

Dairy Situation and Outlook

Robert Tigner

Iowa State University Extension

Farm Management Specialist

New Hampton, Iowa

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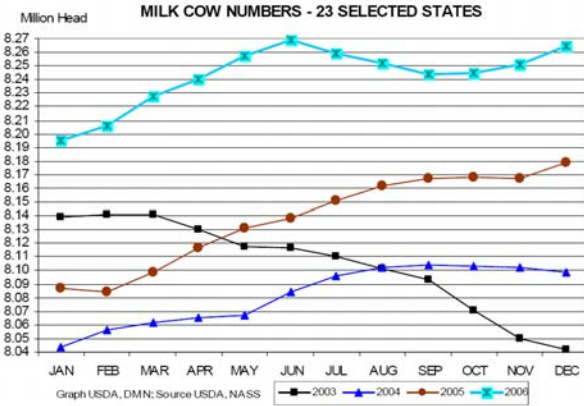
Dairy Herd & Milk Production Grows

December 06 milk production rose 2.7% in the 23 reporting states. The Nov 06 report was revised up by 13 million pounds for an additional 0.1%. Production per cow averaged 1689 pounds which was a 26 pound increase from Dec 05. The dairy herd was 86,000 more than one year ago and 14,000 more than Nov 2006. Fourth quarter US milk production was up only 2.2%. Average US herd size was 9.12 million cows, 56,000 more than the same period last year.

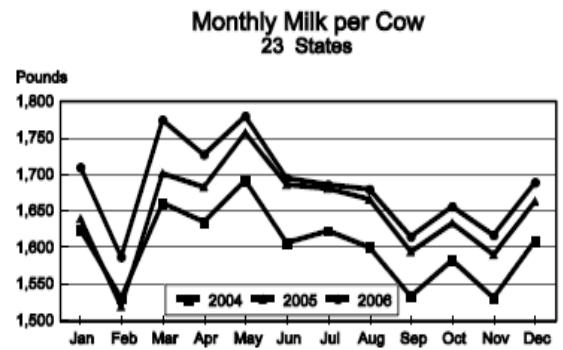
Production per cow in Iowa was 1725 pounds, the same as one year ago. Milk cow numbers rose by 5,000 compared to one year ago and the previous month. More milk cows added 9 million pounds of milk to Iowa's production. Iowa cheese production during Nov 06 was 11.675 million pounds, down 13.4% from Nov 05 and -3.8% from October 06.

Milk Production: Selected Dairy States, December 2006

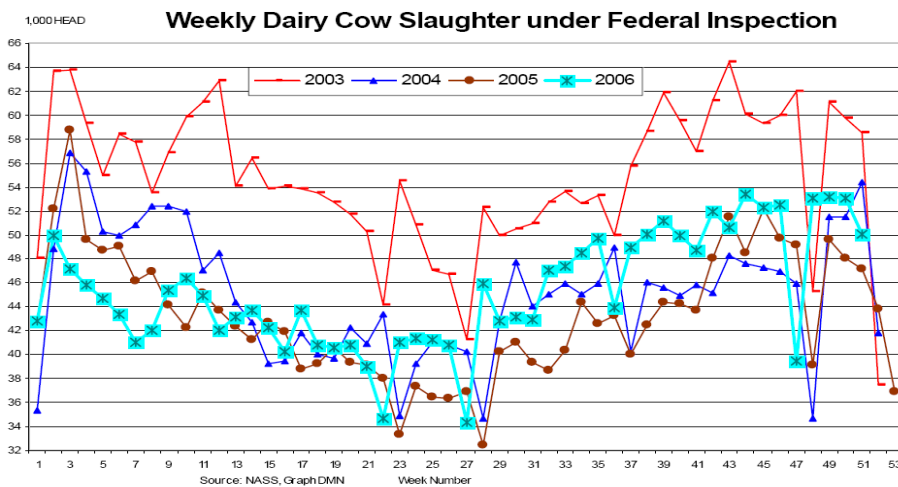
State	thousands			pounds			million pounds		% change total milk
	2005 cow numbers	2006 cow numbers	% change cow numbers	2005 milk per cow	2006 milk per cow	% change milk/cow	2005 total milk production	2006 total milk production	
Iowa	200	205	2.50%	1725	1725	0.00%	345	354	2.61%
MN	445	455	2.25%	1545	1575	1.94%	688	717	4.22%
WI	1239	1247	0.65%	1550	1570	1.29%	1920	1958	1.98%
IL	104	103	-0.96%	1570	1620	3.18%	163	167	2.45%
CA	1771	1785	0.79%	1795	1850	3.06%	3179	3302	3.87%
CO	105	114	8.57%	1890	1910	1.06%	198	218	10.10%
ID	472	500	5.93%	1830	1820	-0.55%	864	910	5.32%
NM	339	360	6.19%	1780	1690	-5.06%	603	608	0.83%
PA	557	549	-1.44%	1580	1620	2.53%	880	889	1.02%
NY	650	629	-3.23%	1545	1565	1.29%	1004	984	-1.99%
TX	324	345	6.48%	1720	1770	2.91%	557	611	9.69%
23-State	8179	8265	1.05%	1663	1689	1.56%	13599	13963	2.68%



