milk-fat products (such as anhydrous milk fat—99% pure milk fat) entered the U.S. as imports. USDA's "Cold Storage Report" on butter inventories includes imported anhydrous milk fat as "butter," even though anhydrous cannot be manufactured into table-grade butter.

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The Milkweed

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