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Milk Prices Coming Down; 1996 Grain Prices in Review; 1996 - A Mixed Year for South Dakota Livestock Producers

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MILK PRICES COMING DOWN

by

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After setting record high prices last summer, milk prices to the farmer are coming down. Those record high prices were the result of (1) poor quality feed, especially in the West, which lowered production per cow, (2) high priced feed, forcing dairy producers with tight cash flows to feed diets that produced less milk per cow, (3) less than ideal weather conditions, putting additional stress on the cows (It was cold and wet last winter and spring in California and very hot in the South last summer.), (4) fewer cows going through milking parlors and (5) a larger than expected growth in demand for dairy products.

Now, the very things that caused the high prices earlier are changing and prices are coming down. Production per cow is up for several reasons and is increasing total milk output. The 1996 feed crop is of better quality. Lower corn and other feed prices are making for better cash flows and allowing for better balanced rations. The hot weather has cooled off in the Southeast and Southwest, relieving the heat stress on the cows. Also, there has been some herd expansion in the Mountain States. However, this has been partially offset by declines in cow numbers in other states.

As a result of the improved conditions, USDA's total expected output of milk for calendar year 1996 has been increased by 300 million pounds to 154.6 billion. The expected production for calendar year 1997 is projected to be 156.0 billion pounds, up 1.4 billion pounds (1%) over expected 1996 production.

High milk prices resulted in higher prices for all dairy products, including fluid milk, cheese, ice cream, butter and other products. Those higher prices caused consumers to cut back, especially in the purchasing of cheese, ice cream and butter. Some restaurants shifted from butter to substitutes.
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1996 GRAIN PRICES IN REVIEW

by

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For three of the principle grains grown in South Dakota, 1996 was a year of large price fluctuations. Corn, wheat and soybeans all experienced large price movements from the beginning to the end of the year. For corn and wheat especially, the prices quoted on the futures board and cash price bids offered and paid in the state reached highs rarely, if ever, seen.

Soybean futures on the Chicago Board of Trade began the year trading in the $7.50 range and did not close below $7.00
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1996 ... A MIXED YEAR FOR SOUTH DAKOTA LIVESTOCK PRODUCERS

by

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The South Dakota beef cattle, hog and sheep industries had both good and bad news in 1996. Most of the bad news was in the cattle industry, most of the good news was in the sheep industry. The following sections include a brief review of 1996 and a comment or two about 1997 for each of the above industries.

Cattle Industry

<u>Calves</u>: The typical cow-calf producer in South Dakota did not enjoy a particularly good 1996. Prices for 400-500 pound
(Continued on p.3)

The same was true for many homemakers. Fast food outlets, which are big users of cheese, cut back on specials featuring cheese. Altogether, the result was increased inventories of cheese and butter in manufacturing plants' coolers. In some cases, it was necessary for cheese makers to find commercial storage.

At high cream and butter prices, butter makers became reluctant to make butter, preferring to sell their cream when they could. They were willing to make only as much butter as they could sell immediately and to fill contractual agreements. They did not want to take a hit in the loss of inventory value when prices would eventually decline. Thus, butter makers churned only the cream they could not find use for elsewhere. This caused the amount of butter in commercial cold storage to actually decline from March through October.

Much the same was true for cheese makers, only worse. High priced milk made the cost of producing cheese higher than the public was willing to pay. Inventories of American cheese in commercial cold storage increased from 323 million pounds in January to 369 million pounds in August. A small decline occurred in September but then increased to 375 million pounds by the end of October. Nobody wanted to hold large inventories because of the expected price decline. Buyers would not reorder until their stocks were depleted and then would order only for immediate needs.

Then the expected happened. At the National Cheese Exchange (NCE), the price of cheese in barrels fell 4 cents on September 27. It's been down hill since. By November 22, barrels had declined $.61 or to $1.1575 per pound. Prices for 40 pound blocks of cheese dropped 39.5 cents between October 11 and November 15. Additional declines are expected. Because the price of cheese at the NCE is the major determinant of milk prices paid to farmers, the farm gate price of milk is coming down.

Butter prices followed the same path. For example, the price of Grade AA butter at the Chicago Mercantile Exchange dropped from $1.53 per pound on October 11 to just $.74 in only 4 weeks. This put butter prices at the lowest level they had been since April 1995. The price on November 22, 1996 was 36 cents under the price a year earlier. Lower butter prices will result in a decline in the premium paid for milk that is over 3.5% butterfat.

On the brighter side, the year-end holiday season is the time of the strongest demand for butter and cheese. With lower cheese prices, restaurants and fast food chains are ordering more cheese and butter for Christmas shoppers and for those who like to eat out. Specials featuring cheese are increasing. The seasonal increase in home baking for the holidays results in increased butter use. Pre-holiday orders have been good this year.