Source: Dairy Market News



Source: Milk Production, NASS



Source: Dairy Market News

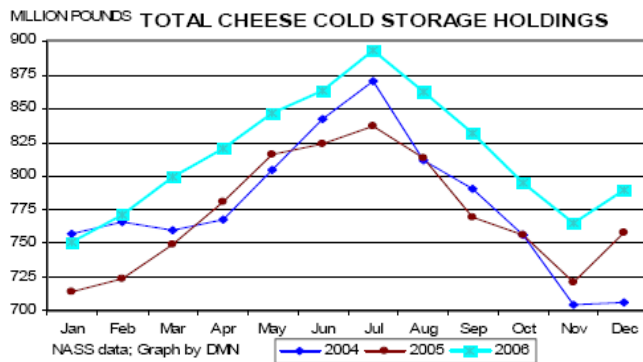
Dairy Product Demand

Dairy product demand has gotten very interesting, especially dry dairy products. Dry whey and non fat dry milk (NDM) supplies are very tight due to domestic and export demand. Whey prices have been above \$0.40 per pound since early November. A 1 cent rise in whey prices at this level translates to a 5.8 cent increase in Class III milk prices. Whey prices were as low as 27-30 cents per pound during summer 06. NDM prices range from \$1.05-1.20 in the western US with Central and Eastern prices from \$1.105-1.40.

November 06 fluid milk sales were up 1.8% compared to Nov 05. Year to date 2006 fluid milk increase has been 1.1%. A few early months of 2006 were actually below year ago amounts. Organic fluid milk sales are being reported but no growth rate reported since a full year of data has not yet been collected. The rate of growth will be interesting to see.

Total butter inventories as of Dec 31, 06 were 158% of Dec 05 and 98% of Nov 06. Total cheese inventories were 4% higher compared to one year ago and 3 % higher than the previous month.

Total commercial disappearance as of Oct 31, 2006 is estimated up 1.2% for Aug-Oct. Year to date, Jan-Oct, the increase totaled up 2.1%. The largest increase was in American cheese, up 5.5% year to date.



Analysis

As I have mentioned before there continues to be a disconnect between CME futures prices and the fundamentals of dairy supply and demand. As of closing on Jan 26, 2007, the CME Class III futures prices averaged \$15.02 for calendar year 2007, up 58 cents from the previous week. Cash cheese prices averaged up 5.75 cents for blocks and 6 cents for barrels. The change in CME futures prices during the week did reflect the cash cheese market change. But based on a historic cash cheese market relationship to Class III prices, one would expect Class III prices to be \$1-1.50 per hundredweight lower.

Another consideration for dairy farmers looking at price risk is the opportunity they now have. The average 2007 CME Class III prices as of Jan 26 were not far from the record average of 2004. Most of that record was due to three very high months, April, May and June, That was a very unusual time of year for milk prices to reach a high, the spring milk flush.

The real story for the milk market bulls is the NDM and whey market. These products are very tight with the export market having a very strong influence on their supply and prices. Other dairy products have adequate supplies.

Much of the bullish sentiment in the dairy market appears to be the spillover in the corn market and worries about future milk supplies due to increasing feed costs. For some dairy producers it is a very real concern. Large dairy farms that produce minimal feed volumes are at much more risk than smaller operations that can produce all their forage and some grain. Using a typical Iowa dairy ration, feed costs could increase 70-85 cents per cow per day, possibly 20-25% more. Average daily milk production for a lactating cow is about 65.6 pounds. The gross income per cow per day has increased about \$1.50. That increase is due to higher Class III prices, up \$2.41 per hundredweight from September to December. At least for now milk prices have risen enough to offset increased feed costs. September's Class III price was too low for most dairy farms to cash flow, so these higher prices still haven't given good profitability to many dairy farms yet.