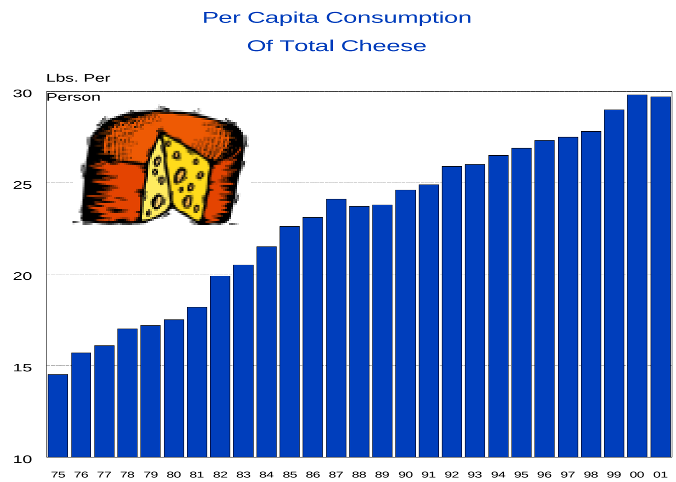
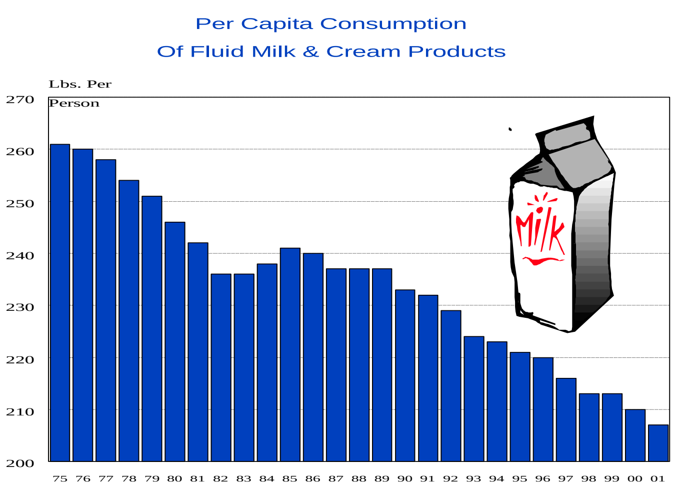
Marketing Service Bulletin

Cheese: The Good, Bad & the Ugly . . .

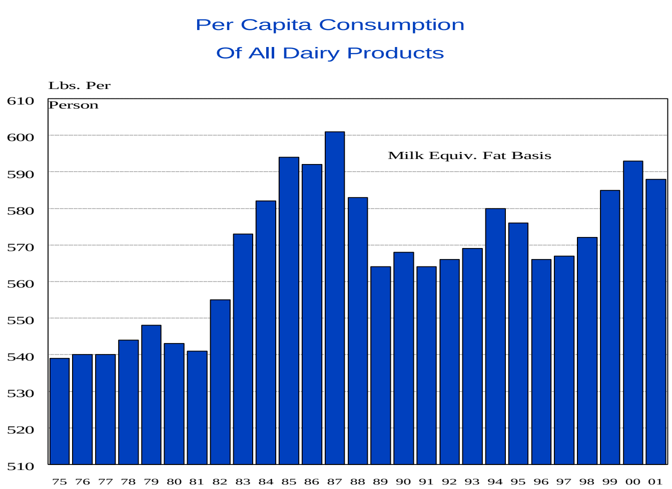
OCTOBER 2002



Until recently, cheese consumption maintained an upward march and has consistently provided "Good" news during a time the consumption of other dairy products appeared bleak. Per capita consumption of all cheese is up 104.8% (1975 through 2001) from 14.5 pounds to 29.7 pounds. Consumption fell slightly in 2001 and many predict lackluster performance in 2002.