Retailers now are scrambling to put together last minute holiday specials on butter. Reports indicate that orders since the price decline have been so good that printers (those who repackage 25 kilogram boxes into 1 pound and 1/4 pound packages) have not been able to keep up. One local retailer had a pre-Thanksgiving special at $.88 per pound on a private brand label of Grade AA. Lower prices and specials will help move the existing inventories and help butter makers, handlers, and printers with their production and inventory management. Hopefully, prices will recover to a more "normal" level.

The USDA now is projecting the average price of all milk to be between $14.60 and $14.70 per cwt. for calendar year 1996. That will be up from the $12.74 average for 1995. The price outlook for 1997 currently is between $13.30 and $14.20 per cwt. While the price of all milk is expected to be lower in 1997 compared to 1996, costs of production also are expected to be lower. This will help ease the pain and maybe even leave more dollars in farmers' pockets.

While it has been noted earlier that there have been wide price variations for milk and other dairy products, there are ways of offsetting some of that variation. Two major tools for helping inventory holders and large users deal with these price swings have been implemented recently. Cheese futures and options have been in existence only a little over 2 years. Butter and liquid milk contracts started earlier this year. The problem, in part, is that many who could use these contracts to protect inventory value are unfamiliar with how they work. And those who know how they work are not willing to do so because there are so few using them. They fear that the market is not "liquid" enough and that they could get stuck in a position they do not like. To help over come this fear, the exchanges have "market makers," that is, traders who will guarantee a buy or sell for those who want to get into or out of a contract. Maybe in time, there will be enough futures trading that dairy producers and those higher in the dairy marketing chain will feel comfortable in using futures and options to shift price risk to those willing and better able to handle it.

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(1996 Grain Prices ... Continued from p.1)

until early October. Between January and October, the 1996 September futures contract reached a high of $8.35/bu. in early September and the 1996 November contract traded at the lowest point of $6.67 in late October. Cash soybean prices in South Dakota began the year showing an average low in the $6.60 range to an average high in the range of $7.50 to $7.75. Typical harvest pressure drove cash soybean prices down to the low $6.00 range in late October, the lowest point of the year.

Corn futures on the CBOT experienced a steady increase during the first six months of 1996. The March 1996 futures contract began the year at $3.69. The July 1996 contract reached a high of $5.39 in mid-July. Cash prices followed the same pattern. Cash prices began the year in the $3.00 to $3.10 range and reached a high of $4.80 to $5.00 in mid-July. Prices began dropping on the futures board in mid-July and by mid-December futures prices traded in the $2.60-2.70 range. Cash prices stayed in the $4.00-5.00 range through most of the summer months until the start of new crop cash bids in mid-September. South Dakota cash corn prices reached lows of $2.10 to 2.30 in mid-December.

Spring wheat futures on the Minneapolis Grain Exchange reached their highest point of 1996 in late April, when the May futures contract closed at $6.97. Futures prices for spring wheat began a consistent downward trend throughout the rest of the spring, summer, and fall, reaching a low in early November when the December 1996 futures contract closed at $3.83. Cash prices followed the same downward pattern. Prices were quoted as high as $6.00-6.50 in the spring to a low of $3.60-3.70 in the fall.

The 1996 U.S. corn and soybean crop turned out much better than had been anticipated during most of the 1996 growing season. With larger than expected production of soybeans and a larger than expected supply, price prospects for soybeans through the rest of the winter likely will stay in a sideways pattern. Not much upward movement is expected until spring. However, expect a choppy market at least until early 1997. This may create some pricing opportunities for producers positioned to take advantage of them. Factors such as the flow of farmer sales of soybeans, conditions of the South American crop, strong demand for soy products, U.S. planting intentions for 1997, and the final USDA crop estimate in January likely will influence any potential price changes.

Corn carryout estimates for 1996-97 have increased almost three fold over the 1995-96 carryout. This is the result of the third largest U.S. corn crop in history. An estimated carryout of over 1.1 billion bushels indicates abundant supplies. This will have a continued dampening effect on corn prices for the rest of the winter. Prices in 1997 are most likely to be influenced by increased domestic demand in both the processing industry and livestock feeding business, weaker worldwide demand, changes in the government farm program, planting intentions for 1997, production expectations for the 1997 crop, and world production of corn and other coarse grains for the next marketing year.

Wheat prices have dropped steadily, and while continued long term declines are unlikely, prospects for substantial upward price movements are limited. World supplies are abundant due to very strong foreign production. This has resulted in a very weak export demand. USDA projects 1996-97 wheat exports to be as much as 23% below last year's export figures. This would put U.S. exports at the lowest levels since the mid-1980's. Price movement for the next six months likely will be in a sideways pattern. Price improvement could possibly develop if future world and U.S. production expectations decline.

