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Dairy Outlook; Hog Comments

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DAIRY OUTLOOK

by
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In mid-August, Extension economists from ten of the North Central States met at Purdue University to discuss the price outlook of various farm commodities for the 1993-94 marketing year. This article is intended to pass along some of the ideas presented on milk.

Today, dairy producers and processors face challenges unknown to the dairy industry a few years ago. This challenge is learning to operate in an environment where prices are determined by market forces instead of by government price supports. The government has lowered the price supports below the current market prices, making dairy products subject to market forces and fluctuations.

Milk Price Determination

The main determinant of milk prices today is the price of cheese. There is a 92% correlation between the price of cheese and the price of milk, with cheese prices in the lead. Butter has virtually no effect on milk prices and nonfat dried milk has only a minimal effect. The Dairy Export Incentive Program (DEIP) has added an estimated $0.50 to the hundred weight price of milk.

The price of cheese used for determining the price of milk is determined at the National Cheese Exchange located in Milwaukee, Wisconsin. The National Cheese Exchange is open only one-half hour a week and accounts for only about 1% of the cheese sold, but it is used as the guide for all other cheese and milk markets.

Milk Production

Looking at national production capabilities as of July 1, 1993, cow
(Continued on p.2)

HOG COMMENTS

by
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Through the first three quarters of 1993, the nation's pork producers have been saying that the hog and pig inventories in the U.S. are below levels provided in the Hog and Pig reports. The producers' voices have been heard mainly through slaughter levels that, by October 1, were about 2% below year to date levels in 1992. Yet, hog and pig report estimates would have indicated slaughter levels above year earlier levels.

The September 1 Hog and Pig report (released on Sept 30) was a change to the above picture. Not only are inventories now more in line with slaughter, but the expansion shown earlier this year has turned to contraction. Slaughter for the rest of 1993 and even early 1994 now is expected to be 3% below year earlier levels. And, if producers hold to their "sow farrowing intentions", marketings should stay below year earlier levels through at least the first half of 1994.

A Word of Caution

The above situation certainly was good news to the hog industry. The futures market immediately rallied with two days of limit up moves. The cash market, already well above levels expected, seemed more likely to hold rather than drop from the current upper $40's to the once-feared lower $40's or upper $30's. So, why is "caution" needed?

First, producers must be "cautioned" to watch for forward pricing opportunities. Often, the market over-reacts to news, whether that news be good or bad. When that happens, better-than-expected and better-than-can-be-maintained prices are offered. Producers should be ready to act and, if the situation fits them, lock in
(Continued on p.3)

(Dairy ... cont'd from p.1)
numbers are down about 1%, while production per cow is up about 2%. This nets out to a national increase in milk production of 1%.

In the Midwest, cow numbers and total production are declining. Minnesota and Wisconsin have about 20% of all cows in the nation, but culling this year is running about 20% ahead of last year. The increase in culling is partly due to a poor growing season this year, with producers choosing to sell cows rather than buy feed. But the Midwest also is experiencing a general reduction in dairy operations. As facilities become obsolete or worn out, many Midwestern producers are ceasing production rather than reinvest in plant and equipment. Of the dairy barns still in use in Wisconsin, the average age is 46 years.

Meanwhile, there is substantial growth in cow numbers and dairy operation in the South and West, despite lower farm milk prices in the West.

The decrease in Midwest milk production has created excess capacity in the milk processing business. As processors bid for the remaining milk supplies, they have been bidding the farm price above what is profitable for the plant. This will continue until Midwest producers expand production or some processors drop out of business.

Milk Product Inventories and Commercial Sales

Nationally, inventories of dairy products are increasing except for butter. Commercial supplies of American cheese in storage as of June 30 are up 24% to 404 million pounds compared to year-ago levels. Nonfat dry milk is up 46% to 143 million pounds, while butter in storage is down 43% to only 16.5 million pounds. As inventories build, prices wane. Cheese inventories are usually built in the spring for the Thanksgiving-New Year period when heaviest cheese purchases occur. These inventories will begin to decline in August and September.

Commercial sales of American cheese from January through May 1993 were up 3% compared to a year earlier, while other cheese sales rose 1.9%. Due to a decline in exports, nonfat dry milk sales were down 38.7%. Fluid milk sales were down 0.7%, while butter sales were up 10.8% during the same time period. Butter sales increased due to a lower government support price. However, total butter consumption still equates to only about 4 pounds per person per year.

Milk Product Futures Markets

The cheese and nonfat dried milk futures markets, which were initiated in June of 1993 by the New York Coffee, Sugar, and Cocoa Exchange (CSCE), have not been adopted as a tool to reduce the new price risks in the milk and cheese markets. Both markets are suffering from lack of hedgers and speculators. The volatility in the cheese and nonfat dried milk markets should be adequate to support futures markets, yet the response has been poor.

