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What's Ahead for Consumer Fluid Milk and Cheese Demands?

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Trends in per capita demands for fluid milk and cheese in the U.S. have traced different paths over time – per capita cheese demand has been increasing while per capita fluid milk demand has fallen. U.S. dairy producers have questions about both trends; i.e., will the downward trend in fluid milk demand persist into the future, and is the favorable trend for cheese approaching its peak? Predictions of future market demands and farm prices for dairy products are important determinants in developing future marketing strategies and farm production planning decisions.

Studies have shown that recent changes in per capita demand for dairy products are mainly a result of changes in population demographics and food-spending patterns, and are less influenced by direct changes in economic variables such as real price or income. For example, recent reductions in per capita fluid milk demand are leveraged largely on decreases in the portion of the population that is five years old and younger, a high consuming cohort group. Over this same time period, important contributors to growth in per capita cheese demand has come largely at the hands of a growing Hispanic population and increases in per capita spending on food away from home.

Utilizing current USDA and U.S. Census market projections for the next ten years, combined with existing econometric models of demand and supply, we are able to forecast the retail demands for fluid milk and cheese and the supply and price of farm milk over the next

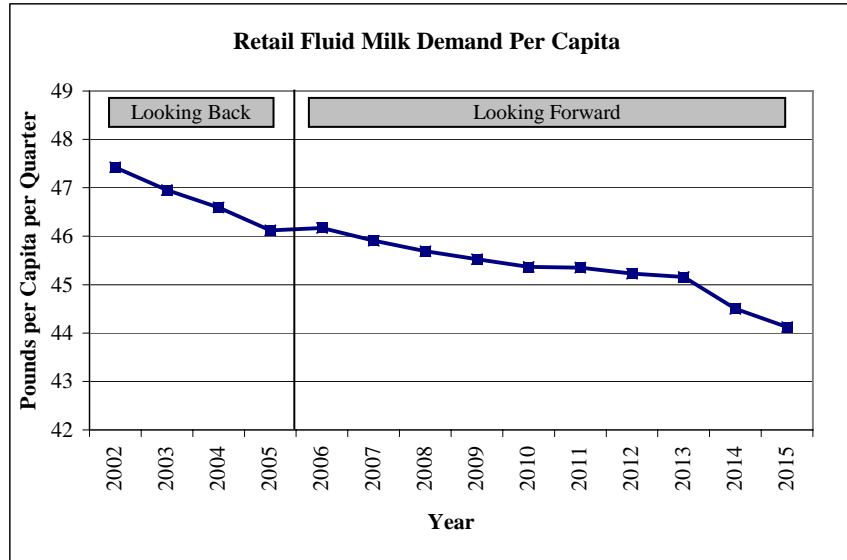
decade. By doing so, we can investigate whether projections of population and consumer food-spending habits will extend or alter current consumption trends.

Some important projections affecting future supply and demand include:

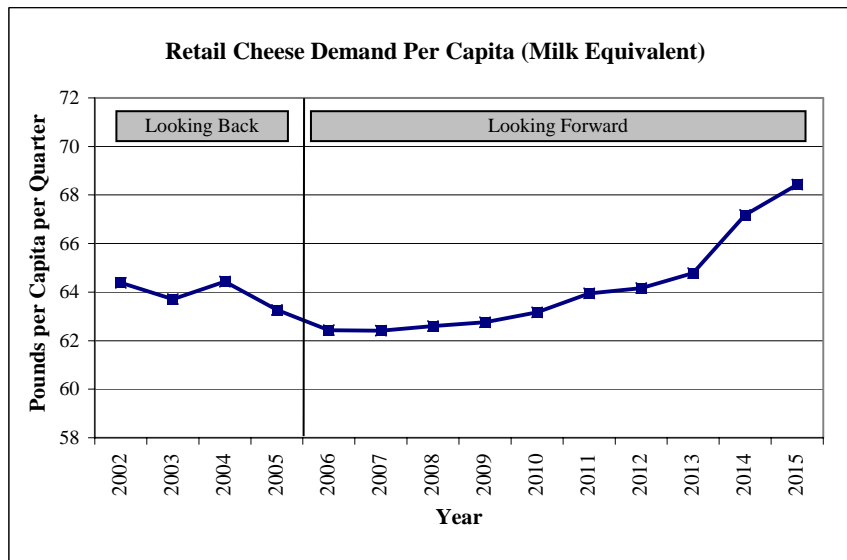
- Retail consumer price indexes are expected to show steady increases, with average annual percentage changes over the next ten years of 2.9%, 2.3%, and 0.7% for all products, nonalcoholic beverages, and retail meat products, respectively.
- Minority populations are expected to continue to increase in both size and proportion. Specifically, strong growth in the proportion of Asians and Hispanics is anticipated at nearly 1.9% per year. This compares with proportional growth rates for African Americans and White populations of 0.3% and -0.2%, respectively.
- Recent modest gains in the portion of the population under age five are expected to fade at the beginning of the forecast period and thereafter show modest increases until the end of the forecast period when reductions again are projected.
- Growth in real income is expected to be strong over the next decade with an annual average growth rate exceeding 2.5%.
- Average annualized growth in feed costs is expected to be a hefty 4.4% per year.
- The recent strong growth in energy costs is expected to stabilize during the next few years but begin increasing steadily thereafter, implying a modest annualized growth rate of 1.4%.
- Real per capita expenditures on food eaten away from home have shown steady growth in recent years and are expected to continue at an annual growth rate of 1.5%.