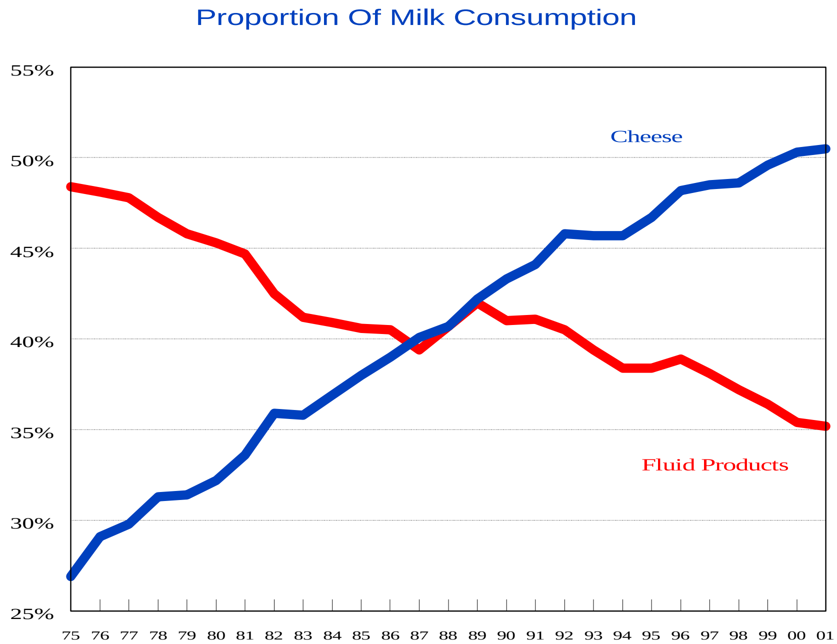
Conversely, the per capita consumption of fluid milk and cream products declined again in 2001 and continues along a downward trend covering most of four decades. Per capita fluid consumption averaged 207 pounds in 2001 which was down 20.7 percent from 261 pounds in 1975.



Per capita consumption of all dairy products (milk equivalent basis) has rebounded somewhat from the early nineties. However, it remains below the 1987 level when per capita consumption of all dairy products totaled 601 pounds. 2001 per capita consumption fell 2.2% from this level to 588 pounds.

In 1988, milk used in the consumption of cheese (1 lb. cheese = 10 lbs. milk) equaled the amount of milk consumed in fluid and cream products. Since then,

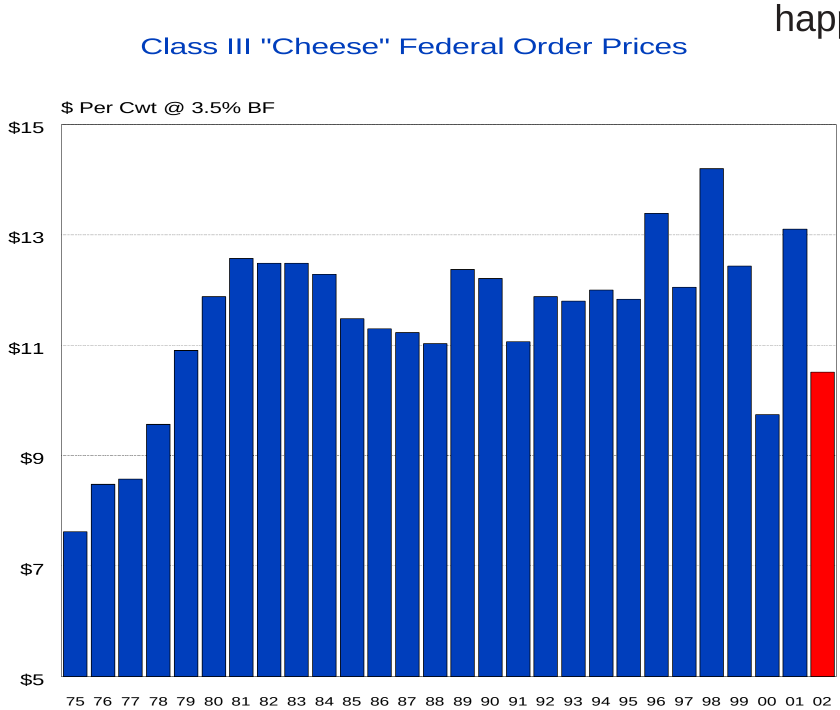
Issued by Donald R. Nicholson, Market Administrator, for the Information of Producers Who Are Not Members of a Cooperative Association.



the milk equivalent of per capita cheese consumption has exceeded the fluid & cream consumption. The difference has increased in each subsequent year. The graph at the left illustrates the growth of per capita cheese consumption contrasted with the decline in fluid milk and cream products. In 2000, milk consumed in cheese increased to 50% of the total milk consumption.

Federal milk orders were first authorized in 1935 as a result of farmer unrest and disorderly marketing. The charge was to facilitate orderly milk marketing and thus assure an adequate supply of milk. Provisions were formulated that segregated milk by classes of utilization so that surplus milk would not set the price for an entire market. Resulting policies and economic theories placed more value on fluid milk than on milk utilized in manufactured products. This concept is still in practice today. Milk used in cheese manufacturing was considered to be "surplus" since cheese has an extended shelf life and milk used in cheese production could be made from both Grade "A" or "B" milk. As a result of both of these factors, cheese has historically carried a lower value than its fluid counterpart.

This aspect represents the "Bad and Ugly" news in that all milk used in cheese is priced at levels which are structurally and historically lower than most dairy products. This happens while per capita consumption of milk used in cheese continues its upward movement and outpaces milk used in fluid and cream consumption.



