U.S. dairy market at a crossroads

Mike North for Progressive Dairyman

The first quarter of 2017 could have been well described by Shakespeare when he penned the famous comedy Much Ado About Nothing. Prices raced higher into the opening days of the year, with thoughts of a production meltdown beginning to unfold in Europe and Oceania amid a growing movement to secure fat. As both production concerns faded and domestic inventories strengthened, prices fell away from February highs to test fall lows.

A sense of normal seasonality took hold as sleepy markets marched through April, with quiet trade and diminishing domestic price outlooks. However, in the backdrop of what appeared to be normal seasonality for U.S. markets, global fat markets were anything but normal or seasonal (see Figure 1).

Butter prices would ordinarily soften in the weeks following Easter. However, this year the markets were just warming up. U.S. markets, global fat markets were anything but normal or seasonal (see Figure 1).

Secondly, European Union (EU) butter production has been lagging previous-year levels. In the last three calendar quarters, European butter production totaled 3.3 billion pounds, down 188 million pounds (5.7 percent) from the same period a year earlier. With U.S. inventories now at 313 million pounds, you can understand why this catches the market’s attention.

The final piece in the puzzle was demand. Ever since news broke supporting butter as a healthy fat in the human diet, demand has been steadily climbing. In Europe, an early 2016 estimate of domestic butter consumption was projected at 8.8 pounds per person per year. It appears this projection missed the mark by more than 3 percent. This trend is just as true in the U.S., where per-capita butter consumption stands at 5.6 pounds per year. A 24 percent increase in the last decade. While butter consumption in Asia has been lagging the human diet, demand has been steadily climbing. In Europe, an early 2016 estimate of domestic butter consumption was projected at 8.8 pounds per person per year. It appears this projection missed the mark by more than 3 percent. This trend is just as true in the U.S., where per-capita butter consumption stands at 5.6 pounds per year. A 24 percent increase in the last decade. While butter consumption in Asia has been lagging

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While butter has grabbed the headlines, a rising tide raises all ships. This has been especially true in the fat complex. The price of anhydrous milkfat on the Global Dairy Trade (GDT) auction rose 29 percent since the start of the year. Whole milk powder began its move last summer and peaked at the start of the year. After falling to March lows, prices have rebounded 9 percent but still remain nearly 9 percent behind their price at the start of 2017.

Market response has extended beyond fat in the second quarter. Global product prices across the board have managed to work to higher levels. The average GDT price for cheddar is 6 percent higher than at the start of the year and 25 percent higher than its April low. Like whole milk powder, the price of skim milk powder rose 16 percent from its April low but remains 16 percent below

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Where do we go from here? All the talk of supportive world markets must surely give producers something to smile about. While European milk production was below year-ago levels through February, EU producers posted gains of a combined 73,000 MT in March and April, even though Germany and France fought harsh spring weather and lagged their 2016 spring performance. Anecdotal evidence suggests May and June performance has continued the trend of growing European production.

New Zealand producers struggled under their own concoction of financial headwinds and weather woes. Earlier in their year, production was projected to be more than 6 percent short of the previous season. In the end, production lagged by only 1 percent. As they head into their next production season, early projections suggest strong performance built on high pay prices. Fonterra’s first announcement for 2017-2018 farmgate on high pay prices. Fonterra’s first announcement for 2017-2018 farmgate prices suggests a pay price of $6.5 per hundredweight (MT) in March and April, even though Germany and France fought harsh spring weather and lagged their 2016 spring performance. Anecdotal evidence suggests May and June performance has continued the trend of growing European production.

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The U.S. milk market finds itself squarely at the crossroads of a large domestic production/inventory situation and a global fat market supporting prices of all product categories. The butterfat story is real and demands respect. But it may be too much to ask for the U.S. to capture any significant portion of that opportunity. A look back at the history of butterfat (butter, butter oil and anhydrous milkfat) exports reveals a limited capacity of the U.S. to participate in that market. Apart from the late 2013/early 2014 market spike (experienced by all product categories), butterfat has been a declining export market since 2011.

The hope, then, comes in product areas where we have been a strong competitor. Historically, that has been in milk powders and proteins. In the last several years, nonfat dried milk, skim milk powder and the family of whey products have topped the list of export products. Cheese follows at distance behind.

Mexico remains as our largest outlet for powders and cheese, with China and other Asian countries demanding the greatest amount of U.S. whey products. While politics have been touted as a possible interference in these transactions, volumes have yet to suffer. There remains some hope for prices to improve as a result.

Warring against that hope is the constant reminder of large production and strong inventories. The U.S. continues to grow milk production by 1.5 to 2 percent relative to 2016 levels – a function of rising cow numbers and cow productivity. Together with top management, milk production is flowing at a record rate, playing out in massive/record inventories of cheese, butter, nonfat dried milk, dry whey and other product categories – even after recent exports.

We are left at the mercy of the domestic buyer. Which story will they give the greatest weight: the threat of export competition or comfortable inventories? That remains the question, and it comes with no easy answers. They are truly caught in the crossroads and have pulled U.S. producers into the intersection with them.

When a few buyers move toward an answer to that question, we witness short bursts/breaks in our markets. If either of these movements gain momentum, we are left with the obvious result. Many buyers have simply gone hand-to-mouth with what they need. It has allowed the market to simply maintain mediocri prices, neither too high to excite large herd growth nor too low to cause culling.

To that end, the U.S. dairy farmers should prepare for either boom or gloom. Several strategies exist to help one plan for both outcomes.

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