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MCT COMPASS

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Milk Country Mired in Pain

At this time last year, inflation was in full swing and analysts from all industries were warning of a pending recession as the U.S. Federal Reserve Bank began its series of interest rate hikes. Yet despite those warnings, the labor market has remained strong and consumers have continued to increase travel, dine out, and spend on other goods and services. That behavior hasn't really changed. Travel continues to rebound, both on the nation's highways and in the air. U.S. consumers are also gaining confidence about the future, and COVID is now just a passing thought for most people. However, repercussions still remain and some changes could be long-lasting, such as increased telework, a renewed love of cooking and baking, and regionalization of supply chains.

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The dairy industry, however, is in much worse shape than it was a year ago. Following improving profit margins in 2022, on-farm milk margins are once again painful. For instance, in 2022, the Dairy Margin Coverage (DMC) program margin over feed costs averaged $10.73/cwt., up $3.81 from 2021, and last August, year-over-year output was up 1.6%. This year, the May margin fell to $4.83, the lowest since the DMC program began, output and U.S. demand for most dairy products has been flat, Chinese demand for dairy products has moderated significantly, and milk and dairy products continue to be in surplus.

To get a sense of where markets might go from here*, MCT Compass* interviewed a panel of four dairy analysts: Bill Brooks, economist with Stonehart consulting and ag instructor at Northwest Missouri State University; Sara Dorland, managing partner at Ceres Dairy Risk Management; Monica Ganley, principal at Quarterra, an agricultural consulting firm in Buenos Aries; and Sarina Sharp, analyst with the *Daily Dairy Report*.

All four agree that what happens in China will have a significant impact on milk and dairy product prices going forward, but some are more optimistic than others. Ganley, for example, said, "The question is not whether Chinese demand will improve, but rather when. The Chinese government is taking measures to stimulate its economy, and this should eventually begin to support additional dairy consumption."

However, others think a more significant slowdown could be coming. "The U.S. dairy industry should be

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Ken's Corner

by Ken Meyers
President , MCT Dairies Inc.

The recession that last year many analysts thought was inevitable has not yet materialized, and a growing number now think the Federal Reserve might successfully engineer a soft landing. Whether the landing is soft or a mild recession occurs, the dairy industry has not been able to escape the consequences of last year's runaway inflation.

Inflated retail prices put a damper on overall world demand, particularly in the developing world. However, as demand slowed, producers worldwide were still making as much milk as they could after expanding their herds last year. That expansion was short-lived, and another mass exodus of dairy farms will have occurred by the time this cycle is over.

While this boom-and-bust cycle has played out many times in the past, the pain has been immense. Estimates suggest 2,000, or 7%, of dairy farms will go out of business as a result of this downturn, a contraction that unfortunately is needed before milk prices can rise to profitable levels again. Today, several analysts think current Class III futures prices could still be optimistic. That does not bode well for the Upper Midwest, but if world economies rev up, low cheese prices could also spark a rebound in exports, perhaps saving some dairies from bankruptcy. **MCT**

...farm bill on tap

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in better shape to grow exports to China versus other U.S. agricultural sectors, but long-term growth to China will probably slow to all dairy suppliers as the Chinese population continues to age and shrink," Brooks said.

Sharp agreed, adding that "China's population has reached a tipping point, with fewer young people every year. Like a glacier inching across the landscape, the impact of China's demographic decline will be both incremental and monumental."

The farm bill will also be front and center this coming year, especially with new numbers from the Congressional Budget Office that showed continuing the farm bill without changes would cost $750 billion over the next five years, up from $428 billion. "SNAP (Supplemental Nutrition Assistance Program) and WIC (Women, Infants, and Children) funding will be important to watch as they not only provide access to healthy food for families in need, but they also support farms that may otherwise lose some demand when the economy slows," Dorland noted. Allowing for the continual updating of the production history under the Dairy Margin Coverage (DMC) program, retaining the Dairy Revenue Protection (Dairy-RP) and Livestock Gross Margin (LGM-Dairy) programs will also be important, but even more critical will be what happens with crop Insurance, which could have a big impact on feed costs. **MCT**

July 12 CME Futures Settlement Prices

	Cheese	Class III	Butter	Class IV	Whey	NFDM
July	1.4890	13.84	2.45	18.05	0.27	1.15
Aug	1.5900	14.84	2.44	17.75	0.27	1.13
Sept	1.6900	15.81	2.44	17.59	0.28	1.10
Oct	1.7880	16.75	2.44	17.61	0.29	1.10
Nov	1.8380	17.31	2.45	17.84	0.29	1.13
Dec	1.8490	17.53	2.40	17.84	0.40	1.15
2H 2023 Avg	1.7073	16.01	2.44	17.78	0.30	1.13
2024 Avg	1.8921	17.83	2.32	18.18	0.35	1.27

What the experts say...

Bill Brooks: It will likely be a few years before the repercussions of the pandemic are behind us. We have experienced inflation pressures not seen in 40 years and now are going through an increase in interest rates to slow inflation. Some commodity prices are already increasing because markets expect the Federal Reserve to hike interest rates only once more before pausing. Unfortunately, these higher commodity prices could fuel another round of increased inflation. Federal spending also needs to be reined in for the impacts to be behind us.

Sara Dorland: China and exports will be the key drivers of dairy markets for the rest of this year. Milk production gains are slowing. U.S. and possibly EU output could be flat to less than a year ago by third quarter. In China, low milk prices and slack demand are lowering on-farm margins. Even big, corporate farms are struggling, which has dropped year-over-year output gains from more than 9% earlier to just over 1% in second quarter. There is reason to be optimistic about global dairy demand, especially as prices ease. Markets will face challenges, but they should start to normalize at current prices.

Monica Ganley: In the United States, producer margins have been tight enough for long enough that we are starting to see milk volumes moderate. Similar margin issues are at play in Europe and are being exacerbated by extremely hot temperatures in the southern part of the continent. However, many of the major milk-producing countries are still substantively expanding volumes and it could take them a bit longer to get back on track. In the Southern Hemisphere, El Niño threatens to negatively impact milk production in the second half of this year.

Sarina Sharp: Feed is expensive, milk prices are inadequate, and beef prices are record high. Producers have every incentive to cull hard, and the dairy herd will shrink in the second half of the year. Many producers will be forced to exit the industry. The dairy herd is already shrinking in the Southwest. Later this year, we could see many sellouts in the Upper Midwest, where the milk surplus has exacted a steep discount on already low Class III prices. A significant setback in the size of the U.S. dairy herd likely will mean much higher milk prices in 2024.

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