

## An Update on Milk Prices

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Back in November, when I was preparing for our annual Agribusiness Outlook, I forecast that 2009 was going to be a bad year for milk prices. At that time, my forecast called for a more than \$3.00 drop from the 2008 levels. I have now revised my price outlook significantly downward from that already gloomy forecast.

Only a couple of months ago, we were beginning to understand that our economy was headed into a substantial downturn but we hadn't even attached the word "recession" to the economy yet. The decline in domestic demand for dairy products would have been bad enough, but the recession we are facing is a global one.

The tremendous farm milk prices of 2007-08 were primarily due to large increases in export demand for dairy products. The United States had always been a bit-player in world markets, exporting between 3-4 percent of our milk production. Growth in world economies like China and oil exporting nations stimulated a growth in demand for dairy products world wide. This also came at a time when traditional suppliers, like the European Union and Oceania were experiencing changes in foreign policy and natural disaster (drought) respectively, seriously reducing their ability to supply as much product to world markets as they historically had. Lastly, the U.S. dollar had become very "weak", making U.S. prices look appealing to people paying in other currencies. The three factors created a "perfect storm" of opportunity to export dairy products and in 2007-08, we exported between 10-12 percent of our milk supply. This was more than double the average of the previous 10 years.

Both the supply of milk and the demand for dairy products are "inelastic". This means that relatively small changes in quantities will give us fairly large swings in milk prices. Historically, if we experienced a 1-2 percent variation in milk supply we would see very large swings in milk prices.

All three factors of the "perfect storm" are reversed today. The dollar has strengthened, worldwide demand is weak, and production in Europe and Oceania is improved. Dairy product exports will not go to zero from the U.S. in the current environment, but they will be greatly diminished. Let's guess that we might only export half of what we had in the past two years—about 5 percent of our milk supply. If nothing else changed, that would mean that we had an additional 5-7 percent of milk staying on our domestic market. That alone would send tremendous shock waves through our dairy markets. Now, couple that with a domestic economy in recession and a more than 1 percent growth in production to boot and I think that you can imagine that we will be seeing milk prices at support levels this year.

We haven't sold significant amounts of dairy products to the CCC since the early 1990s. This year, we will sell perhaps as much as 400 million tons of nonfat dry milk, substantial quantities of butter and probably cheese to the government. Of course the

implications of sales to the CCC are support level prices for milk—somewhere around \$10.00 per hundredweight for class III and class IV.

Although feed prices have declined from the \$6 level for corn, they remain high by recent historic standards. I recently heard a large dairy producer from the Southwest (where producers buy most of their feed) say that for the first time in his 25 years of dairying, milk prices will not be enough to cover *variable* costs of production. Recall that in tough economic times a firm may choose to produce at a loss as long as their variable costs of production are covered. Relatively fixed costs—like equipment purchases or a new roof on the barn—may have to be delayed while capital is consumed. But, an economist would say that producing when variable costs are not covered is irrational.

This dairy producer was further indicating that they would have to look at substantially culling the herd to the point where the most efficient animals would at least produce enough milk to cover their feed costs. Dramatic culling is the only way that we can reduce the milk supply by enough to pull milk prices back above support levels any time soon.

My updated milk price forecast is given in the table below. This equals an average farm milk price decline of something like \$4.70 per hundredweight from 2008 levels.

Date	CI Mover	Class II	Class III	Class IV	Boston Uniform	MILC
Jan-09	\$15.74	\$11.41	\$10.70	\$9.80	\$14.02	NA
Feb-09	\$10.82	\$10.89	\$9.35	\$10.10	\$12.28	\$1.38
Mar-09	\$10.10	\$10.71	\$9.75	\$10.15	\$11.86	\$1.61
Apr-09	\$10.10	\$11.05	\$10.30	\$10.50	\$12.36	\$1.87
May-09	\$10.43	\$11.38	\$10.65	\$11.00	\$12.89	\$1.76
Jun-09	\$10.92	\$11.51	\$11.55	\$11.00	\$13.16	\$1.57
Jul-09	\$11.45	\$11.76	\$12.25	\$11.10	\$13.74	\$1.36
Aug-09	\$12.10	\$11.99	\$13.25	\$11.45	\$14.45	\$1.07
Sep-09	\$13.14	\$12.18	\$14.00	\$11.70	\$15.10	\$0.70
Oct-09	\$13.94	\$12.57	\$14.50	\$12.10	\$15.71	\$0.49
Nov-09	\$14.51	\$12.72	\$14.60	\$12.20	\$15.90	\$0.47
Dec-09	\$14.62	\$12.91	\$14.60	\$12.25	\$15.94	\$0.49
Average	\$12.32	\$11.76	\$12.13	\$11.11	\$13.95	\$1.16

*Jan 21, 2009*

This is going to be a most difficult year for dairy producers. From what I understand, agricultural credit is available but loans will be scrutinized carefully for credit worthiness. Interest rates may be low and appealing but eligibility requirements will probably be very high. It is also likely that other traditional sources of credit, including feed, equipment and fertilizer dealers, may be more restrictive with open accounts. Farms will need to be on top of anticipated cash flow shortfalls and work with their lenders sooner rather than later.

This financial outlook may place many producers under tremendous emotional stress during the year. Please know that there are resources to help deal with these problems too—from informal sources like a local house of worship, to more formal such as counselors, Cornell's Extension staff and Farm Net specialists. Encourage folks to seek emotional support if they are in need.

This collapse of milk prices won't last forever. On the contrary, I think that the U.S. has officially entered the realm of world exporter of dairy products and that several emerging economies will demand increased consumption of dairy products in their diet. However, the global recession will have to show signs of a turn-around before that will impact our milk prices once again and that is likely to be a couple of years away. If producers cull the national herd heavily enough—and I expect they will—we could see some strengthening in milk prices by the second half of this year.