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(Murra ... Continued from p.1)

calves were around the $60 level early in the year and were closer to $70 late in the year. Prices early in 1996 were $25-30 below 1995 levels but were about equal to 1995 prices late in the year. When compared to the 1990-94 average, 400-500 pound calves were $40 lower in early 1996 and still $30 lower late in the year.

Yearlings: In 1996, yearling cattle prices were in the $50-60 range early in the year and in the low $60's later. High corn prices were a main reason, especially for the low prices early in 1996. When compared to 1995, yearling prices were $15 lower early in the year but were about equal to 1995 levels late. Yearling prices in 1996 were $25 below the 1990-94 average early in the year. By year's end, prices in 1996 still were about $20 below the early 1990's average.

Slaughter Steers: In 1996, slaughter steer prices were as low as $56 to about $65 early in the year. For most of the last part of 1996, prices have been above $70. When compared to 1995, slaughter steer prices in 1996 were as much as $10 lower early in the year to as much as $10 above later in the year. Generally, 1996 Fall prices have been $5 above 1995 Fall prices. Early in 1996, slaughter steer prices were $20 below the 1990-94 average. By the end of 1996, prices were equal to $5 above 1990-94 averaged.

1997 Prospects: Price forecasts for 1997 are varied. The slaughter cattle industry outlook is the most pessimistic. There, plenty of cattle on feed and expected increases in the production of pork and poultry combine to keep most forecasts in the mid-$60's early in the year to the low $60's later. Even the upper $50's cannot be ruled out for short periods.

The feeder cattle industry (both calves and yearlings) is also guarded. Certainly, if fed cattle prices are in the low-to-mid $60's, there is a damper on where feeder cattle prices can go. However, even then, there are a couple of bright spots. First, there already has been a fairly widespread reduction in the cow herd. That should reduce supplies of feeder cattle and help prices. Second, the 1996 corn crop was the third largest on record. Another large corn crop in 1996 would give a big boost to feeder cattle prices. Of course, a small crop would do the opposite.

Hog Industry

Slaughter Hogs: Slaughter hog prices were on an upward trend early in 1996. Prices were close to $40 early in the year and had reached almost $60 by early Summer. During most of the last half of 1996, prices were in the mid-to-upper $50's. When compared to 1995, slaughter hog prices in 1996 were $10-15 higher. Early 1996 prices were only $5 above the early 1990-94 average. By late 1996, prices were equal to and then eventually $10 above the 1990-94 average.

Feeder Pigs: Feeder pig prices were in the $30's most of the first half of 1996. For most of the last half of 1996, prices were in the $40's. Those price levels were close to early 1995 levels, but were $10-15 above the prices noted late in 1995. Price averages in the 1990-94 period were $10-15 above early 1996 prices. By late in the year, 1996 feeder pig prices were equal and then $10 above the 1990-94 average.

1997 Prospects: It is evident that the hog industry is in an expansion mood. High slaughter hog prices and cheaper corn are the main catalysts. Most of the supply pressure from that expansion is not expected until late Summer. Prices for slaughter hogs close to $55 or a little above are expected for the first few months of 1997. Prices below $50 (maybe closer to $45) would not be surprising.

Feeder pig producers should enjoy fairly high prices for a few months. However, by Spring prices could drop substantially. That means prices in the $30's, or even lower.

Sheep Industry

Sheep and Lambs: If there was a bright spot in the livestock industry in 1996, it was sheep and lambs. Prices for both slaughter and feeder lambs set record highs in the Summer. Early in 1996, prices were in the $80's. That was $10 above 1995 and $30 above the 1990-94 average. By Summer, prices were as high as $120 for a short time. That was $25 above 1995 and $55 above the 1990-94 average. By Fall, prices were in the low-to-mid $80's, or $5 above 1995 and $25 above the 1990-94 average.

1997 Prospects: There are no indications that the sheep industry is expanding, at least not by much. While 1996 probably will not be duplicated, 1997 should be another good year for the sheep industry.

Final Comments

Prices alone do not tell the whole story. However, in most cases, the prices noted above also were reflected in "how well each industry did".

This past year was not a good one for most cow-calf operators. Low feeder cattle prices were reflective of low (negative) profits. Higher prices later in the year, along with lower corn and feeder cattle prices, helped most cattle feeders to earn profits. Whether those profits offset earlier losses is questionable.

Hog producers had a more profitable last half of 1996 than they did the first half. There, higher slaughter hog prices helped both feeder and fed hog producers.

In general, sheep producers had a good year. Even with higher production costs, they still earned profits because of high prices.

Most cattle producers are hoping 1997 will be better than 1996. That may not happen. Also, 1997 probably will not be as good as 1996 for hog and sheep producers.

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