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Avian Influenza Outbreaks Reduce Broiler Export Expectations

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The U.S. poultry industry continues to be rocked by Avian Influenza (AI). There now have been outbreaks in Delaware, New Jersey, Pennsylvania, Texas, and most recently in Maryland. Due to the export bans or restrictions by other countries, the forecast for broiler exports was lowered to 4.955 billion pounds. Based on previous AI outbreaks, it is assumed that their national bans will be regionalized to specific States, provided there are no further outbreaks of AI. Mexico has already announced that exports from some States can resume. Despite expected lower exports and increased production in 2004, broiler prices are forecast record high. Prices are expected to average 69-73 cents per pound this year, compared with 62 cents last year.

Strong beef demand and poor feedlot performance due to poor feeding conditions are helping to offset the negative impact of the export ban on U.S. beef and cattle since the discovery of a BSE-infected cow last December. The beef production forecast is below earlier expectations because of a slower-than-expected slaughter pace and severe winter weather that kept weights below last year. Lower expected beef supplies and continued firm demand in the meat sector are helping support prices.

Forecasts for first-half 2004 hogs and pork products prices moved higher at the same time that 2004 slaughter and production are shaping up to be larger-than-earlier expected. Despite the depreciated value of the U.S. dollar, record-large numbers of imported Canadian feeder pigs and slaughter hogs are moving slaughter and production upward, while pork consumers—domestic and foreign--appear willing to pay higher prices for greater supplies of pork products. Consumer interest in high protein diets, relatively high prices for substitute animal proteins, and strong Asian demand for U.S. pork products, are the major factors driving the pork market right now.

Dairy sector conditions in 2004 promise to be considerably different from 2003, which was a year of transition. The period of surging dairy farm expansions and very low exit of weaker farms, both triggered by the generally high returns of 1996-2001 has ended. Farm structural changes in 2004 are likely to show the effects of the low 2002-03 returns, while milk per cow is beset with a number of possible weaknesses. Dairy product use moved out of its late 2001-2002 weakness by the end of 2003. Demand this year appears to be mostly back to normal, with moderate stocks providing dairy markets better balance. Prices are expected to recover this year as milk production hovers near the levels of the past 2 years.

Poultry

Avian Influenza Outbreaks Cloud Trade Outlook

The U.S. poultry industry continues to be rocked by outbreaks of Avian Influenza (AI) in various States. There have been outbreaks in Delaware, New Jersey, Pennsylvania, Texas, and most recently in Maryland. The outbreak in Maryland was at a commercial broiler operation and located where there are a large number of other operations within a relatively short distance. The current assumption is that the countries currently banning all U.S. poultry shipments will, over time, eventually target specific States, provided there are no further outbreaks of AI. The timetable for this regionalization process will vary from country to country. Mexico recently announced that some exports from the United States can resume. There are restrictions on what products specified States can export to Mexico and on the storage of poultry products in Texas before entering Mexico. Due to the number of bans or restrictions placed on the export of broiler products, the forecast for broiler exports was lowered to 4.96 billion pounds from the previous forecast of 5.28 billion pounds.

Broiler Production Rises in January, Production Expected Higher in 2003

Broiler production for January 2004 was reported at 2.84 billion pounds, up 2.3 percent from the previous year. Weekly chick placements are continuing to average about 1.5 percent higher than the previous year, and the forecast for broiler production in the first quarter of 2004 is now almost 8.1 billion pounds, 3.6 percent higher than a year ago. Along with the increase in the number of chicks being placed for growout, the average weight of birds at slaughter has been running over 2 percent higher than the previous year. The overall broiler production estimate for 2004 is now 33.93 billion pounds, up 3.6 percent from 2003.

Revisions in broiler production contained in the *Poultry Slaughter-Annual Summary* for 2003 increased total broiler production for 2003, to 32.75 billion pounds, up 1.6 percent from 2002. The increase is due to an increase in the average weight at slaughter, as total broiler slaughter declined slightly.

A strong domestic economy and relatively small growth in broiler production has pushed prices for broiler products well above year-earlier levels. Over the first 2 months of 2004, the 12-city whole broiler price has averaged 71.8 cents a pound, 19 percent higher than during the same time in 2003. Prices have also risen for other broiler products. Prices for boneless-skinless breast meat in the Northeast market averaged $1.69 per pound during January and February, 24 percent higher than the previous year. Prices for rib-on breasts averaged 96.4 cents per pound, up 15 percent from the same time in 2003. Prices of these products, which are mostly sold on the domestic market, have risen due to the combination of a strengthening economy, strong prices for other protein products, the effects of consumer reaction to the BSE situation, and high-protein diets increasing broiler demand. Prices for other broiler products, more dependent on the exports market, have also moved significantly higher. Leg quarter prices in January and February averaged 34.6 cents per pound, up 73 percent from the same period in 2003. The same pattern can be seen for wings, up 72 percent and thighs, up 32 percent. Even with a forecast of higher production in 2004, domestic broiler prices are expected to remain strong. How strong will depend on both the domestic economy and how quickly other countries relax bans and restrictions on imports of U.S. poultry products.

Turkey Production Seen Down in 2004

Turkey production in 2004 is forecast at 5.63 billion pounds, down about 25 million pounds from the previous year. Over the last 13 months, the number of poults being placed for growout has only been above its year-earlier level once. While prices for turkey products have begun to strengthen, they have not shown the price strength that broiler products have.

