

Livestock, Dairy, & Poultry

Surging Demand Pulls Dairy Industry In New Directions

Dairy markets during 1998-2000 faced one major question: Will milk production expand enough to meet the extraordinary growth in demand for dairy products? In 1998 and most of 1999, production did not keep pace, and prices soared. Since late 1999, however, the situation has reversed. Prices fell in response to pressure from very large supplies, even as the strong economy generated the strongest demand in many decades.

Growth in milk output is expected to ease slightly in 2001. This drop in growth may allow prices for milk and dairy products to recover in calendar 2001, at least somewhat. With the economy projected to expand in 2001, consumer incomes and spending should continue to gain. Demand for dairy products, therefore, is expected to stay strong, although actual growth may ease a bit. Demand for dairy products used by restaurants or as ingredients in prepared foods will probably be particularly brisk.

Markets for dairy products have changed substantially in recent years. Retail sales no longer are the main outlet for most dairy products and, during the last few years, have lagged behind other outlets. Although most fluid milk is still sold at retail, cheese and butter are used mostly by away-from-home dining establishments or by makers of processed food. Large shares of ice cream and fluid cream sales also are outside retail channels. In total, slightly less than half of milkfat and only slightly more than half of skim solids are now sold through retail stores.

Sustained economic growth has produced improved consumer incomes, strong stock prices, and low unemployment. Inflation and interest rates have stayed relatively

low. As a result, consumers have been in the mood to treat themselves and, atypically for this far into a growth period, have been boosting real expenditures for food. Spending for food away from home has grown fastest, although retail food expenditures have also increased. Dairy products are far from unique in benefiting from strong demand. High-quality beef, the more expensive cuts of beef and pork, and commercially prepared foods generally have been favored.

Since 1997, commercial use of cheese has grown by almost 5 percent per year, even though prices have been relatively high throughout most of that period. The strong restaurant market has increased cheese demand. Restaurants like cheese for its versatility and flavor, as well as for its prominent role in a number of ethnic cuisines. In particular, fast-food chains include cheese, often paired with bacon, as a component of their special feature sandwiches. Pizza sales and sales of commercially prepared entrees using cheese also continue to increase. This powerful demand for cheese supports dairy markets overall, since cheese now uses about half the milk supply.

Retail sales of cheese have increased, too, although these increases were somewhat more modest until weaker prices prevailed in 2000. Consumers have expanded their cheese buying for themselves and guests in their homes, although the increase in restaurant meals has limited these gains somewhat. Retail demand reportedly has been better for specialty cheeses than for the more common cheeses.

Despite almost constant buffeting by high (sometimes extremely high) and volatile prices in recent years, butter sales have

been brisk, rising 6 percent annually since 1997. Large shares of butter go into away-from-home eating, particularly in more expensive restaurants, and into more expensive prepared foods. Retail sales also have grown because butter is now seen as a "little luxury" consumers can afford. Fluid cream sales also have flowed briskly for many of the same reasons.

Not all dairy sales have been strong. Demand for dairy products sold mostly at retail generally has weakened. In recent years, fluid milk sales have been basically flat. Greater away-from-home eating has reduced fluid milk use because people tend to order other beverages in restaurants. Yogurt use has slipped somewhat since 1997. Retailers have become more restrictive about the space allocated to yogurt, and yogurt as a light lunch may have lost some popularity. Consumption of cottage cheese has been about steady.

Although regular ice cream consumption has risen (particularly premium ice creams), the overall frozen dessert category has stagnated. A strong economy is not necessarily good news for ice cream. Consumers perceive it as a "cheap luxury"—one they can easily afford to replace with more expensive treats.

The only major weakness in dairy demand has been for skim solids as ingredients in processed foods. Use of nonfat dry milk and other forms of skim solids grew during the early and mid-1990's because of the introduction and short-term popularity of nonfat and low-fat versions of foods. But the collapse in the market for most of these products has sharply reduced demand for skim solids as ingredients. In addition, substitution of whey solids (and possibly milk proteins) for skim solids has undergone one of its periodic surges. **AO**

*James Miller (202) 694-5184
jjmiller@ers.usda.gov*

The next issue of Agricultural Outlook will appear
in March 2001