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AgLetter

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MILK PRODUCTION LAGGING

Milk production has fallen well short of expectations so far this year and further declines are projected through this fall. The USDA's latest projection is that milk production will total only 154 billion pounds in 1996, down nearly 4 percent from their projection at the beginning of the year and 1 percent below last year's tally. Declining cow numbers and less output per cow account for the production cuts. Meanwhile, disappearance of milk continues strong and the imbalance between supplies and consumption has pushed milk prices sharply higher.

On a quarterly basis, the current cyclical downturn in milk production started during the fall of last year. The year-over-year decline widened from 0.2 percent last fall to 0.7 percent in the first quarter (daily, leap-year adjusted basis) and to 1.9 percent in the second quarter. USDA analysts are now projecting a slightly larger decline for the third quarter, followed by a much smaller decline in the fourth quarter. First quarter 1997 production is expected to be comparable to the year-earlier level on a daily average basis. The projected 1 percent decline in milk production for all of this year, although seemingly modest, would mark the biggest annual decline since 1984 when a special dairy support program was launched to encourage cuts in milk production.

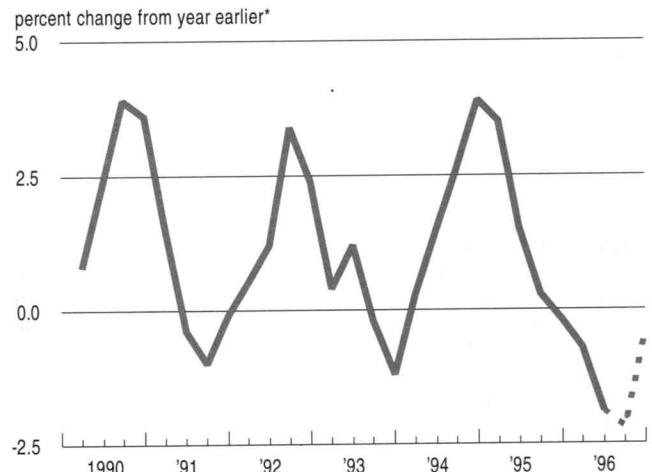
The current downturn in milk production reflects a fairly normal attrition rate in the dairy cow herd and an unusual decline in the amount of milk produced per cow. As of mid year, dairy cow numbers were down 1 percent nationwide, matching the compound rate of decline since 1989. Trends in cow numbers in District states range from virtually no change in both Iowa and Michigan to a decline of 3 percent in Wisconsin.

The decline in milk per cow in recent months marks an unusual departure from the normal trend. On an annual basis, output per cow declined in only two other years since 1970. (Like this year however, both of those earlier downturns, 1973 and 1984, coincided with sharply higher grain prices and feed costs.) Over the last ten years, milk per cow rose at a compound annual rate of 2.4 percent. When a synthetic growth hormone (rbST) was initially approved for use in early 1994, analysts were expecting steeper productivity gains as the new technology was adopted by dairy farmers.

Following a 3 percent spurt in 1994, however, the rate of increase began to slow last year. On a daily average basis, milk per cow barely matched the year-earlier level in the first quarter of this year and fell behind by nearly 1 percent in the second quarter. Preliminary figures for the 22 major dairy states show a comparable decline for July and August. Observers attribute the decline in output per cow to the very limited supplies of high quality forage and hay and to the exceptionally high grain prices of recent months. The high grain prices caused farmers to trim their feed rations and apparently contributed to a downturn in the use of rbST.

Most major dairy states are experiencing a decline in milk production. However, the five states of the Seventh Federal Reserve District account for a disproportionately large share of the decline. Through August, milk production in District states was down 2.8 percent from last year's pace. The decline for other major dairy states surveyed monthly was a nominal 0.2 percent. (A double-digit rise in Idaho countered most of the declines elsewhere.) Among District states, the steepest decline was in Iowa while the smallest was in Illinois. In Wisconsin, milk production through August was down nearly 3 percent.