The lower poult placements are expected to result in lower turkey production over the first half of 2004. Turkey stocks at the end of January were down 9 percent from the previous year, a wide departure from the beginning of 2003 when they were up over 30 percent. Smaller stocks of both whole birds and parts, along with lower production is expected to gradually strengthen prices over

2004. The outlook for turkey production and prices has been helped by Mexico's announcement that poultry exports from the United States can resume, under certain restrictions. While no turkey production operations have tested positive for AI they have been under the same trade bans as broilers. Also, Mexico accounts for about 50 percent of all U.S. turkey exports.

Revisions in turkey production slightly raised 2003 production to 5.65 billion pounds, still down 1 percent from 2002. The decrease in turkey production was the result of a lower number of birds being slaughtered, as the average weight was unrevised.

Cattle/Beef

Poor Feedlot Performance Offsets Export Supplies, Supporting Prices

Strong beef demand and poor feedlot performance due to poor feeding conditions are helping to offset the negative impact of the export bans on U.S. beef and cattle since December 23. Additional help is on the way as the United States, Canada, and Mexico finalize protocols that will allow beef and cattle to move within the three NAFTA countries. Safety certification issues were resolved with Mexico on March 9, and three U.S. plants were approved to begin shipping boneless beef from cattle under 30 months of age to Mexico. The three countries also are likely to resolve issues regarding beef processed on a supply line dedicated to cattle under 30 months of age.

First-quarter beef production is expected to decline about 6 percent as the supply of market-ready cattle slows due to poor feedlot performance. Steer and heifer federally inspected slaughter weights in late February were averaging 25 to 30 pounds under a year earlier. However, weights are expected to move well above year-earlier levels this spring and throughout the rest of the year, particularly in comparison with the sharply lower weights in 2003. Dressed slaughter weights in first-half 2003 were also held down by poor weather conditions, then in the second half as weather conditions improved, fed cattle were marketed ahead of schedule due to the ban on importing beef and cattle from Canada and very tight beef supplies. First-quarter slaughter weights will likely be near 10 pounds below last year's low level and about 16 pounds below the 2002 record. Weights seasonally decline into late April-early May depending on weather conditions.

Cow slaughter has dropped sharply below the large year-earlier levels. Total cow slaughter rose 6 percent in 2003, the largest slaughter since 1997. First-quarter cow slaughter is expected to decline about 12 percent, with the sharpest declines occurring in beef cow slaughter. Cow slaughter will likely remain well below the large recent levels for the next several years, but forage conditions remain an important determinant. Steer and heifer slaughter, while remaining below year-earlier levels this year, are expected to rise seasonally through summer. Dressed weights are expected to rise above a year earlier in late spring, likely exceeding 2002's record setting pace in the second half of the year as demand for higher grading beef remains strong and beef supplies tighten into fall.

Beef Supplies Remain Tight, Demand Strong

Retail Choice beef and Choice boxed beef prices remain sharply above year-earlier levels in early March, but below the peak set last fall when high quality beef supplies were extremely tight. Retail prices for Choice beef likely averaged in the $3.90-range in February, down from November 2003's record $4.32, but well above the $3.48 in February 2003. With certification issues being resolved with Mexico and Canada, trade will resume with both countries, but U.S. beef supplies will tighten, with prices remaining historically high. However, some pressure on domestic prices is reduced as product normally destined for Japan and South Korea is available domestically. Retail prices are expected to fall below the rapidly rising prices of a year earlier beginning this spring, but remain above previous years' averages. Any opening of banned markets as negotiations continue will add to an already volatile price situation. A return to favorable forage conditions this spring and at least normal conditions in the grain production areas are expected to result in female retention and further tightening of supplies for the next 2 to 3 years.

Fed cattle prices averaged near $80 per cwt in January-February and rose into the mid-$80s in March as slaughter weights declined. Prices are expected to decline into the low-$70s this summer before rising to the upper-$70s this fall as supplies decline seasonally and cyclically.

Yearling feeder cattle prices remain fairly stable, averaging in the mid-to-upper $80s per cwt. Feeder cattle supplies at the beginning of the year were 4.5 percent below a year earlier, and if heifer retention begins, supplies will tighten even more in 2004. Even with only normal forage conditions, demand for stocker cattle for grazing this spring and summer will be strong, but profit margins will be difficult to achieve unless grain prices rise sharply, placing a premium on heavy feeder cattle. Prices are likely to remain in the mid-$80s for much of the year.

Prices for Utility cull cows have averaged in the mid- to upper-$40s for much of the past year, and prices are expected to remain strong in 2004.

Prices for 90 percent lean trim strengthened along with the other beef items in general through last fall. However, rather than declining, lean beef prices have strengthened even more into the winter quarter as cow slaughter declined.

Exports Expected to Pick Up to Mexico

U.S. beef exports for 2004 are forecast to total 430 million pounds, an increase of 210 million pounds from the 220 million pounds expected last month. The main reason is due to the conditional removal of the ban on U.S. beef imports by Mexico. The flow of beef to Mexico is to be governed by protocols defining product characteristics and verification procedures. Product flow is likely to accelerate in the second quarter of 2004 as the protocols are fully implemented and more plants are certified. This pattern would be similar to that observed on the imports of Canadian beef into the United States after the U.S. ban on Canadian product was lifted in August 2003.

The renewed flow of beef exports to Mexico later in 2004 is partly offset by a downward revision in exports to Canada during the first quarter. Negotiations on protocols regulating shipment of U.S. beef to Canada began immediately after the cow with BSE was discovered in Washington State on December 23, 2003. However, weekly shipments of beef out of the United States have totaled only about 100 tons (product weight) per week since then, including limited shipments of beef to a few other minor markets. First quarter export estimates are reduced from 50 million to 10 million pounds.