One problem may be the large contract size. One contract of nonfat dried milk is 44,000 pounds which equates to about 495,000 pounds of fluid whole milk. The large contract size makes it difficult for all but the very large dairies to use, although such contracts would afford price protection to large dairy processors which want to offer cash forward contracts or minimum price contracts. The same applies to cheese manufacturing. The large contract size (40,000 pounds) may be keeping speculators at bay.

A second problem is the lack of information about the futures trade and prices. The prices determined by the cheese and nonfat dry milk futures trading are not as readily available as for most traded commodities. The author has never seen dried milk or cheese futures prices quoted with other futures prices in farm papers or magazines. Only the nearby contract for nonfat dried milk is quoted in the <u>Wall Street Journal</u> and cheese futures prices are not quoted there. If these futures markets do survive and grow, they could be highly useful in dampening the large price swings felt by dairy producers and processors.

Current Milk Price Situation

The current market situation for milk is characterized by price instability. Low support prices mean that prices will continue to be determined by market forces, not by government action. Short-run inelastic supply and demand schedules for

milk means that small shifts in either demand or supply mean large shifts in price, until producers and buyers have time to adjust. Since both producers and processors are learning to operate under these new conditions, some costly mistakes may be made.

Prospective Milk Prices

Milk production for 1993 and commercial sales are fairly well in balance. Commercial sales are expected to increase about the same as production in 1994. The DEIP has been slow but is expected to add strength to prices this Fall.

Projecting into the future, cheese will continue to be the main determinant of milk prices. By the end of 1993, farm milk prices are expected to have fluctuated by $1.50 to $2.00 per cwt. The same variation is expected for 1994. The annual averages for 1992, 1993, and 1994 are expected to be within $1.00 of one another. The 1993 average M-W (Minnesota-Wisconsin) price per cwt. is expected to be in the $11.55 to $11.65 range at the farm and the South Dakota average all milk price in the $12.40 to $12.45 range.

Looking ahead to 1994, there is about a 50-50 chance that the average milk price may weaken, but not by more than 10 to 15 cents per cwt. If prices increase, they are likely to not increase more than 50 to 70 cents above the 1993 average. This puts the projected 1994 average M-W price between $11.45 and $13.35 per cwt. and the US all milk price in the $12.70 to $13.60 range. The Minnesota average all milk price runs about 40 cents under the US all milk price and the South Dakota all milk price about 45 cents under the US.

Projections for the next 5 years indicate that the national average all farm milk price should stay between $12.25 and $13.50, assuming normal crop yields and no major changes in dairy policy. Any event that causes a major shift in feed prices or quality, such as drought (or bumper crop), could cause higher (or lower) prices. For example, the cool weather during the summer of 1993 kept the average production per cow higher than expected and, consequently, prices lower than expected. A lack of top quality alfalfa due to the cool rainy summer could cause lower production this winter, thereby supporting prices.

Other possible market movers include BST, NAFTA, or a change in government policy with respect to dairy. BST is currently so hot politically that its use during 1994 is unlikely. NAFTA, if implemented, may result in increased sales to Mexico, but the impact on price would be minimal in 1994. Continued funding of DEIP is important to maintaining prices. Don't expect any change in policy to enhance prices.

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(Hog Comments -- cont'd. from p.1)
prices.

Second, part of the Hog and Pig report includes "intentions". This Fall's higher prices can change those intentions into "expansion" rather than "contraction".

Finally, there is concern that the changing structure of the hog industry, both in terms of production and marketing, may make both estimation of "what is out there" and prediction of what to expect more difficult. Extremely large-scale, highly integrated production has occurred and continues to occur in many areas, including some which were important in hog producing and in others where hog production didn't exist on a commercial scale.

And so, caution is needed. The reports include intentions -- intentions can change. The last report said contraction -- reports are subject to sampling, reporting and statistical errors. The pork industry has changed. Is it possible to get a good handle on where we are? Any of these concerns could cause an "optimistic" outlook to change to one not nearly as rosy.

What To Do?

The many changes which have occurred and will continue to occur in the pork industry make it essential for producers and others involved in the industry to be informed. Only by being informed can anyone make intelligent decisions. A meeting, sponsored by the South Dakota Pork Producers Council on November 16 at the Ramkota Inn in Sioux Falls, is one way to learn.

The afternoon session of the meeting starts at 1:00 PM and will include discussions about where we are, where we

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are going, and new approaches, including contracting and coops. The evening session will be a "planning" meeting to help participants answer questions and provide input.

Many of the speakers at the meeting are nationally known and come from a background of involvement and participation. The meeting will be an excellent way for producers and others to learn about the "new pork industry" and then to help them evaluate their approach and position in that industry.

Many producers who were in business even two or three years ago no longer produce hogs. Sometimes that is of their own choosing, sometimes they "just couldn't keep up" with the rest of the industry. That same thing probably could be said in another two or three years. If you go out of business because you want to, that's OK. But, if you go out because you aren't informed, that is not <u>and</u> that often can be changed.

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