CoBank Dairy Outlook

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The U.S. dairy sector remains in a state of transition. The first part of 2019 was marked by high dairy cow culling evidenced by significant YoY growth in dairy cow slaughter. For the year, national milk output increased only slightly YoY as cow numbers continued slipping through June. September and October were the first months to show the U.S. adding cows in response to higher milk prices. The national herd reached 9.327 million head, still 0.4% below a year ago. Dairy cow slaughter will end the year between 2% and 4% above a year ago.

Lower milk production in the first half of the year set the stage for increasingly higher prices. The national All Milk price began the year at $16.60 per cwt and will stretch to over $20 per cwt by the end of the year. However, while milk prices have posted a strong recovery, dairy producers are juggling higher feed costs.

Corn prices rose 7% over the 2018-2019 marketing year, while national soybean meal prices are estimated to have fallen by nearly 11%. Alfalfa supplies are still tight and prices remained similar to last year. The combination of rising milk prices and mixed feed prices resulted in better margins on an annual basis, although most of the gains were made in the second half of 2019.

Domestic demand for value-added products soared in 2019. Higher cheese prices were the main driver behind the All Milk prices received by producers reaching $20 per cwt. Block cheese prices rose to $2 per pound – the highest since 2014. Domestic disappearance of American-type cheeses (cheddar, Colby, Monterey, and Jack) through September averaged 4.5 million pounds per month higher than in 2018.

Exports for cheese through September were also stronger, up 3.2% YoY. The higher demand for Class III milk by cheese processors has tipped the Class III to Class IV price spread in Class III's favor. Class III is now $2.67 per cwt higher than Class IV. Although Class IV milk prices have not seen the gains that Class III had, it too posted gains in 2019. Class III milk price started the year at $13.96 per cwt and was $19.40 per cwt in mid-December. In contrast, Class IV started 2019 at $15.48 per cwt and in mid-December settled at $16.73 per cwt.

Export butter demand struggled in 2019 but domestic demand was very strong, with domestic disappearance averaging 1.3 million pounds higher than 2018 through the first nine months of the year. Although butter prices are still high by historical standards, the trend has been lower in 2019. The U.S. weekly average butter price reported by USDA-AMS reached as high as $2.41 per pound in July, but since that week has fallen sharply.

Mid-December wholesale butter prices were averaging below $1.95 per pound. Butter production is down 0.5% year-to-date in 2019, but cold storage inventories have climbed above the prior year since July. Although cold storage levels are not considered burdensome, the price impact on higher domestic demand appears to be primarily driven by smaller export figures.

Butter exports are down 42% so far this year. Mexico and Canada are the two primary markets for U.S. butter exports. Mexico this year is off 72% of last year's volume while Canada is down 42%. Together they account for more than 11,000 metric tons lost compared to last year in the January through September timeframe. U.S. butter prices have been notably higher than competitors'. Both Oceania and Western Europe are reporting FOB prices that calculate to less than $1.90 per pound in U.S. dollars since August. With the signing of TPP, Canada and Mexico consumers will have better access to Australian and New Zealand brands through larger quotas. The USMCA will finally see resolution with Congressional approval. However, even with this agreement, U.S. exporters could face steeper competition in these two key markets. The fourth quarter of 2019 is one of the highest consumption periods in the year for butter and cheese.

These holiday season trends support a further rise in milk prices to close out the year. However, with domestic consumption being the primary driver, milk prices are likely sensitive to slower macroeconomic activity.

The rapid rise in milk prices, gaining 10.9% YoY in October, will be a driving force to add more cows to the herd. The last two months have shown small gains, 5,000 head each, to the total U.S. sector. Dairy replacement prices are already climbing. After bottoming in 2019, the third quarter showed the highest dairy replacement price nationally in more than a year. The Jan. 1, 2020, cattle inventory report will provide a better indication for what to expect out of growing dairy cow numbers. Dairy heifers held for replacement were below a year ago in July. Expect dairy heifer supplies to tighten further as a result of the higher milk prices.

The increased use of sexed semen could help speed up heifer replacement growth, but in the near-term, dairy heifer replacement prices are expected to increase. The dairy industry is facing a new world with the signing of TPP, with the U.S. on the outside looking in. U.S. competitors now have improved access to the Pacific Rim. This year exports were largely mixed; butter and concentrates were down, as were whey and yogurt products. While the U.S.-Japan agreement provided similar access to the Japanese market for beef and pork, some dairy products were left on the sidelines, namely butter and skim milk powder. However, cheese, one of the largest U.S. dairy exports to Japan, will see the same benefits as TPP partners. The world dairy stage may see a bit of reshuffling over the next couple of years in the wake of new trade deals, a resolution with China, and new suppliers potentially emerging (India).

U. S. milk prices in 2020 are expected to be above a year ago, in part restrained by available heifer supply limiting rapid expansion in the short term. Domestic consumption is expected to continue to underpin the demand for dairy products, and is dependent on continued positive GDP growth. On the producer margin side, feed costs are expected to come down in 2020 with additional corn and soybean acres coming into production and normal yields continuing to support alfalfa availability and lower prices. The improved feed and milk price outlook will bolster dairy profit margins next year.