Nearly all of the additional 250 million pounds of exports added to the last three-quarters of 2004 are expected to go to Mexico. By the third quarter, U.S. beef exports to Mexico are expected to average about two-thirds of the 155 and 156 million pounds reached in the fourth quarters of 2001 and 2002. Exports are expected to be limited because beef from U.S. cattle over 30 months of age (largely culled cows) remains banned, while Canada will be a strong competitor in the market for beef products from animals under 30 months of age. Canada is expected to slaughter a record 4 million cattle this year from large beginning inventories, as its exports of live animals to the United States remain banned. Not only may Canada have an ample supply of boneless beef cuts from younger animals but supplies of processing beef from nonfed steers and heifers under 30 months of age are also likely to remain high. A large proportion of this beef will be forced into the export market, either in the United States or Mexico, even at declining prices.

High U.S. Beef Prices and Exchange Rates Will Influence U.S. Beef Exports

Continuation in the weakness of the U.S. dollar against the Canadian dollar could somewhat mitigate the low Canadian export prices and favor substitution of U.S. for Canadian beef in Mexico. Between the first 2 months of 2003, for example, and the first 2 months of 2004, the U.S. dollar lost 14 percent of its value against the Canadian dollar. That would make U.S. product 14 percent cheaper than Canadian product, other things being equal, and give U.S. beef some advantage against the large Canadian supplies. However, if the U.S. dollar does not remain weak against the Canadian currency, the opposite situation could prevail, and some recent evidence suggests this possibility. Between January and February of this year, the U.S. dollar appreciated against the Canadian dollar, buying an average of only 1.3 Canadian dollars in January but 1.33 in February, according to the Federal Reserve Bank.

In any case, U.S. beef exports to Mexico may also be limited by continued weakness of the Mexican peso and high relative U.S. prices. The peso began its latest cycle of weakening from a monthly average 9.1 pesos-per-dollar in March 2002, to nearly 11 pesos-per-dollar in February 2003, and reached 11.25 pesos-per dollar in December 2003. In 2004, the peso has been trading around 11-to-1. While the United States did export a record 629 million pounds of beef to Mexico in 2002, the falling peso during that year may have contributed to fourth-quarter 2002 exports being only flat, compared with fourth-quarter 2001 exports. U.S. beef exports to Mexico dropped 10 percent in first-quarter 2003, compared with the same quarter one year earlier, and U.S. exports to Mexico the first three-quarters of 2003 were flat, compared with the record levels achieved in the first three-quarters of 2002.

Very tight U.S. fed beef supplies at record prices were also responsible for limiting U.S. beef exports to Mexico in 2003, and U.S. prices are expected to remain at historically high levels. In addition to the 20-percent depreciation of the peso between March 2002 and February 2003, U.S. fed cattle prices increased about 10 percent, compared with first-quarter 2002, to average $77.82 per cwt in first-quarter 2003. This means that the decline in U.S. beef exports in first-quarter 2003 occurred with fed beef prices about 30 percent higher than a year earlier, when expressed in pesos. With fed cattle prices in the United States expected to average $74-76 per cwt in 2004, beef prices are likely to remain relatively high in terms of pesos and limit Mexico's ability to import U.S. beef, unless the peso were to strengthen significantly.

Hogs/Pork

Higher Hog and Pork Prices Expected

Price forecasts for first-half 2004 hogs and pork products moved higher at the same time that 2004 slaughter and production are shaping up to be larger-than-earlier expected. Despite the depreciated value of the U.S. dollar, record-large numbers of imported Canadian feeder pigs and slaughter hogs are ratcheting slaughter and production upward, while pork consumers–domestic and foreign–appear willing to pay higher prices for greater supplies of pork products. Consumer interest in high protein diets, relatively high prices for substitute animal proteins, and strong Asian demand for U.S. pork products, are the major factors driving the pork market right now.

U.S. Pork Production Edging Higher on Larger Slaughter

Pork production is expected to be 20.3 billion pounds of pork in 2004, on a slaughter of more than 102 million head of hogs. At the margin, U.S. hog slaughter and pork production are each being ratcheted higher by U.S. hog finisher demand for Canadian feeder pigs, and by U.S. processor demand for Canadian slaughter hogs. Weaker product demand and a lower slaughter in Canada make U.S. processor offers more attractive to sellers of Canadian slaughter hogs. On a cumulative basis through February 21, 2004, Canadian slaughter was 1 percent lower compared with the same period last year, while cumulative U.S slaughter over the same period is running about 1 percent ahead of last year.

USDA's Animal and Plant Health Inspection Service (APHIS) data suggest that imports of Canadian feeder pigs so far in 2004 are running significantly ahead of the same period last year. Through the third week of February, APHIS reported that more than 1.4 million swine were imported from Canada, 66 percent of which were feeder animals. Last year during the same period, less than 1 million animals came across the border, 70 percent of which were feeder animals.

Canadian Hogs Become an Important Component of U.S. Hog Supply

Data sources from both the United States and Canada suggest that the integration of U.S. and Canadian hog production into a North American industry continues. Effectively, part of the U.S. breeding herd has been replaced by breeding herd increases in Canada. APHIS data show that a significant share of imported Canadian swine originate in Ontario and Manitoba. Statistics Canada's most recent issue of *Hog Statistics* shows breeding herds in Ontario and Manitoba were 6.3 and 5.5 percent greater in January 2004 than a year earlier. Swine enterprise budgets published by the Ontario Ministry of Agriculture and Food show that only farrow-to-wean operations were profitable in 2003. On a cumulative basis, farrow-to-wean operations in Ontario earned $CN 1.17 per sow, while other hog production operations (farrow-to-feeder pig, farrow-to-finish, finishing) lost between $CN 158 and $CN 242 per sow in 2003.

