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MARKET SNAPSHOT

Dairy

January 24, 2024

12-Month Profitability Outlook

Executive summary

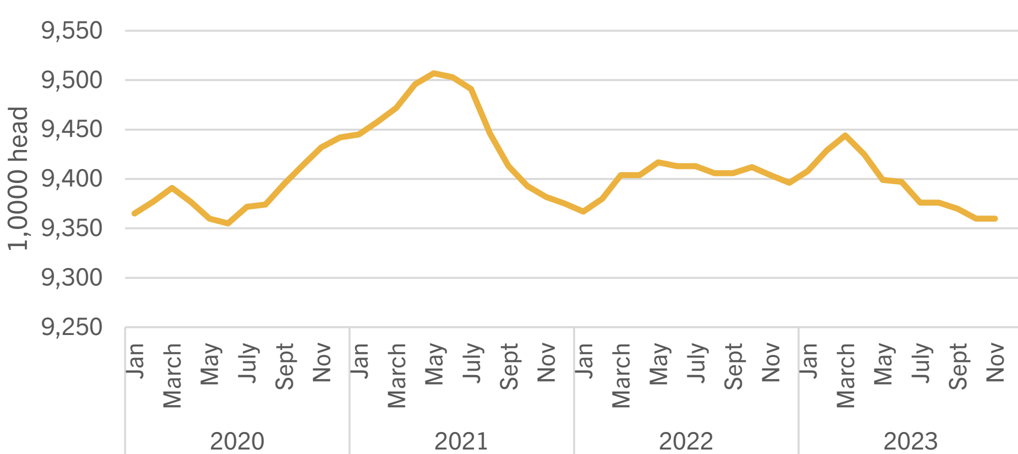
AgWest Farm Credit's 12-month dairy profitability outlook suggests slightly unprofitable returns. Milk production is declining due to a shrinking herd and prices will likely increase in 2024, so long as demand remains consistent. Dairies face headwinds from inflation and a slowing global economy, requiring careful cash flow management and risk mitigation strategies.

Industry drivers

Milk production declines

November milk production dipped 0.6% nationwide, marking the fifth consecutive month of decline. The West saw the biggest slump, with production down in every state except Idaho and Arizona. Since March of 2023, the milk cow herd is down 84,000 head. California, the top dairy state, lost 11,000 cows in a year and saw milk production drop 1.7%. Idaho's production dipped for the first time this year in October despite a stable herd, suggesting lower output per cow, which was unexpected given the mild temperatures (warmer weather means cows expend less energy keeping themselves warm and can produce more milk). Despite the production drop, dairy products and prices faced another difficult month. While some analysts speculate that less milk production could support higher milk prices, prices are often slow to respond to production changes.

U.S. milk cow herd



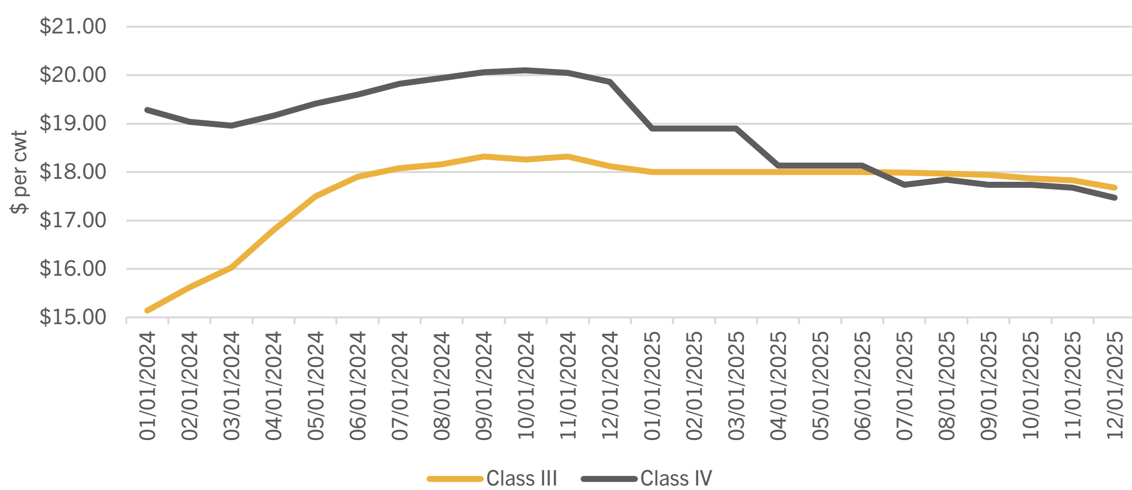
Milk production declined for the fifth consecutive month driven by a shrinking national milk herd.

Source: USDA NASS. Compiled by AgWest.

