

# The Milkweed

Dairy's best marketing info and insights

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## Drought/Energy Costs to Cut U.S. Milk Output

by Pete Hardin

Present dairy commodity prices are ruinous for many dairy farmers and cheese plants. Spring 2006 cheese milk prices could end up below \$11/cwt. for both the federal milk orders as well as California's state milk-ricing system. Given rising energy costs, dairy is truly in a price-crisis--for producers, marketers, processing plants and milk haulers.

This year is shaping up into two different parts: too much milk in the first part, and too little milk in the second. Extreme dry conditions over many key parts of the country mean Mother Nature will have the final say on U.S. milk production.

The "gamblers" are betting on lowball milk prices as far as they can see. As of March 28, the monthly Class III (cheese) milk futures at the Chicago Mercantile Exchange were projected to stay below \$12.00/cwt. until June 2007. Bunk!

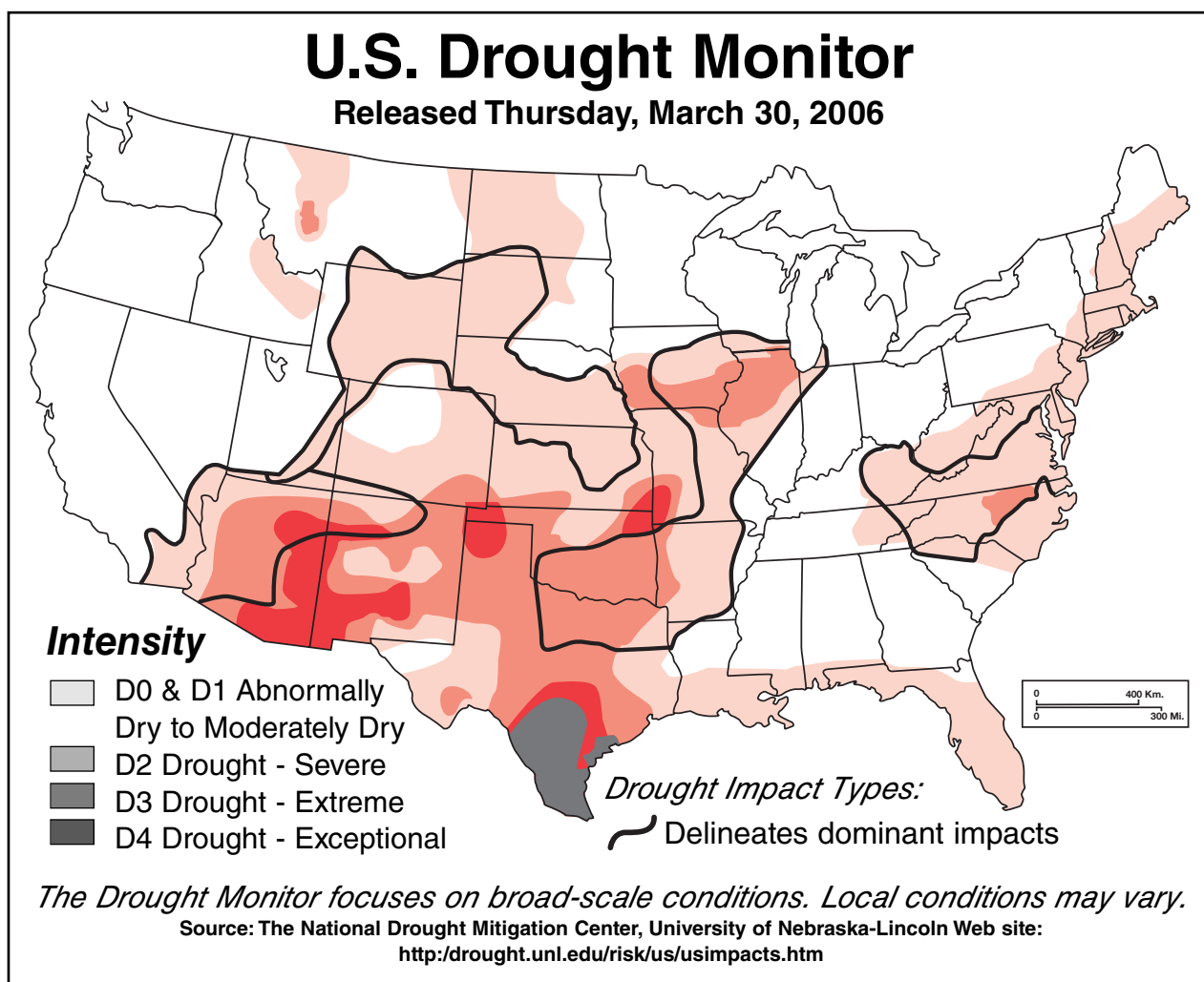
Don't accept as Gospel the forecasts for long-term, low-ball milk prices. Mother Nature and energy prices will change the complexion of dairy marketing faster than the computer-obsessed, yuppie analysts can foresee. Study the drought map on this page!