Hog and Pork Prices Higher, Despite Larger Supplies

The first quarter price of U.S. 51-52 percent lean hogs (live equivalent) is expected to average between $42 and $43 per cwt (hundredweight). The first quarter 2004 hog price forecast is 20 percent above first-quarter 2003, while pork production is likely to run more than 3 percent ahead of last year. Part of the reason that packers are paying more for hogs this quarter is because wholesalers are paying higher prices for pork products. For January-February, the USDA Estimated Pork Carcass Cutout has averaged $62.29, 17 percent higher than the same period last year. Higher carcass values likely reflect domestic consumers' willingness to pay more for pork products, and increased foreign demand for U.S.

pork products in the face of reduced supplies of both imported beef and poultry products due to disease bans or restrictions. First-quarter 2004 retail pork prices are expected to average in the upper $2.60s per pound, about 2 percent higher than in the same period last year.

Two factors likely explain U.S. consumers' willingness to pay more for greater quantities of pork: First, prices of substitute animal proteins—beef and poultry—are significantly higher than a year ago. Retail beef prices have indeed declined since discovery of a BSE infected animal on December 23, 2003, but first-quarter 2004 beef prices remain 12 percent above a year earlier. First-quarter 2004 retail chicken prices are almost 7 percent higher than last year, due primarily to lower growth in the U.S. poultry industry. Higher relative prices for beef and poultry make pork products more attractive to U.S. consumers. When consumer demand increases faster than pork supply, prices rise.

Another factor driving hog and pork prices higher in the first quarter—despite larger pork supplies—appears to be a discrete jump in consumer demand for all animal protein—beef, pork, poultry, eggs, and dairy products. Anecdotal evidence in the popular media, as well as in the industry/trade press, supports the hypothesis that significant numbers of weight-conscious U.S. consumers have increased consumption of animal proteins in pursuit of weight control/loss goals. U.S. consumers appear willing and able to pay higher prices for available supplies of pork products.

Foreign demand for U.S. pork is also contributing to the escalation of U.S. pork prices. With important Asian markets closed to both North American beef and poultry from Avian Influenza affected countries, importers have few alternatives to pork products. Moreover, the depreciated value of the U.S. dollar makes U.S. pork products highly attractive to Asian importers. Foreign demand thus combines with strong domestic demand to bid pork and hog prices to higher-than-earlier anticipated levels.

2003 Exports Increase Almost 7 Percent; Strong Growth in 2004 Expected

The United States exported over 1.7 billion pounds of pork products in 2003, more than 6 percent above the previous year's total. Japan, Mexico, and Canada together accounted for almost 80 percent of total U.S. pork exports. A lower valued dollar and economic growth created demand for U.S. pork products last year. The same factors, together with disease-related foreign market closures to beef and poultry will likely spur U.S. pork exports this year.

Japan imported more than 790 million pounds of U.S. pork products last year, an increase of more than 2 percent over 2002. Over 50 percent of total U.S. pork exports were sent to Japan, making it by far the largest overseas market for the U.S. pork industry. Last year, a respectable rate of economic expansion and a relatively strong yen likely pushed Japanese pork imports higher. The same factors again favor higher Japanese imports this year. And clearly, the closure of Japanese markets to imports of North American beef and to poultry from AI-afflicted countries creates very strong opportunities for pork exporting countries. The relatively cheap dollar will help to make U.S. pork products especially attractive to Japanese buyers compared with Canadian and Danish products, the other major international products in the Japanese market.

Canada received about 10 percent of U.S. exports last year. U.S. exporters shipped 191 million pounds of pork to Canada last year, an increase of almost 2 percent over 2002. In 2004 U.S. exports to Canada are likely to increase on the strength of the high degree of integration that exists between the Canadian and U.S. pork markets. This factor, together with the lower valued U.S. dollar, creates opportunities for companies to source pork products in the United States for sale in Canada.

After contracting in 2002, Mexican demand for U.S. pork products increased more than 11 percent in 2003. Mexico imported almost 350 million pounds of U.S. pork in 2003, accounting for almost 18 percent of U.S exports last year. A recovering economy largely explains expansion of pork demand in Mexico last year. Because of the positive relationship between economic growth and meat demand in Mexico, strong economic growth prospects for 2004 bodes well for continued expansion of Mexican imports of U.S. pork products.

U.S. Imports Higher in 2003, Expected To Be Flat in 2004

The United States imported 1.2 billion pounds of pork in 2003, almost 11 percent more than in 2002. As in past years, Canada and Denmark were the primary sources of foreign pork in 2003. Canada accounted for 81 percent of U.S. imports last year, and 13 percent of imports were sourced from Denmark. Import growth slowed in the later quarters of 2003, as the value of the U.S. dollar declined. The relatively weak U.S. dollar will likely hold 2004 imports to about even with those of last year.

Fundamentals of Canadian Market To Improve in 2004, but U.S. Imports Again Likely To Be Record

U.S. imports of Canadian hogs were record-large last year at 7.4 million head, almost 30 percent more than in 2002. Three key factors explain the increase: first, appreciation of the Canadian dollar made Canadian pork products less competitive in foreign markets, weakening Canadian packers' margins and spelling "trouble" for an industry that exports fully half of its pork production. Second, the identification of a BSE-infected cow in May appeared to shift Canadian consumers' demand from pork to beef, compounding an already difficult situation. And third, new feeder pig operations in Ontario and Manitoba, built to meet U.S. hog finisher demand, came on line in 2003. When added to increased numbers of slaughter animals coming across the border, the aggregate numbers were record.

