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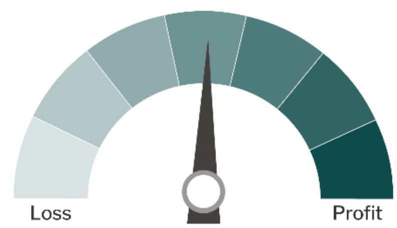
MARKET SNAPSHOT

Dairy

March 31, 2023

Executive Summary

12-Month Profitability Outlook



AgWest Farm Credit's 12-month dairy profitability outlook suggests break-even returns. Dairies will face headwinds from continued elevated feed costs, tight forage supply and weaker milk prices. National milk production has increased more rapidly than domestic use and exports, resulting in downward price pressure.

Industry Drivers

Inflation shifts dairy demand

Inflation has impacted U.S. food costs, resulting in consumers adjusting their grocery budgets and purchasing behavior. Over the past year, overall consumer food costs rose 9.5% and dairy prices increased 12.3%. As a result, consumers are switching to lower-cost options like generic brands. Total dairy consumption was down 1.4% in January compared to last year. Additional pressures on consumer grocery spending will be felt as the enhanced SNAP benefits are removed in April (an extra $90 per person of nutrition assistance for 41 million Americans).

While consumers are buying fewer dairy products, restaurant demand started the year with mixed signals. Mozzarella production, an indicator of pizza sales, fell in January. However, the National Restaurant Association is optimistic about increased restaurant sales in the first half of 2023. Ultimately, domestic demand hinges on consumer income and spending, which will be impacted as inflation increases and if recession concerns grow. If domestic demand is weakening, milk prices will likely face further downward price pressure.

Strong exports expected for 2023

In January 2023, U.S. dairy exports set record highs, up 13.2% from the previous year, indicating strong exports will continue. The total export volume surpassed the previous January record (set in 2020) by 27 million lbs. due to shipment increases to Mexico and China. Strong January sales were primarily attributed to increased shipments to Mexico as the Mexican Peso appreciated relative to the U.S. dollar, making it more advantageous to purchase U.S. dairy products. Increased Chinese demand following COVID-19 recovery (China removed their zero-tolerance policy on Dec. 7, 2022) will likely play a prominent role in supporting U.S. export demand, accounting for 18.7% of U.S. dairy exports. The USDA forecasts 2023 dairy exports at $8.8 billion, down 3% from 2022 export records. However, if realized 2023 exports would be incredibly strong, the second largest on record. Competitive (and lower) dairy prices should support trade, but international buyers will face headwinds from global economic uncertainties.

Spot prices lower with spring flush

An oversupply of milk during the spring has depressed Midwest milk spot markets, placing downward pressure on all milk prices. The spring season marks the start of the "spring flush" as longer days, warmer weather and calving seasons lead to peak U.S. milk production from March through June. The last month of spring flush coincides with lower domestic demand (as most U.S. schools take summer vacation for 3 months typically starting in May or June meaning less fluid milk demand). During this time, processors shift from fluid milk to storable products (i.e., cheese, butter, milk powder). Even with the production shift, excess milk remains. Falling spot prices indicate that milk production expansion is overwhelming processing capacity, highlighted by Central U.S. milk spot prices hitting eight-year lows in mid-March selling $4 to $12 per cwt below Class III prices. This oversupply directly impacts all U.S. dairy producers' revenue, evidenced by lower milk and dairy product prices.

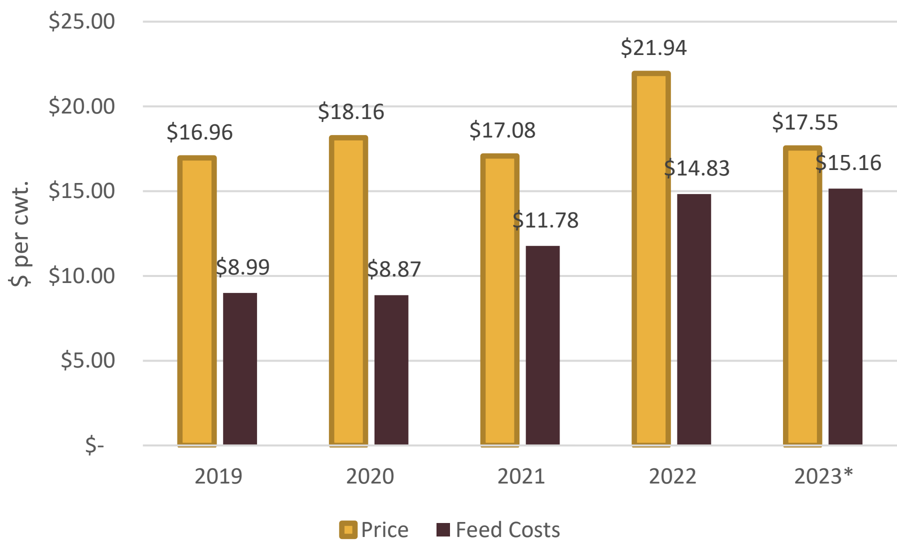
FDA released guidance on milk labeling

The dairy industry has advocated for rules to regulate using the word "milk" in advertisements for plant-based beverages. The U.S. Food and Drug Administration (FDA) draft guidance was not the outcome the dairy industry hoped for. The FDA ruled plant-based beverages can use the term "milk" on their labels. The guidance also suggests plant-based beverages should include a voluntary nutritional label to highlight the dietary differences between their beverage and cow's milk. However, since the nutritional label is voluntary, it's unlikely manufacturers will choose to follow the guidance.

Profitability

In 2022, record Class III and IV prices supported dairy producers. Now, elevated production costs and lower milk prices are squeezing dairy profitability. Many producers will defer a significant amount of income into 2023, but lower prices will hurt profits with current 2023 Class III milk prices forecasted at $17.55 per cwt, down $4.39 per cwt from 2022. Milk futures are also lower with 2023 Class III and Class IV futures trading under $20 per cwt. Analysts expect bearish dairy prices with Class III prices likely to fall another 10% below USDA's estimates. At the same time, dairies are experiencing elevated feed, fuel, labor and fertilizer expenses (see **Crop Input Snapshot**) and are unlikely to make significant improvements soon.

U.S. Average Class III Price and DMC Feed Costs



In 2023, national milk prices have softened while feed costs remain elevated.

Source: WASDE & USDA FSA, Compiled by AgWest Farm Credit.

*Average of data available through March 2023.

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