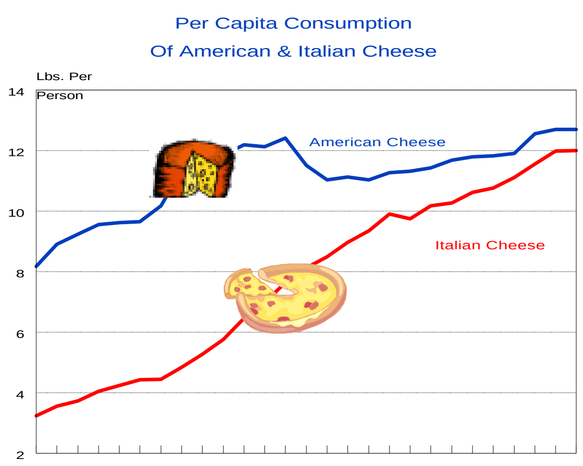
Federal order "cheese milk" prices can be examined by the graph at the left which depicts the federal milk order Class III price from 1975 through 2001. This price series, through various methods of calculation, has generally been determined by cheese prices. It represents market prices of federal order milk used in cheese production. The twenty-year average ('82-'01) for the federal order Class III price was $12.02. The 2002 year-to-date average Class III price is $10.52 per hundredweight. When milk used in the consumption of cheese accounts for half of the nation's milk supply these historical "cheese milk" price levels take on increased importance.

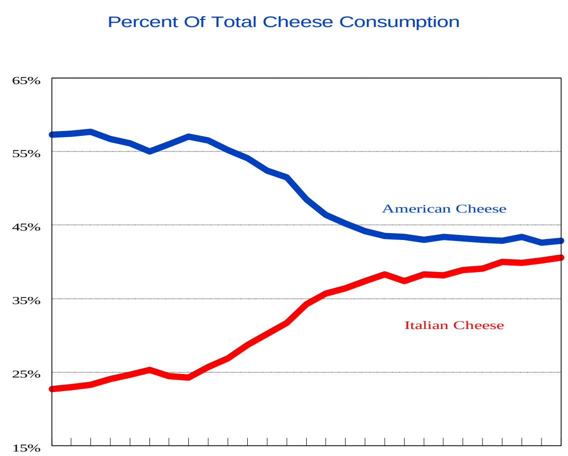
Today, many dairy industry publications contain a variety of articles on the "tanking" of cheese prices. Many analysts do not predict any significant recovery until well into 2003. The implications of this are far-reaching. Those familiar with milk pricing certainly realize and understand that Class I "fluid" prices will be lower as a result of lower manufacturing prices. In the absence of increased cheese prices, the resulting dairy producer prices do not hold much promise in the near term for the nation as a whole when the majority of milk is utilized in a product with a low class price.

The effect of federal milk order pricing reform has been positive. No longer are Class I "fluid" milk prices dependent on cheese alone. Under federal order reform, Class I pricing is now based on the higher of the advance Class III or Class IV (butter-powder) prices. Since January 2000, this change has extracted more value from the market place for dairy farmers than was previously available since the Class IV "butter-powder" price has been higher than the Class III "cheese" price in 27 of 35 months since federal order reform took place.

The bottom line -- long-term gains in dairy producer prices will be hard to achieve as long as milk used in the production of cheese constitutes the largest slice of the nation's milk supply and it is priced at lower levels.

What Is Driving The Growth In Cheese Consumption?





Italian-type cheeses. Per capita consumption of Italian cheese increased 270.4% from 3.24 pounds in 1975 to 12.00 pounds in 2001. American cheese also noted a large increase of 55.4% from 8.17 pounds to 12.7 pounds. American cheese still accounts for the largest percentage of total cheese production at 42.9% during 2001. Italian cheese was a close second, accounting for 40.6% of the total.

	Statistical Uniform Price		Producer Price Differential		Class I Utilization	
	9/2002	8/2002	9/2002	8/2002	9/2002	8/2002
Pacific Northwest	10.66	10.66	0.74	1.12	27.24	26.34
Western	10.55	10.35	0.63	0.81	17.31	21.50
Arizona-Las Vegas	11.03	11.04	-----	-----	36.02	35.60
Central	**10.74**	**10.58**	**0.82**	**1.04**	**26.33**	**27.02**
Southwest	11.92	11.95	2.00	2.41	45.25	45.01
Upper Midwest	10.46	10.20	0.54	0.66	20.60	19.90
Southeast	12.56	12.63	-----	-----	65.60	67.28
Mideast	11.09	11.19	1.17	1.65	38.69	41.61
Appalachian	12.76	12.87	-----	-----	71.22	72.52
Northeast	12.20	12.16	2.28	2.62	46.30	43.26
Florida	13.97	14.19	-----	-----	89.20	91.98

USDA United States Department of Agriculture

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