January 1, 2004, breeding herd inventories (up 6 percent) recorded by Statistics Canada in Manitoba and Ontario–the source of most imported Canadian feeder pigs–make it likely that increased numbers of feeder animals will cross the border in 2004. Slaughter hog imports are expected to decline however, given strong Asian demand for pork products. The lower valued U.S. dollar will translate into fewer Canadian dollars, making feeder pig operations less profitable this year. But with hog prices driving strong hog finishing demand in the United States, and few marketing alternatives in Canada, it is likely that U.S. imports of Canadian hogs will be record large--7.8 million head--again in 2004.

National Pork Producers' Council Files Anti-Dumping Petition

On March 5, the National Pork Producers' Council (NPPC) and other state pork production organizations charged in petitions filed with the U.S. Department of Commerce and the International Trade Commission, that "subsidies" paid by the Canadian Government are enabling Canadian hog producers to "dump" live hogs in the U.S. market. The petition will shortly be made available on the web site of the International Trade Commission.

Dairy

Dairy Outlook for 2004

Last year was a year of transition. The surge in dairy farm expansions and the period of very low exit of weaker farms, both triggered by the generally high returns of 1996-2001, finally came to an end. Meanwhile, dairy product demand was slowly moving out of its late 2001-2002 weakness. It only remained to work off the huge butter stocks before dairy markets could return to better balance—something that was accomplished by yearend.

Conditions in 2004 promise to be considerably different. Farm structural changes are likely to show the effects of the low 2002-03 returns, while milk per cow is beset with a number of possible weaknesses. Demand appears to be mostly back to normal, and stocks are moderate. Prices are expected to recover this year.

Demand Slowly Recovering

Recent patterns of commercial use illustrate how the structure of dairy product demand has changed over the years. Restaurant use of butter and cheese began to weaken in late 2001-early 2002 in response to economic softness and shifting consumer expenditures. This weakness persisted well into 2003. By late in the year, economic recovery had brought restaurant spending back, and cheese and butter use were showing some strength. However, dairy demand from this sector still lagged the very brisk 1999-2001 period.

Food processor use of dairy products as ingredients was particularly sluggish during the last 2 years. Dairy products are generally used to boost quality in premium versions of foods, a position that makes them vulnerable when consumers become more conservative about food spending. There may have been a modest recovery in ingredient use late in 2003, but this segment generally remains weak.

The retail segment was a bit more robust than the other segments in 2003 but was somewhat sluggish most of the year. Consumers seemed to be passing by the treats they had bought in earlier years. However, the autumn holiday season reportedly was the strongest in a number of years.

Despite generally favorable dairy prices in 2003, commercial use grew only modestly. Milkfat sales grew about 2 percent following 2002's fractional increase. The 2003 use of skim solids was about 1 percent larger than in 2002, after no growth that year. Cheese sales rose only about 1 percent as a slip in American cheese use offset part of the gain for other varieties. Restaurant woes may have been particularly important for American cheese sales. Commercial disappearance of butter rose 1 percent in 2003, as strength late in the year overcame early declines. However, butter use probably was even stronger than autumn disappearance data indicate because the very disappointing 2002 holiday season probably had left swollen pipeline holdings at the start of 2003. Fluid milk sales slipped fractionally, while use of most perishable manufactured products was weak.

Dairy demand appears to have gained some momentum during 2003 and is expected to continue its recovery this year. The restaurant segment is projected to do better, and ingredient use should come back somewhat. However, the improvement as yet has not been either steady or strong. Consumer spending may stay unsettled. In addition, it is unclear what the effects of recent intense media attention on weight problems might be.

Commercial use of all dairy products is projected to grow about 1 percent on a milkfat basis in 2004. Boosted by expected larger ingredient use, commercial use on a skim solids basis is projected to rise more--about 2 percent. Although welcome, these increases represent only modest recovery in dairy demand.

Milk Production Slows

Milk per cow grew only fractionally in 2003. More tellingly, the rise from the 5-year moving average was dramatically below the long-run trend. However, this has been far from unusual in recent years. Expansion has been well below average for 3 straight years and for 6 of the last 8 years.

A number of factors contributed to last year's sluggish gains in milk per cow. Milk prices were low relative to concentrate feed prices. Although the milk-feed price ratio does not shape gains in output per cow as much as formerly, recent ratios have made producers cautious about boosting concentrate feeding. In addition, 2003 resembled 2002 in having large amounts of mediocre alfalfa hay but tight supplies of good hay.

Other factors probably included an unusually large share of first-calf heifers in the milking herd and somewhat conservative use of bovine somatotropin (BST). Supplies of heifers available to start production in 2003 were quite large, a welcome relief from the heifer shortage of 2002. But, such a large cohort of heifers serves to lower average milk per cow the first year. Low milk prices probably made farmers leery of using BST on cows other than those with high odds of a profitable response.

Monsanto has announced that it will accept no new BST customers in 2004 and that established users will be allowed only half their normal purchases. With more than a fifth of the cow herd currently receiving the hormone, reduced availability will significantly affect 2004 milk per cow. Somewhat unattractive milk-feed price ratios and uneven forage quality probably will also work against recovery in milk per cow. On the other hand, a much smaller number of first-calf heifers should spur gains in milk per cow.

Milk per cow in 2004 is expected to rise only slightly more than 1 percent from 2003 on a daily average basis. Growth may pick up later in the year but significant recovery probably will have to wait until 2005.

Changes in milk cow numbers during 2002 and 2003, like most earlier periods, were driven by structural changes induced by milk prices and returns. What made these years different was the delay between changes in returns and the effects of structural adjustments. The generally high returns of 1996-2001 unleashed a wave of dairy farm expansions during 2001 and 2002. However, many of these new facilities were not completely filled until 2003 because of the shortage of dairy replacements. These expansions bolstered milk cow numbers into early 2003.

