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OUTLOOK FOR DAIRY

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Dairy markets in 1990 were characterized by wild price swings. Counterseasonal price rises occurred when seasonal declines usually occur. Counterseasonal price declines occurred when seasonal increases usually occur. Milk and dairy product prices during the normal seasonal price peak of November-December will be among the lowest of 1990. A fitting end to the crazy markets of 1990.

As an unusual price year comes to an end, we look to 1991 and a return to more normal seasonal price patterns. In addition, dairy markets in 1991 will be characterized by sharply lower prices, a continued expansion in milk production, and increased commercial sales of dairy products.

Forecasts for 1991 take into account dairy provisions included in the 1990 farm bill and the 1991 deficit reduction bill. These provisions include: a minimum price support price for manufacturing grade milk of \$10.10 per cwt; price support adjustments based on projections of Commodity Credit Corporation (CCC) purchases of dairy products under the price support program on a milk equivalent, total solids basis; and a 5 cent producer assessment associated with deficit reduction.

Commercial Use

Strong domestic cheese demand and recovery in butter use were the primary forces contributing to a more than 5 percent increase in the commercial use of dairy products during the first half of 1990. Fluid milk sales ran fairly even with a year earlier. Frozen yogurt sales increased sharply, while sales of other frozen dairy products and cottage cheese fell.

Second half commercial use has been affected by the sudden loosening of tight markets, as product supplies increased and the demand for pipeline holdings

fluctuated. Nevertheless, a general pattern of continued recovery in butter sales, substantial (but possibly lower) growth in cheese use, and declining commercial use of nonfat dry milk is expected for the second half of 1990.

Recent price declines are expected to offset the effects of a weakening economy and higher inflation rates. For all of 1990, commercial use of dairy products is forecast at 140 billion pounds (milk equivalent, milkfat basis), more than 3 percent above a year ago.

In 1991, commercial use is forecast to be up 1-3 percent from 1990, as the continued recovery of cream-based product sales and further growth in cheese use are expected. Forecasts for the general economy support a continued strong use of dairy products in 1991. However, risks of a recession-induced weakening are higher than in recent years. Disappearance of skim solids in 1991 are not expected to match 1990's because of weaker disappearance of nonfat dry milk.

Milk Production

Milk production started 1990 about 1 percent above a year earlier. During the spring and summer, milk production rose more than 2 and 4 percent, respectively, from the weak output of a year earlier. However, growth in milk output remained steady and moderate when compared with 1988 levels. High milk prices since mid-1989 created ample incentives for increases.

Although milk-feed price ratios have been favorable, milk output per cow has not been able to surpass trend. Increases in concentrate feeding generally have been moderate. Nevertheless, output per cow clearly has recovered from last year's weak levels.

Sharply improved returns since mid-1989 have reversed earlier declines in milk cow numbers. Although rises have been relatively small, milk cow numbers were slightly above a year earlier during the second quarter of 1990 for the first time in 5 years. Dairy farmers apparently remained conservative about expansion and new investment.

Although fourth quarter milk prices are forecast substantially below a year earlier, returns over concentrate costs are expected to be relatively favorable. As a result, milk production is projected to follow recent patterns. Milk cow numbers probably will average a bit above a year earlier. Year-to-year change in milk per cow is expected to be smaller than during the third quarter, but only because of 1989's recovery between the third and fourth quarters.

Total 1990 production is projected at almost 148 billion pounds, up more than 2 percent from 1989. Milk cow numbers are expected to be close to last year and milk per cow will rise more than 2 percent from the weak 1989 level, but only 3 percent from 1988.

Production Outlook

Many dairy farmers likely will enter 1991 in a good financial condition and could consider expanding their operations. Average debt-asset ratios have declined considerably over the past few years and some of this year's high returns could be available as liquid assets. However, in recent years farmers generally have been conservative about expanding and taking on new debt.

Early-1991 output is projected to post a sizable rise, as the high milk prices of late 1989 and 1990 generate enough pressure for milk production to expand in the near future. However, production increases will be eroded as the year progresses, as the combination of falling milk prices and fairly steady concentrate feed prices reduce favorable milk-feed price relationships.

If in 1991 milk prices fall as much as anticipated, the milk-feed price ratio could drop from the 1.7 posted last year to about 1.3-1.5. These ratios are associated with below-trend growth in concentrate feeding and milk per cow. In addition, returns over concentrate costs could fall about 25 percent from 1990's near record to the lowest level since 1978.