Prices are a mixed bag for 2024

Milk prices are uncertain as conflicting bullish and bearish signals play out in the dairy markets. Trade opportunities and a smaller global milk supply support higher prices in 2024. In the short term, Class III milk prices should benefit as U.S. cheese prices are less expensive than European cheese prices, and markets will adjust to close this gap. U.S. cheese futures prices were nearly $0.20 below the global cheese prices. The futures market expects to see this gap closed by April 2024, with U.S. cheese prices increasing to the $1.80 range (up from the low-$1.50 range during early January 2024). Cheese prices largely influence Class III prices and dairy producers can expect a short-term boost to Class III milk prices. Additionally, a smaller national herd and less global competition from New Zealand (whose pasture-based dairy system is forecasted to be stunted by El Niño drought conditions) would also support higher prices in 2024. However, global dairy demand declined in 2023. Dairy exports decreased from 18% of total dairy sales in 2022 to 16% of dairy sales in 2023. The greatest threat to seeing higher forecasted dairy prices in 2024 would be a global recession, which could further dampen consumer demand for dairy products. While there are factors supporting both higher and lower prices, the Dairy Futures Forward Curve predicts moderately higher Class III and Class IV prices. Even with higher prices, many producers will still be approaching breakeven margins.

Class III and Class IV Futures Forward Curve

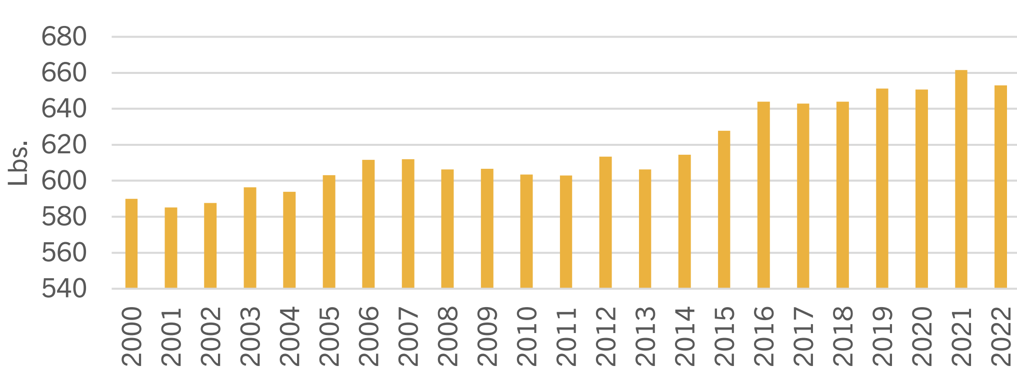


Source: Bozic LLC.

Dairy demand

U.S. per capita dairy consumption declined 1.2% year-over-year due to higher prices for many dairy products, which led to lower consumption of butter (-6.3%), yogurt (-2.8%), and fluid milk (-3.0%). Cheese and ice cream, however, had modest increases in demand. Inflation and higher prices were the largest factor impacting dairy demand. Due to grocery budgets being squeezed, 76% of consumers changed their grocery shopping habits reducing the amount of goods they purchased. While the latest consumption data is from 2022, the same trend appears to have held for 2023. Domestic and export dairy demand will continue to face headwinds from inflation and higher food prices throughout the grocery store.

U.S. dairy consumption per capita



Dairy consumption declined between 2021 and 2022 due to higher dairy prices. The same downward trend is expected for 2023.

Source: USDA NASS. Compiled by AgWest.

Dairy exports hindered by slowing Chinese economy

China's economic slowdown has weighed down U.S. exports. China is the world's largest dairy importer and its imports of U.S. whole milk powder, skim milk powder, butter, and fluid milk have all declined year over year. China’s economy is facing headwinds from weakness in the property sector and government debt issues, which have constrained public spending and investment. The only bright spots for the dairy industry were cheese and whey exports to China, which increased year over year. However, this was not enough to offset the overall impact of China's slowing economy on the dairy sector. China's real GDP growth has fallen from 6%-10% during 2010-2019 to a forecasted 5.4% in 2023, and the International Monetary Fund expects it to continue to decelerate until 2028. Slower Chinese dairy demand could create headwinds for global dairy prices and the U.S. dairy industry will have to cope with lower export demand for the foreseeable future.

Profitability

Dairy producers are stressed and margins will take time to recover. Production costs are forecasted to remain a mixed bag. In the Northwest, the average breakeven price for producing milk shot up from $17 per cwt on average in 2021 to over $21 per cwt in 2023. While forecasted declines in feed, fuel and fertilizer expenses will benefit dairies in 2024, an expected 2%-3% decrease in expenses will not be enough to offset the run up in production costs over the past 18 months. As margins remain under pressure, dairies are likely to cull more cows through the first six months of 2024. Fewer cows could lower national milk production supporting higher prices which will be vital to improving dairy margins. However, milk price increases tend to lag several months behind production declines. Even if Class III prices increase, it will likely not be enough to fully offset greater production expenses. Managing costs, capital expenditures and risk management options are paramount.

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