Similarly, the rate of farms exiting was relatively low in 2001 because of the strong returns. The exit rate stayed slow during most of 2002 in spite of sharply lower returns. Even the relatively weak farms entered the year much better able to continue than normal, and their ability to persist was further enhanced by the Milk Income Loss Contract payments. However, the low returns were taking their toll by late 2002 and 2003, and the exit rate picked up considerably.

Milk cow numbers declined rapidly during the last three-quarters of 2003, going from 0.3 percent above a year earlier in January-March to 1.4 percent below in October-December. Once expansions began to slow, the accelerated exit rate became the dominant force shaping cow numbers. In addition, rising cull cow prices during the year and the much lower replacement price throughout 2003 sharply narrowed the gap between replacement and slaughter values, lowering the share of cows in exiting herds that went into other herds.

Returns in 2004 are expected to be somewhat stronger than in 2002 or 2003 but still relatively weak. Dairy farm exits probably will remain numerous. Expansion by stronger producers might pick up a bit after the 2003 hiatus but is projected to stay fairly modest.

Significantly fewer heifers will enter the milking herd this year, even though the overall herd of replacement heifers on January 1 was only 2 percent below a year earlier. An unusually large share of the year-earlier heifers were older animals, and the number expected to begin milking in 2004 was down 4 percent. And, no Canadian replacements will be available so long as the ban on importation of live animals continues. Although new regulations are in the comment process, it is uncertain when the current prohibition will end.

Cull cow markets remain unsettled. The loss of beef exports will require that additional quantities of fed beef be absorbed domestically, weakening cow beef prices as well as fed prices. In addition, some buyers reportedly are hesitating to deal with older dairy cows. However, beef supplies remain tight, demand has held, and cow prices are projected to stay fairly high.

Milk cow numbers are projected to decline at a fairly rapid rate throughout 2004. For the year, cows are expected to average almost 2 percent

fewer than in 2003, the largest decline since at least 1991.
Milk production in 2004, on a daily average basis, is projected to be about the same as in 2003. Production in 2003 was likewise steady. Such stability would be highly unusual in an industry where typical shifts in output have become much larger than in the past.

Butter Stocks Trimmed

A sharp seasonal drawdown in commercial butter stocks largely eliminated the burdensome excess that had plagued the market through most of 2002 and 2003. Holdings fell almost 200 million pounds between July 1 and January 1, as lower butter production was accompanied by fairly brisk sales. Stocks rose seasonally during January but the increase was similar to those of recent years. On February 1, commercial inventories were still about a third less than a year earlier.

Commercial stocks of other dairy products have generally stayed moderate. Cheese inventories in recent months have been slightly below the moderate levels of a year earlier. Even though 2004's production and sales uncertainties probably boosted desired stocks somewhat, the February 1 levels probably would have been considered adequate—if pipeline stocks outside warehouses had been normal. However, warehouse cheese stocks clearly were not sufficient to contain a sustained buying surge. Manufacturers' stocks of nonfat dry milk were up a little on February 1 but not markedly. Excess industry powder stocks can easily be drained away by sales to the Government.

February 1 stocks were equivalent to about 9.7 billion pounds of milk on a milkfat basis, down 1.5 billion from a year earlier. On a skim solids basis, commercial holdings were 8.7 billion pounds, milk equivalent, very close to a year earlier. These stocks probably were roughly neutral factors for dairy prices. Traders will watch stocks very carefully in coming months for signs that markets are more or less tighter than expected.

Supplies of milk for manufacturing during December-January fell about 2 percent from a year earlier, primarily because of reduced milk production. Butter-powder production felt the brunt of the tight milk supplies, even though cheesemakers' advantage in competing for milk diminished substantially during this period. Cheese buyers were fairly aggressive about replenishing pipeline holdings, and even a small advantage was enough to keep milk flowing into cheese. December-January production of all cheese rose about 2 percent, although Cheddar output, the benchmark variety for cheese prices, stayed below a year earlier.

Manufacturing milk supplies are expected to run slightly below a year earlier in coming months. Recent strength in butter prices imply that cheese will not as readily attract extra milk. Although some types of cheese may be able to pull more milk, the allocation of available supplies might be quite sensitive to even small changes in wholesale prices. At least through midyear, changes in product output are projected to be relatively uniform.

The 2003 surplus of skim solids stayed quite large but declined slightly from 2002. Commercial use grew somewhat more than did production. Net removals totaled 8.6 billion pounds milk equivalent, skim solids basis (about 5 percent of marketings), down from 9.8 billion pounds a year earlier. Growing commercial use in 2004 is projected to trim the skim solids surplus further.

The milkfat surplus was equivalent to only 1.2 billion pounds in 2003. Exports of butter under the Dairy Export Incentive Program (DEIP) and small cheese purchases boosted milkfat removals from the negligible levels of 2001 and 2002. The surplus of milkfat is expected to stay small in 2004 as milkfat markets probably will remain relatively tight.

International Prices Firm

International market prices of butter and nonfat dry milk have risen since mid-2003. Seasonal tightness in the Northern Hemisphere played a role (particularly for butter), as did Oceania's lackluster rebound from the previous season's drought. However, the primary factor in the price rises was simply the weakness in the U.S. dollar.

Import demand has been modestly good. The key importers of milk powders generally have had economic growth and increased consumption of dairy products. Butter import demand has improved in both Russia and the Middle East. However, neither product is likely to experience the kind of buying spree that would send prices sharply higher. Nonfat dry milk prices are effectively capped by U.S. domestic prices, while butter demand seems unlikely to grow much.