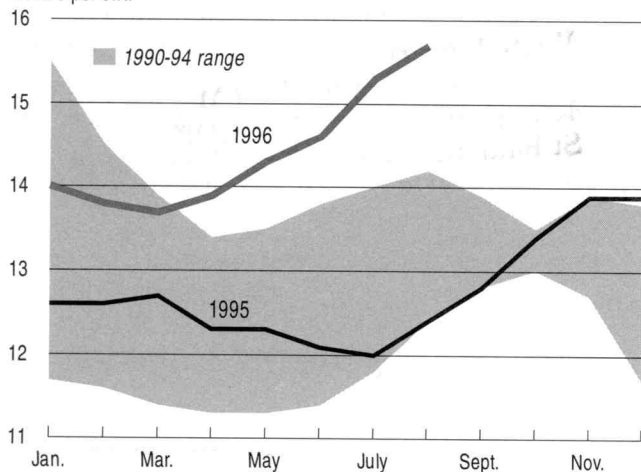
Downturn in milk production may extend through fourth quarter



*Daily average basis.
Source: U.S. Department of Agriculture.

Milk prices received by farmers

dollars per cwt.



Source: U.S. Department of Agriculture.

The steeper cuts in milk production this spring and summer followed on the heels of a strong demand for dairy products. Together these developments have depleted stocks of manufactured dairy products and contributed to sharp increases in milk prices. At the retail level, the index of dairy product prices, seasonally adjusted, rose more than 5 percent during the three months ending with August. That surge pushed retail dairy product prices nearly 9 percent above the year-earlier level, substantially above the 3.6 percent rise in overall food prices. At the farm level, milk prices in August reached \$15.70 per hundredweight, the second highest on record and up more than 25 percent from a year ago.

These soaring prices represent the moving fulcrum that, in time, will bring a more even balance between production and consumption in the dairy market. High retail prices will counter the continued growth in the overall economy and could soon begin to dampen consumer demand for dairy products. Simultaneously, high farm-level milk prices, coupled with the growing evidence of some easing in the tight feed (grain) markets, will bring an upturn in milk production. The timing of the upturn is hard to gauge, however. The shortages of high-quality forage and hay supplies may be slow to recover in many areas. And rising protein prices counter some of the recent easing in grain prices. Nevertheless, a successful completion of a fall harvest of the size recently projected by the USDA and a resumption of more widespread use of rbST could bring an upturn in milk per cow this fall.

Dairy cow numbers, however, may remain below year-ago levels. As reflected in the number of dairy cows moving to packing plants, it appears that the heavy culling of the dairy herd continued through August. Weekly tabulations at Federally-inspected plants show dairy cow

slaughter held 8 percent above year-earlier levels during July and August, matching the stepped-up pace recorded in the second quarter. Moreover, the availability of heifers that could enter the dairy herd has tightened. The USDA's mid-year cattle survey found the number of such heifers was down 5 percent from the year before. As a result, the heifer-to-dairy cow ratio has retreated from a comparatively high level at the beginning of this year to the lowest mid-year reading in 17 years.

Gary L. Benjamin

PORK A LEADER IN FOOD PRICE GAINS

Consumer price data released by the Bureau of Labor Statistics (BLS) shows that food prices registered a modest rise through the first eight months of this year. The consumer price index (CPI) for food averaged 2.9 percent higher through August when compared to a year ago, slightly higher than the gain in nonfood prices. The relatively modest rise in food prices came about despite concerns that year-over-year gains in crop prices would lead to large price increases in grocery stores and eating establishments. Among the individual retail categories that make up the CPI for food, large increases for pork, fresh fruit, and eggs were tempered by declines in beverage, beef, and fresh vegetable prices. However, the gain in food prices has accelerated in recent months.

The CPI for food consists of two broad measures. One is the price index for food consumed *away from home*; the other an index of prices for food consumed *at home*. The first represents food purchased and consumed in eating and drinking establishments, while the second is an index for food items purchased at grocery stores. Of the two groups, the at-home component has shown the larger gain this year, rising an average of 3.2 percent. However, the rate of increase has been widening steadily over the past three months. In August, the CPI for food at home was 4.3 percent higher than a year earlier. Pressure has been building under pork, poultry, and dairy prices, while the acceleration in egg prices fell off rapidly during the summer.