Annual 1991 production is projected to rise 1-2 percent, as a modest gain in milk per cow outweighs a slight decline in cow numbers. Relatively low milk-feed price ratios probably will hold milk per cow to below-trend growth.

Stocks

While the milk equivalent (milkfat basis) total of commercial stocks throughout 1990 was similar to levels in 1989, the composition of these stocks was markedly different. In 1989 butter holdings were ample, American cheese stocks stayed low, and manufacturers' stocks of nonfat dry milk were small relative to commercial use. In 1990, cheese stocks increased as storers tried to replenish low levels and butter holdings declined considerably. Also, manufacturers' stocks of nonfat dry milk started to back up when relatively high wholesale prices in early summer and signs of market weakening led nonfat dry milk buyers to cut purchases to a minimum and wait for prices to drop before buying more aggressively.

The only significant Government stocks continue to be of butter. As of November 1, the CCC held no uncommitted inventories of American cheese and only about 35 million pounds of nonfat dry milk.

Government Purchases

After 2 years of buying nothing but butter under the milk price support program, the CCC has been buying nonfat dry milk since September, when market prices dropped to support in the West. Nonfat dry milk purchases are expected to continue during the rest of the year. Commercial use is not expected to be strong enough to absorb available supplies. Similarly, large butter purchases will continue.

For all of 1990, net removals of dairy products are forecast to be close to 8 billion pounds (milk equivalent, milkfat basis) down from 9 billion pounds a year earlier. Net removals in 1991 are expected to be near the total removed this year. Commercial use in 1991 is forecast to grow only slightly more than milk production. Purchases of butter in 1991 are expected to be lower, while more cheese and nonfat dry milk will be bought.

Wholesale and Farm Prices

Price patterns during 1990 have been anything but normal; neither the seasonal price declines of the spring nor the seasonal autumn increases have occurred. Strong commercial cheese sales and memories of 1989's tight markets for cheese and nonfat dry milk shaped wholesale prices during the first half of 1990.

Manufacturers' and buyers' overreaction to the availability problems of late-1989 sent wholesale prices soaring. However, by late summer, wholesale prices started to tumble. Milk supplies were increasing, demand for user stock building was satisfied, and manufacturers' stocks were beginning to grow. By late October, prices were at or near support purchase levels.

Counterseasonal rises in cheese and nonfat dry milk prices boosted milk prices during the first half of the year. However, the counterseasonal declines in wholesale cheese and nonfat dry milk prices brought the October Minnesota-Wisconsin (M-W) price of manufacturing grade milk down to \$10.48 per cwt, \$2.95 below the July peak and \$3.39 under a year ago.

The M-W will decline further by yearend. By November-December (the normal seasonal peak), the M-W will be at its 1990 lows.

Despite late-1990 weakness, the annual average milk price will be a record of about \$14.00 per cwt, up about 3 percent from 1989 and about 14 percent from 1988. Even adjusted for inflation, 1990 milk prices were relatively high.

In 1991, milk prices are expected to fall \$2-3 per cwt below 1990 levels. Markets are likely to be operating under a situation of larger milk supplies, rebuilt stocks, more normal seasonal changes, and possibly a slackening in commercial use of skim milk.

Retail Dairy Prices

Retail dairy prices were slow to follow early-1990 declines in wholesale and farm prices. As early as February, signs emerged that wholesale product prices might be starting counterseasonal price rises. During April-June, retail dairy prices rose a tenth from a year earlier, as widening of the farm-to-retail spread more than matched the jump in farm prices. Retail prices continued to rise sharply from a year earlier during the summer. However, dramatic, late-1990 declines in wholesale and farm prices are expected to start eroding retail dairy prices.

For all of 1990, retail dairy prices will average about 9 percent above 1989. In contrast to the eighties, dairy prices in 1990 rose substantially more than did price indices for all food or all consumer items.

The downtrend in retail dairy prices probably will continue through most of 1991. For the year, retail dairy prices are expected to decline 1-4 percent, depending on how brisk retail movement remains.

International Trends

World prices of major dairy products have fallen considerably since the beginning of 1990, as export supplies and stocks increased in the major producing nations. Sales of heavily discounted product by some East European nations have added downward pressure on world market prices. Also, world consumption of dairy products has remained stable. The downward trend in world dairy product prices is expected to continue well into 1991. This trend does not provide a bright outlook for U.S. commercial exports.