

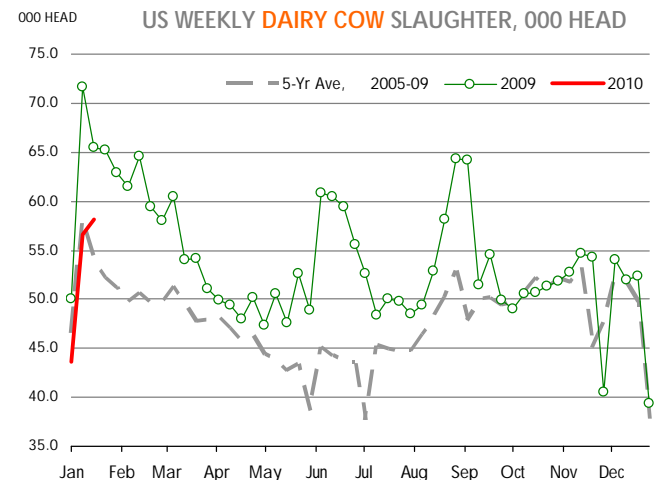
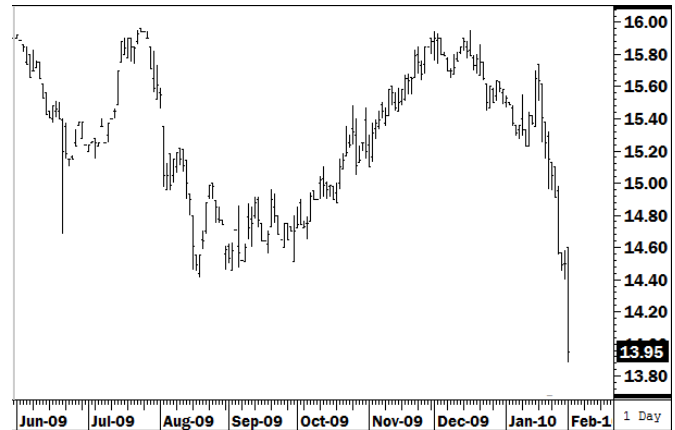
Daily Livestock Report

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Market Comments

Dairy cow slaughter was a topic of much discussion in 2009 and judging by the action in the CME Class III milk futures this January, **it is likely that we will again hear about dairy cow buyback programs in 2010.** As we noted in our report yesterday, futures were likely to view the dairy heifer retention numbers as negative...and they did. For those that did not look at the cattle inventory numbers we showed yesterday, the USDA report indicated that the number of heifers held back for dairy herd rebuilding was 4.516 million head, 106,000 head or 2.4% larger than the previous year. Pre-report estimates were looking for a 2.5% reduction in replacement dairy heifers, so this was a 5% swing in what the market was anticipating and what the actual number ended up being. Milk futures dropped sharply on Monday trading, deferred futures bearing the brunt of the decline. Nearby milk futures already had been under a lot of pressure given continued weakness in cash markets. It appears that a number of market participants finally gave up on prospects of tighter milk supplies in 2010. The January USDA WASDE report forecast 2010 US milk production at 188.4 billion pounds, just 0.4% lower than the 2009 production level. And that report was released before the herd rebuilding numbers came out. So far the industry has reduced dairy cow numbers (January 1 inventory was down 252,000 head or 2.7%) but much of the reduction in inventory has been offset by improvements in productivity. With more heifers being held back, the industry now also has to contend with herd rebuilding at a time when the demand picture has yet to improve. As we have noted before, dairy prices will greatly depend on what happens with US foodservice sales. Pizza, sandwiches and burgers all have cheese in them and until we see a recovery in sales at fast food and casual dining restaurants, the dairy industry will find it difficult to gain traction. The latest foodservice sales forecasts from the National Restaurant Association point to an expected 2.5% increase in nominal sales growth **but a 0.1% decline in real (inflation-adjusted) sales.** It is a sobering forecast given that real (inflation-adjusted) restaurant sales were down 2.9% a year ago. If the current forecast materializes, **it would represent the third consecutive year of declines in inflation-adjusted foodservice sales.** In the four recessions of the last forty years, inflation adjusted foodservice sales never declined for more than one year (they did not decline in 2002). Rebuilding the dairy herd in this environment is a truly courageous or foolish thing to do. Dairy cow slaughter in the last three reported weeks has been on average 15% lower than a year ago, but that may quickly change.

Milk Futures Pull Back Sharply: Class III Milk Futures, CME June 2010 Contract



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