Export supplies in 2004 are expected to be moderate. The European Union (EU) position is projected to remain similar to 2003. Conditions in New Zealand have been sharply mixed during the current season, as parts of the North Island have had extraordinary good weather while the South Island has been in drought. Overall, New Zealand output has been slightly above a year earlier. Australia's production has been lower as they had substantial problems recovering from the effects of last season's drought. U.S. supplies of nonfat dry milk will be large—but will be available internationally only as long as international prices stay near current levels. Only modest amounts of U.S. powder are expected to be needed by international buyers, but this could easily change.

Short-run price prospects probably will be affected much more by exchange rates than by dairy market developments. Supplies from Oceania reportedly are fairly fully committed for the rest of the season, the EU situation likely will be fairly stable, and demand seems to be on a fairly steady course.

At current U.S. butter prices, high tariff imports of milkfat are profitable. However, the size of imports beyond the tariff-rate quotas (TRQ) are quite uncertain. Oceania supplies reportedly are very limited for the rest of the season, although diversions from other customers or good late-season weather could make more milkfat available. Supplies elsewhere probably also will be tight. Lastly, previous experience indicated that the inherently high risk of over-TRQ imports trims the amount brought in unless a buyer is willing to commit firmly well in advance.

Dairy Prices Jump

Counterseasonal increases in wholesale butter and cheese prices have been large this winter. By mid-March, butter prices had jumped more than 80 cents per pound since late December, exceeding $2 for the first time since the summer of 2001. Meanwhile, cheese prices rose more than 50 cents per pound and had surpassed their 2003 peaks.

The roots of these price rises lay in the strong finish to the 2003 holiday season. Recovery in demand and continued slight weakness in milk production left pipeline holdings tight and pulled down the heavy warehouse stocks of butter that had dogged dairy markets since the spring of 2002. Prices began to rise as buyers sought some protection from this market tightening. Since then, a series of bullish factors (mostly related to lower expected production) have created self-perpetuating price increases, as buyer actions to protect against future tightness dried up current markets.

The peculiar mix of a counterseasonal price rise, tightened current market fundamentals, and the key role of anticipated market conditions make the ultimate size of the price rise, its duration, and the steepness of the subsequent downward adjustment very difficult to gauge. Given expected conditions, elevated wholesale prices are projected to persist through midyear, with gradual declines during the second half of 2004.

Farm milk prices are expected to average more than $14 per cwt in 2004, running well above a year earlier until at least autumn. Milk prices now seem likely to average substantially higher than the low levels of 2002 or 2003. However, prices may be quite volatile, and a sudden collapse will remain a possibility.

Retail dairy prices in 2003 averaged just barely lower than a year earlier, following a fractional increase in 2002. The farm-to-retail price spread fell as retail prices did not keep pace with rising farm milk prices. Since 2000, moderate declines in the spread have alternated with sizable increases. For 2004, retail dairy prices are projected to rise 4-6 percent from a year earlier. The boost in farm prices may be joined by a modest increase in the spread.

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The recent discovery of bovine spongiform encephalopathy (BSE) http://www.ers.usda.gov/features/BSE/index.htm in a dairy cow in the State of Washington has caused importers to either ban or restrict beef imports from the United States.

Data

Retail Price Reporting for Meat

http://www.ers.usda.gov/Data/Meatscanner/ A new ERS database contains monthly average retail prices for selected cuts of red meat and poultry, based on electronic supermarket scanner data. While not based on a random sample, the raw data underlying the database are from supermarkets across the United States that account for approximately 20 percent of U.S. supermarket sales. Leland Southard, (202) 694-5187.

Web Sites

Animal Production and Marketing Issues, http://www.ers.usda.gov/briefing/AnimalProducts/
Cattle, http://www.ers.usda.gov/briefing/cattle/
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Dairy, http://www.ers.usda.gov/briefing/dairy
WASDE, http://www.usda.gov/oce/waob/wasde/latest.pdf

