Michigan Dairy Outlook
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Michigan dairy industry demonstrated its resiliency in 2000. It took severe blows from the dramatic milk price decline and the bovine tuberculosis crisis. Yet government program generated inexpensive feed and direct payments along with new Federal Milk Marketing Order (FMMO) rules and continuation of the dairy price support program combined to produce continued growth in Michigan’s dairy industry. Although the milk price outlook looks moderately brighter in 2001, cost increases and uncertainties associated with energy supplies, environmental regulations, and policy decisions may produce another year of similar farm income to last year.

IT COULD HAVE BEEN WORSE
Milk prices fell dramatically as the dairy industry experienced milk production increases for the third year in a row. Not since the late 1970s and early 1980s had milk production increased based on the expansion of the milk herd in addition to the normal increase in productivity. In 2000 milk production increased 3.2 percent after increasing 3 percent in 1999. Production in Michigan increased 3.3 percent to around 5.63 billion pounds based on increased production per cow combined with an increased dairy herd of 4000 cows. Expansion was fueled by generous supplies of inexpensive feed and government policies that not only aided milk prices but provided two Dairy Market Loss Assistance Program payments.

The average all-milk price (the gross price including all premiums before deductions for hauling) in Michigan during 2000 was $12.90 per hundredweight. This was a drop of $1.90 from 1999 and $2.40 from 1998. Michigan milk prices were aided by the FMMO reforms with combined Michigan’s Federal Orders with others to the south and east resulting in an average increase in the fluid milk utilization for Michigan producers. In addition, the FMMO reforms specified that the Class I and Class II skim prices be moved by the higher of the Class III (cheese milk price) or Class IV (butter-powder price). Since the Class IV averaged $2.09 higher than Class III, Michigan producers gained around another $1.00 over what would have been the case without FMMO reform.

PRICE FORECAST LOOKS BETTER
The new FMMO pricing rules did not help those markets where the predominant milk market is cheese. Wisconsin, Minnesota, Idaho, and others saw pay prices substantially below Michigan’s. This combined with environmental constraints to expansion in California and the more recent energy crisis have finally slowed the milk production increases. For 2001, U.S. milk production will likely only increase 1 percent. Consumer demand has been outstanding. Even though the economy is slowing, employment and disposable income should remain strong enough to tighten milk markets this fall. After some lower prices this spring, cheese prices should increase this fall. Butterfat markets will continue to be strong and push the Class IV market to the point that it will likely be the driver of Michigan producer prices for nearly all the year. When all of this comes together, the all milk price for Michigan should range between $13.00 and $13.50.
POLICY UNCERTAINTY
The increased prices predicted for this year could evaporate if policy, particularly FMMO rules, goes array. At press time a federal judge has halted the implementation of the final FMMO(2001) reform rules. The 2000 rules are now in place but whenever courts are involved on FMMO rules, anything can happen. Also, the USDA can change the price rules on the price support program and cause the Class IV price to drop dramatically. Changing the “tilt” on butter-powder would disproportionately hurt Michigan producer prices. The price support expires on December 31,2001 which means that policy debate must happen this year. The dairy industry will also debate how to use market loss assistance payment monies to deal with the regional impacts of the big differences between Class III and Class IV prices. Throwing in debates about the use of Interstate Compacts, Milk Protein Concentrates (MPCs), forward contracting in the FMMO system, etc., will assure that policy uncertainties will continue to rile the markets.

COST INCREASES TO EAT INTO PRICE GAINS
The outlook for dairy farm costs through 2001 indicates anything associated with petroleum products will stay at higher levels than 2000. Interest rates may drop a small amount. Labor costs will continue to be under pressure to increase. All other cost items will likely continue their upward creep during 2001.

In the following, cost index numbers from the USDA’s “Agricultural Prices” will be cited. The index base = 100 is for 1990-92. The index of prices paid by farmers for all items was about 115 during 1999. By December, 1999 the index reached 117, then increased to 121 by December, 2000. This was an increase of 3.4 percent. The index for family living expenses, based on the Consumer Price Index, was 125 in December 1999 and was 129 a year later. With both business and personal costs moving upward, the possible erosion of prices received becomes alarming.

The price of crude oil was perhaps the most startling business news of 2000. Index numbers for farm prices in December, 1999 and December, 2000 were: Diesel, 109, 158 (+45%); Gasoline, 110, 138 (+26%); LP Gas, 127, 153 (+21%); all Fuels, 112, 152 (+60%). During last year the Organization of Petroleum Exporting Countries (OPEC) made clear what their price goals were for crude oil. The last half of 2000 showed they had trouble precisely staying in the range, but OPEC was successful enough that we can expect to see prices levels of farm delivered energy products stay about where they were during that period of time. However, transport costs may have been slow to catch up. As hauling contracts expire and are renegotiated, expect to see transport costs for a variety of products climb in 2001.

Index numbers for fertilizer prices in December, 1999 and December, 2000 were: Nitrogen, 94, 130 (+38%); Potash and Phosphate, 114, 106 (-7%); Mixed Fertilizer, 109, 108 (-1%), and All Fertilizers, 103, 152 (+48%). These prices will be influenced by natural gas prices within the United States as well as the international price of crude oil. Governmental bodies are increasingly enforcing environmental laws, especially those associated with manure handling. The increase on nitrogen fertilizer costs will add an economic incentive of capturing available nitrogen in animal manures. The tradeoffs will favor increased management attention in the coming year. Expect also to see renewed debate about corn silage versus alfalfa as the latter’s perennial status can reduce the amount of required energy as well as nitrogen fertilizer needs over a 5 year planning period.
The magnitude of the potential impacts of energy cost changes should be considered. In 1999, the average total cash expenses for 153 Michigan dairy farms was $549,442; they averaged to have 183 cows and cropped 561 acres. The fertilizer costs were 4.3 percent of the total cash expenses. Fuel and oil costs were 2.1 percent. Purchased feed costs were 27.8 percent. (See Staff Paper 2000-24 by Nott)

Index numbers for feed prices in December, 1999 and December, 2000 were: Feed Grains, 77, 83; Hay/Forages, 96, 111; Concentrates, 94, 103; Complete Feeds, 102, 104; and All Feeds, 98, 103 (+5%). The cost advantage for those dairy farms that buy their feeds as commodities and mix their own rations is illustrated by the above indexes of feed grain prices versus complete feeds. Purchased grains continued to be a bargain for dairy farms in 2000. They will continue to be through the first part of 2001. The outlook after mid-2001 depends on the weather throughout the world. The best managers will monitor feed prices and be ready to lock in future feed grain prices if conditions favor price increases.

The preceding index numbers were averages for the whole country. Michigan has a unique situation as it deals with tuberculosis (TB) in its deer and livestock herds. Many dairy herds have already undergone whole herd TB tests. By mid-June, 2001, the state will have completed testing of dairy herds in the state. By then, all dairy farm managers will have experienced the management it takes for testing; some will have had to deal with losing animals that were suspected of having TB. Tempers will be frayed as everyone learns to deal with the associated requirements for testing and marketing animals. Direct cash costs will be minimal as the government, both State and Federal, reimburse those directly affected. The impact of temporarily losing markets for breeding and replacement livestock destined to leave Michigan will be felt by many. It is expected Michigan’s dairy industry will work together to assure the continued access to all markets, for both milk and livestock, which consumers perceive to be safe and nutritious.

SUMMARY
It is proverbial good news/bad news. After two years of continuous U.S. milk production increases, production slow downs combined with good demand should push prices higher. However, energy costs because they are so pervasive in both the production and sale of milk and feed, could soak up any additional revenues arising out of the milk markets.