So what do these imply for consumer demand, farm supply, and farm prices?

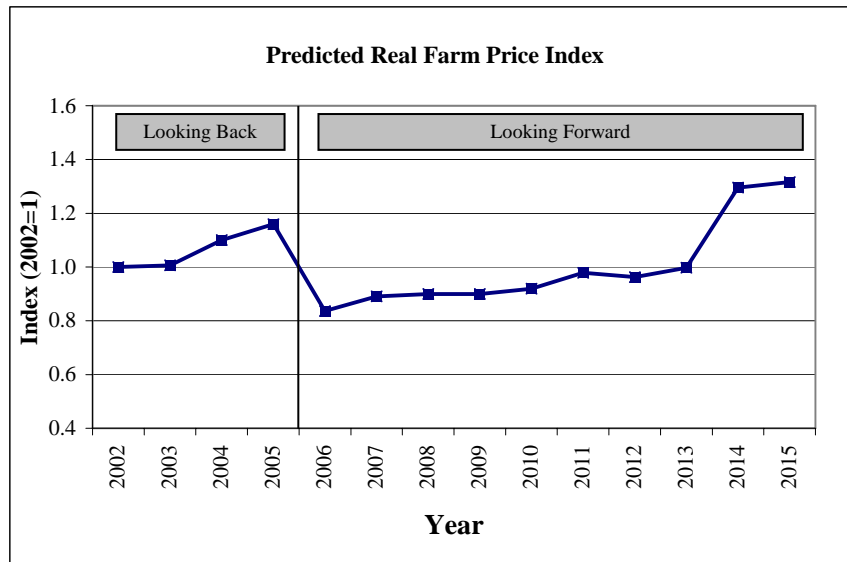
Given the forecast assumptions, continued reductions in fluid milk demand per capita are expected over the next decade, but at a reduced rate from those realized more recently. Specifically, recent reductions on the order of 1.4% per year are projected to temper to a more subdued 0.4% per year. This is due largely to the expected modest growth in the younger-age cohort over the next few years before the proportion begins dropping near the end of the forecast period, and combined with continued, but modest, growth in the African American population.



Growth in retail cheese demand per capita is expected to roughly continue through the forecast period. In fact, relative to recent average annual growth rates of around 0.5%, the next ten years are expected to show an average annual growth rate of 0.8%. Stronger growth trends are due largely to the assumed strong growth in the spending for food away from home and in the size of Hispanic and Asian populations.



Given that the growth in demand for cheese more than offsets losses on the fluid milk side, we expect the total farm milk supply to increase during the next decade and be similar to recent trends of around 1% per year. However, since milk destined for cheese generally receives a lower wholesale price than that for fluid purposes, we expect that real national farm milk prices (i.e., relative to expected feed costs) will remain at levels similar to those realized in 2002 and 2003, with moderate growth over time reflecting the overall increases in dairy product demand. In addition, the assumed relatively strong growth in feed costs dampens improvements in real prices. It is only the larger demand adjustments at the end of the forecast period that signal a distinct improvement in real farm prices.



In summary, it is important to remember that forecast predictions are just that, predictions of future economic activity and market adjustments based on the expected changes in various demand and supply determinants over time and the underlying economic relationships that link them together. To the degree that the expected changes in the determinants come true and that the economic relationships estimated in the underlying economic models remain valid, this is our best prediction of the future at this point in time. A mix of positive and negative changes throughout the marketing system imply a continued but tempered reduction in fluid milk demand, a growth in cheese demand, and moderately improving real prices at the farm gate commencing in 2006.

Smart Marketing is a monthly marketing newsletter for extension publication in local newsletters and for placement in local media. It reviews the elements critical to successful marketing in the food and agricultural industry. Articles are written by faculty members in the Department of Applied Economics and Management at Cornell University.

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