The CPI for food consumed at home can be broken down into several broad product categories, as shown in the accompanying table. Retail pork prices this year averaged 9 percent higher through August, reflecting fewer hogs on farms and a year-over-year decline in pork production. Especially sharp gains were registered since May. In addition, bacon prices were up by more than a fifth from the prior year, pushed higher by rising demand at fast food restaurants and a sharp decline in stocks of pork bellies. Poultry prices also registered sharp gains in recent months and averaged almost 6 percent higher through August.

Eggs and pork lead year-over-year food price gains

	1991-94*	1995	Jan.-Aug 1996
	(------percent-----)		
All Food	2.2	2.9	2.9
Food Away From Home	2.2	2.3	2.3
Food at Home	2.1	3.2	3.2
Beef & Veal	1.4	-0.8	-1.2
Pork	0.8	0.7	8.7
Poultry	1.7	1.4	5.6
Fish & Seafood	2.8	4.8	1.1
Eggs	-2.1	5.4	21.2
Dairy Products	1.0	0.8	4.8
Fats & Oils	1.4	2.8	2.3
Fresh Fruit	4.2	8.8	6.5
Fresh Vegetables	3.3	12.1	-2.5
Processed Fruits	-0.7	3.1	5.3
Processed Vegetables	1.7	1.3	3.1
Cereal & Bakery Products	3.9	2.7	4.0
Sugar & Sweets	2.0	1.7	4.4
Beverage, Nonalcoholic	2.1	6.9	-2.4
Other Prepared Food	3.0	2.4	2.9

*Annual compound rate.
Source: Bureau of Labor Statistics

In general, consumption and prices were boosted by firm domestic demand as well as another strong year-over-year gain in exports. In contrast to pork and poultry, retail beef prices were in a slump most of this year. However, August may have been a turning point, as the retail beef price index posted a year-over-year gain for the first time in nine months.

Retail egg prices rose steadily throughout the second half of last year as excessive summer heat affected layers and caused production to drop. The stronger prices carried over into 1996 and averaged a fifth higher through the first eight months of the year. However, year-over-year price gains will continue to narrow in the second half on the basis of improved production. In comparison, retail dairy prices averaged 5 percent higher than a year ago, but the gains widened in the past three months. Milk production lagged year-earlier levels for several months, while the demand for dairy products remained strong. In particular, butter prices registered an average gain of 20 percent through August. Analysts at the U.S. Department of Agriculture report that butter stocks were pulled down as a result of export agreements negotiated last winter and filled during the spring and summer.

Despite record-high corn and wheat prices earlier this year, the retail price index for cereal and bakery products averaged a comparatively moderate year-over-year gain of 4 percent through August. While some cereal manufacturers cut prices in an attempt to boost market share, part of the reason for the moderate increase is that the cost of the agricultural commodities used to produce these items make

up a relatively small portion of the value of the final product. Consequently, changes in the cost of labor, packaging, or marketing have a relatively larger influence on price changes at the retail level. A similar situation exists for fats and oils, which registered a modest price increase of 2 percent. The price of soybean oil—an important ingredient in salad and cooking oils as well as many other processed products—was down a tenth this year when compared to a year earlier.

Prices of fresh fruits and vegetables are strongly influenced by growing and harvest developments, and can swing widely in response to changes in weather conditions. The price index for fresh vegetables averaged over 2 percent lower through August, in sharp contrast to the large gain of last year. A fall in lettuce prices more than offset increases for potatoes and tomatoes. On the other hand, fresh fruit prices averaged about 7 percent higher this year, reflecting a drop in apple and pear supplies as well as Florida oranges. Retail prices for processed fruits and vegetables so far this year registered gains of 5 percent and 3 percent, respectively.

But what of food prices in the near future? Current projections from the U.S. Department of Agriculture indicate that average corn and wheat prices will be down somewhat from this year, but that soybean prices will push higher. Furthermore, it is expected that hog and poultry prices will be lower as production rises, but that cattle prices will register a modest increase in the coming year. However, much depends upon the outcome of the fall harvest and the extent to which the relatively low levels of corn and soybean stocks are replenished. Indications of an easing in world grain markets could dampen some of the recent gains in food prices. Alternatively, further tightening of grain markets could compound the recent retail price pressures.

Mike A. Singer

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