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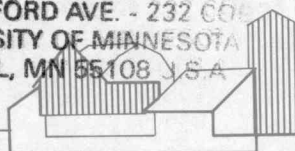
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Milk production is leveling off

Declining cow numbers and moderating gains in output per cow have ended the rise in milk production. Reports from the U.S. Department of Agriculture show that milk production in the 21 major dairy states dipped below year-earlier levels during May and June. The downturn ended the string of year-over-year production gains that started in early 1990 and contributed to the excess supplies and the steep decline in prices that characterized dairy markets since late last summer. Milk prices began to turn up seasonally this spring but remain at a 13-year low and below the cost of production for many farmers.

Milk production rose 3 percent last year as farmers responded to high milk prices and the generally favorable earnings that prevailed from mid 1989 through last summer. But an abrupt reversal in the fortunes of dairy farmers last fall has led to increased culling of the dairy herd and moderating gains in milk per cow so far this year. With the increased culling, the inventory of dairy cows in major states in May and June was down 1 percent from last year. Simultaneously, the year-over-year gains in milk per cow, which approached 3 percent in 1990, narrowed to less than 1 percent during May and June. In line with these trends, U.S. milk production for the entire first half of this year registered a gain of only 1 percent. Milk production in the five states comprising the Seventh Federal Reserve District during the first half was unchanged from the year before as a second quarter decline offset a modest first quarter gain. For the second half of the year, USDA analysts believe that milk production will about match year-earlier levels. The leveling-off in production coupled with an expected pick-up in commercial disappearance should help abate the surplus market conditions that have undermined milk prices in recent months.

Milk prices received by farmers remain depressed. But the downtrend that started last September appears to have ended, reflecting the sooner-than-expected cuts in production and normal seasonal patterns. Preliminary readings show that monthly average milk prices bottomed out at \$11.30 per hundredweight in April. The overall second quarter average of \$11.37 marked a decline of 16 percent from the year before and was the lowest for that period since 1978. USDA analysts expect prices to rise modestly during the second half of this year. The mid-point of the USDA's latest projections suggest that milk prices will average about \$12.50 a hundredweight in the fourth quarter, unchanged from the rapidly declining level of late last year.

For all of this year, milk prices are projected to average about \$11.80 per hundredweight, down from \$13.73 last year.

The sharp declines in milk prices since last summer have led to losses for many dairy farmers. Milk production costs vary widely among farmers because of differences in managerial skills, herd productivity and the scale and structure of operations. Based on various studies, it appears that the cash costs (excluding labor) of producing milk for many dairy farmers can range from \$7 to \$11 per hundredweight of production. Compared to the low milk prices of recent months, it is clear that the net cash flows of higher-cost dairy farmers have left little or no margin to cover such things as capital replacement and/or a return to unpaid family labor. Fortunately, the much more favorable conditions that prevailed in 1989 and through much of last year have helped to cushion the consequences for all dairy farmers.

Some in Congress believe that the dairy support program should be revised to ease the stress on farmers. The Agricultural Committee of the U.S. House of Representative recently approved a bill that would raise the support price of manufacturing milk to \$12.60 a hundredweight in 1992 and 1993, up from the current level of \$10.10. In an effort to keep from stimulating excess production and to honor the "budget-neutral" requirement for all new legislation, the bill would also implement large additional assessments on producers who expanded output. If the dairy surplus were to remain near the levels of recent years, the bill would also implement a two-tiered milk pricing system and assign a production base to each dairy farm. Any farm that marketed milk in excess of its base would receive a much lower price on that share of production.

Observers have noted several drawbacks to the bill. For example, the higher price support would tend to discourage consumption of dairy products and thus add to the potential milk surplus. Moreover, the move to raise price supports would be inconsistent with the U.S. proposal calling for a reduction in trade-distorting subsidies to agriculture among member countries of GATT. In addition, the proposal for individual farm milk bases and a two-tiered pricing system would thwart the goal of encouraging more efficient production. The latter drawback could become particularly significant if BST were to be approved for commercial use in the near future. For these and other reasons, most observers feel the House bill has little chance of enactment.

Gary L. Benjamin

Selected agricultural economic indicators

	Latest period	Value	Percent change from		
			Prior period	Year ago	Two years ago
Prices received by farmers (1977=100)	June	155	2.0	2	5
Crops (1977=100)	June	147	6.5	13	7
Corn (\$ per bu.)	June	2.32	-2.5	-12	-8
Oats (\$ per bu.)	June	1.14	-1.7	-14	-37
Soybeans (\$ per bu.)	June	5.58	-1.6	-5	-21
Wheat (\$ per bu.)	June	2.65	0.4	-14	-31
Livestock and products (1977=100)	June	163	-1.2	-6	4
Barrows and gilts (\$ per cwt.)	June	54.70	0.0	-11	18
Steers and heifers (\$ per cwt.)	June	77.20	-2.9	0	7
Milk (\$ per cwt.)	June	11.40	0.0	-17	-8
Eggs (¢ per doz.)	June	59.3	-0.3	-6	-7
Prices paid by farmers (1977=100)	April	190	1.1*	4	7
Production items	April	175	1.2*	3	5
Feed	April	126	1.6*	-2	-10
Feeder livestock	April	223	3.2*	5	21
Fuels and energy	April	198	-9.6*	5	8
Producer prices (1982=100)	June	122	0.2	3	7
Agricultural machinery and equipment	June	124	-0.1	2	5
Fertilizer materials	June	98	-1.2	8	-5
Agricultural chemicals	June	127	0.2	5	9
Consumer prices (1982-84=100)	June	136	0.3	5	10
Food	June	137	0.3	4	10
Production or stocks					
Corn stocks (mil. bu.)	June 1	2,992	N.A.	5	-12
Soybeans stocks (mil. bu.)	June 1	724	N.A.	21	56
Beef production (bil. lbs.)	June	1.87	-3.8	-5	-7
Pork production (bil. lbs.)	June	1.14	-11.7	0	-10
Milk production (bil. lbs.)*	June	10.7	-4.9	0	3

N.A. Not applicable.

*Prior period is three months earlier.

**21 selected states.

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