Red meat and poultry forecasts

	2001	2002			2003					2004		
	Annual	Annual	I	II	III	IV	Annual	I	II	III	IV	Annual
Production, million lb												
Beef	26,107	27,090	6,284	6,905	7,084	5,975	26,248	5,875	6,600	6,700	6,000	25,175
Pork	19,138	19,664	4,908	4,750	4,815	5,509	19,982	5,075	4,900	4,950	5,325	20,250
Lamb and mutton	223	219	49	50	48	52	199	49	48	47	50	194
Broilers	31,266	32,240	7,786	8,275	8,448	8,240	32,749	8,065	8,565	8,800	8,500	33,930
Turkeys	5,562	5,713	1,380	1,439	1,409	1,423	5,650	1,330	1,405	1,430	1,460	5,625
Total red meat & poultry	83,006	85,669	20,582	21,598	21,976	21,367	85,523	20,557	21,689	22,102	21,501	85,849
Table eggs, mil. doz	6,078	6,190	1,524	1,528	1,559	1,596	6,207	1,545	1,545	1,575	1,610	6,275
Per capita consumption, retail lb 1/												
Beef	66.2	67.6	16.2	16.9	16.8	14.9	64.8	15.8	17.7	17.7	15.7	66.9
Pork	50.2	51.5	12.6	12.5	12.6	14.1	51.8	12.8	12.5	12.8	13.5	51.6
Lamb and mutton	1.1	1.2	0.3	0.3	0.2	0.3	1.1	0.3	0.3	0.3	0.3	1.1
Broilers	76.6	80.5	19.6	20.7	21.3	19.8	81.4	20.1	21.5	21.3	20.5	83.4
Turkeys	17.5	17.7	3.6	3.9	4.6	5.3	17.4	3.7	3.9	4.2	5.6	17.4
Total red meat & poultry	213.6	220.5	52.8	54.8	56.0	54.9	218.5	53.1	56.4	56.7	56.1	222.3
Eggs, number	252.7	255.5	62.5	62.9	63.6	65.2	254.2	62.7	62.8	63.8	65.0	254.4
Market prices												
Choice steers, Neb., $/cwt	72.71	67.04	77.82	78.49	83.07	99.38	84.69	80-81	74-78	70-76	74-80	74-79
Feeder steers, Ok City, $/cwt	88.20	80.04	78.48	82.49	94.90	103.51	89.85	86-87	81-85	81-87	82-88	82-87
Boning utility cows, S. Falls, $/cwt	44.39	39.23	40.53	46.52	49.84	49.60	46.62	46-47	47-49	45-49	45-49	46-48
Choice slaughter lambs, San Angelo, $/cwt	72.04	72.31	91.92	93.71	89.48	92.82	91.98	101-102	96-100	93-99	93-99	95-100
Barrows & gilts, N. base, l.e. $/cwt	45.81	34.92	35.38	42.64	42.90	36.89	39.45	42-43	40-42	38-42	34-38	39-41
Broilers, 12 City, cents/lb	59.10	55.60	60.30	59.60	63.40	64.60	62.00	72-73	70-74	67-73	65-71	69-73
Turkeys, Eastern, cents/lb	66.30	64.50	61.10	60.60	59.10	67.40	62.10	61-62	60-64	61-67	63-69	62-65
Eggs, New York, cents/doz.	67.20	67.10	77.20	73.90	89.90	110.70	87.90	110-112	93-97	91-99	96-104	97-103
U.S. trade, million lb												
Beef & veal exports	2,269	2,447	585	678	681	579	2,523	10	120	150	150	430
Beef & veal imports	3,164	3,218	810	741	619	836	3,006	835	900	855	740	3,330
Lamb and mutton imports	146	162	40	44	35	48	167	48	41	39	42	170
Pork exports	1,560	1,611	413	438	406	460	1,717	460	475	420	470	1,825
Pork imports	951	1,070	289	301	298	297	1,185	285	290	295	300	1,170
Broiler exports	5,555	4,807	1,200	1,166	1,182	1,385	4,932	1,115	1,150	1,340	1,350	4,955
Turkey exports	487	439	103	114	130	136	483	110	85	125	135	455

1/ Per capita meat and egg consumption data are revised, incorporating a new population series from the Commerce Department's Bureau of Economic Analysis based on the 2000 Census.

Economic indicator forecasts 1/

	2002		2003					2004				
	IV	Annual	I	II	III	IV	Annual	I	II	III	IV	Annual
GDP, chain wtd (bil. 2000 dol.)	10,161	10,083	10,210	10,288	10,493	10,599	10,398	10,713	10,826	10,931	11,041	10,876
CPI-U, annual rate (pct.)	2.4	2.2	3.9	0.6	2.3	0.9	1.9	1.7	1.5	1.5	1.7	1.6
Unemployment (pct.)	5.9	5.8	5.8	6.2	6.1	5.9	6.0	5.7	5.6	5.6	5.5	5.6
Interest (pct.)												
3-month Treasury bill	1.3	1.6	1.2	1.0	1.0	0.9	1.0	0.9	1.0	1.2	1.5	1.2
10-year Treasury bond yield	4.0	4.6	3.9	3.6	4.2	4.3	4.0	4.2	4.4	4.7	4.9	4.5

1/ Source: Survey of Professional Forecasters, Philadelphia Federal Reserve Bank, February 2004.

Dairy forecasts

	2002		2003					2004				
	IV	Annual	I	II	III	IV	Annual	I	II	III	IV	Annual
Milk cows (thous,)	9,142	9,139	9,144	9,109	9,073	9,011	9,084	8,965	8,930	8,900	8,870	8,915
Milk per cow (pounds)	4,555	18,608	4,710	4,827	4,601	4,609	18,747	4,805	4,910	4,675	4,695	19,085
Milk production (bil. pounds)	41.6	170.1	43.1	44.0	41.7	41.5	170.3	43.1	43.8	41.6	41.6	170.2
Commercial use (bil. pounds)												
milkfat basis	43.9	170.8	41.4	43.0	44.9	45.3	174.7	42.2	43.8	45.2	45.2	176.3
skim solids basis	41.3	163.9	40.1	41.3	42.3	41.9	165.6	41.0	42.1	43.1	42.7	168.8
Net removals (bil. pounds)												
milkfat basis	0.1	0.3	0.4	0.6	0.2	0.0	1.2	-0.1	0.0	0.1	0.0	0.1
skim solids basis	1.4	9.8	3.1	3.2	1.5	0.9	8.6	2.1	2.0	1.2	0.5	5.9
Prices (dol./cwt)												
All milk 1/	11.97	12.11	11.37	11.07	13.20	14.40	12.51	13.55-13.75	14.50-15.00	13.90-14.70	14.00-15.00	14.00-14.60
Class III	10.10	10.42	9.52	9.62	13.29	13.24	11.42	12.15-12.35	13.40-13.90	13.00-13.80	12.45-13.45	12.75-13.35
Class IV	10.52	10.81	9.89	9.74	10.05	10.33	10.00	12.00-12.30	13.20-13.80	11.75-12.65	11.30-12.40	12.05-12.75

1/ Simple averages of monthly prices. May not match reported annual averages.