Yes, there's a lot of milk around here in early spring 2006. But, in the analysis of *The Milkweed*, the tandem of adverse weather and energy costs will negatively impact U.S. farm milk output later this year. When? That's the question. Major factors include:

### **Weather, particularly drought:**

Serious dry weather conditions are baking virtually all the Southwest, most of the Plains states, the Gulf Coast (and virtually all of Florida). Up the East Coast, we find drought/dry conditions from a wide expanse from the Carolinas out to eastern Kentucky, up through all of Virginia up into eastern Pennsylvania, and up the coast into New England and much of Maine.

Key dairy states that mostly escape



dry/drought worries include Ohio, New York, Michigan, Wisconsin, Michigan, Idaho, California and Idaho.

California's big weather headache is too much moisture. Incessant rainfall in the Central Valley is delaying the 2006 forage harvest and knocking down quality. Carry-over of dairy-quality alfalfa from the 2005 crop on the West Coast is almost zero.

Dairies in the Southwest are already struggling with high costs for purchased hay. If any degree of drought conditions persist throughout

major portions of the U.S. during the 2006 growing season, the impact upon crop yields will drive up costs for many U.S. dairy farmers, and pull down milk production.

### **Even higher energy costs:**

How high will diesel fuel prices per gallon climb this summer ... \$3.50? \$3.75? \$4.00/gallon? Diesel fuel is a critical, costly input for most dairy farms. Given current market conditions, farmers (and their co-ops) are bearing more cost transporting raw milk to market. Lowball milk prices give

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# Drought/Energy Costs Will Pull Down U.S. Milk Output

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dairy farmers zero ability to absorb dramatic energy cost increases—either on the farm or in the market place.

Fertilizer—particularly nitrogen-based fertilizer—is another fast-rising cost item. Some 33,000 BTU of natural gas are needed to produce a ton of nitrogen fertilizer. Fertilizer costs will scale back of productivity of U.S. agriculture—simply because farmers can't afford the costs of fertilizer.

Every sector of energy is rising.

## ***2006—End of “cheap corn” era:***

In early spring, USDA estimates that U.S. corn production will scale back about three percent. U.S. corn acre in 2006 will be reduced—in part due to high costs for nitrogen fertilizer and moisture considerations. Demand for corn is rising, because of additional ethanol-producing plants coming on line. “Cheap grain” has helped foster factory-style dairies. We see 2006 as THE transition away from “cheap corn”, especially if drought problems are widespread in Illinois and Iowa. (Wise dairy producers who

contract grain prices in advance should lock in corn prices as far into the future as they can.)

## ***Fairly low U.S. cheese supplies:***

Despite low prices, cheese inventories remain relatively tight, we're advised. In early spring 2006, cheese marketers are not taking in extra supplies of milk, because plants have taken such a pounding on milk costs and inventory losses over the past six months.

## ***Current U.S. demand solid:***

We detect few signs of declining demand in the U.S. for dairy products. Cheese sales seem strong. Unfortunately, there seems to be little retail promotion designed to boost sales in light of lower commodity prices.

## ***“Oceania”—less milk, shifting markets:***

In the coming years, *The Milkweed* projects imports from Oceania to the U.S. as a decreasing factor in our market place. As New Zealand and Australia conclude their 2005-2006 milk production season, discussion focuses on how much less output those two nations will report. New Zealand's milk flow is down at least 0.5%, perhaps more.

Australia's output is virtually unchanged from last year. Oceania is the primary dairy exporting region. New Zealand controls most of Australia's dairy exports.

New Zealand and Australia dairy manufacturers are shifting their product emphasis and intended export markets. Greater output of whole milk powder will occur—destined for buyers in China and Southeast Asia. Reduced cheese and Milk Protein Concentrate output will result. Asian demand is growing. Whole milk powder production presents higher-value, geographically closer export opportunities for Oceania.

## ***Almost no government inventories:***

Previous dairy commodity down-cycles featured significant inventory holdings by governments in Western Europe and the U.S. At present, that is not the case. European governments own little dairy “surplus”. And USDA's dairy holdings are almost nothing. Thus, when the market turns, there is little cheese or powder in inventory to devastate prices.

## **The outlook?**

Short-term (at least through spring, the U.S. milk supply scene looks burdensome (except in the Southeast), and the short-term market outlook gives little reason for a significant improvement in dairy commodity prices. Beyond that ... we'll just have to watch the forces of Mother Nature, energy costs, and ugly economic have their way with U.S. dairy farmers, milk marketers, and cheese plants.

That's why we caution dairy industry persons of all levels to “hang in there” despite some very ugly prices and marketing conditions in the short term. Yes, on a short-term basis, there's too much milk in the pipeline currently. Much of that extra milk is being diverted to butter-powder, because cheese plants simply can't afford to add much in the way of inventories, given their financial predicaments. The second part of 2006 will be different.