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Staff Paper

2011 ANNUAL AGRICULTURAL OUTLOOK

Coordinated by
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2011 Annual Agricultural Outlook

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THE GENERAL ECONOMY

Les Manderscheid and Bob Myers

The U.S. economy is continuing on the road to recovery but major problems and uncertainties remain in play. Preliminary estimates of annualized GDP growth in the fourth quarter of 2010 have come in at 3.2%, up from 2.6% in the third quarter. Meanwhile, the USA Today recently surveyed 46 economists and found that they were forecasting GDP growth at 3.2% to 3.4% for all of 2011. These would normally be sound growth rates following a recession, but not all sectors are participating. In particular, depressed conditions in the housing and construction sectors continue to weigh on the economy, and consumer confidence has not returned to its pre-recession level. A big part of the problem with consumer confidence is labor market conditions, which continue to cause major concern.

Unemployment has remained stubbornly high at around 9.4% and is not expected to fall any time soon. More than 8 million Americans lost their jobs at the peak of the 2007-2009 recession and approximately 125,000 jobs a month have to be created just to absorb the natural growth in the labor force due to new entrants. So hiring would have to occur at a much faster pace than it currently is to cause a significant drop in the unemployment rate. Meanwhile, many of the unemployed are continuing to have to survive on extended unemployment benefits.

Credit market conditions have improved but many consumers and entrepreneurs, especially small businesses, are still reporting difficulties getting the loans they need. The Federal Reserve is doing its part with a second wave of "quantitative easing" (basically creating money) in an attempt to add needed liquidity to the economy. Many economists are concerned about the long-run inflationary effects of this policy, but the Fed clearly is more concerned that the economy may falter again and will worry about inflation later. The Fed's policy does seem to be keeping interest rates low, so it is a good time to borrow and invest. The problem is that the inevitable tightening of loan standards that followed the financial meltdown has rationed many potential borrowers out of the market, even though interest rates are low.

Oil and other commodity and energy prices are on the rise again, with oil currently above \$90 per barrel. Further increases are being forecast. Grain prices are also rising, and interest and investment in biofuels and alternative energy sectors is returning. These developments bode well for the economies of states that are major grain producers and who are making the push into biofuels and alternative energy.

Overall, the outlook for the U.S. economy is for little to change in the coming year. Growth is forecast to move along at a little over 3%, which is somewhat anemic compared to the typical performance coming out of a recession. Unemployment is forecast to remain high at around 9.5% over the next year, with little expectation of interest rate increases unless the economy really starts to heat up and the unemployment rate does drop.

Michigan economic performance continues to lag that of the U.S. as a whole. Michigan has one of the highest unemployment rates and one of the few states that continue to experience population declines. Nevertheless, there are signs of hope. Restructuring of the Michigan auto industry, together with economic recovery and some miscues at Toyota, have vastly improved the financial position of the big three Michigan auto companies. Real wages in the industry may have dropped but employment in the sector is growing again.

There is also a sense of optimism that newly elected Governor Snyder may be able to get Michigan moving again. However, this is clearly going to require moving beyond the state's

manufacturing roots and focusing on knowledge-based sectors of the economy such as health care, education, finance, etc. Biofuels and alternative energy also offer opportunities. These will be the fast growing and high wage sectors of the U.S. economy today and tomorrow.

POLICY OUTLOOK

David Schweikhardt

The significant changes in the composition of Congress that resulted from the 2010 election suggest there will be very little formal action on farm bill programs in 2011. Representative Collin Peterson (D, MN) served as Chairman of the House Agriculture Committee from 2006 to 2010. During 2010, Congressman Peterson indicated that he would prefer to write a new farm bill in 2011 rather than 2012. With the change in control of the House after the 2010 election, however, the new chairman, Representative Frank Lucas (R, OK), has indicated that a new farm bill will not be considered until 2012. Instead, he suggested that the committee hold an expanded set of hearings to perform oversight on all USDA programs and to prepare for the writing of the 2012 farm bill. Nevertheless, some policy issues are likely to be considered in 2011 that could have implications for Michigan farmers.

The ACRE Decision

Farmers are eligible to enroll in the Average Crop Revenue Election (ACRE) program during the life of the 2008 farm bill (through the 2012 crop year). The ACRE program is offered as a substitute for the direct and countercyclical (DCP) program that has existed since 2002. Producers who do not choose to enroll in ACRE will remain eligible for all DCP benefits. Producers who enroll in the ACRE program must forego: (a) 20% of the direct payments that would be received under the DCP program (a loss of 5.6 cents per bushel for corn, 8.8 cents for soybeans, and 10.4 cents for wheat); (b) all countercyclical payments that would be received in the DCP program (at a market price below \$2.35 for corn, \$5.36 for soybeans, and \$3.40 for wheat); and (c) a 30% reduction in the marketing assistance loan rates for all commodities produced on the farm.

In return for having foregone these payments, the producer is eligible for a revenue-based payment (where revenue = market price X yield). This payment will be based on benchmark farm revenue per acre, an actual farm revenue, a benchmark state revenue per acre, and an actual state revenue. If the benchmark revenue is greater than the actual revenue in both the state and the farm comparison, then the producer will be eligible for an ACRE payment based on the difference between the state benchmark revenue and the state actual revenue. The prices used in the revenue benchmark measures are the national average market price of the two most recent crop years. The yields used to calculate the benchmark measures are a three-year average (using three of the most recent five years, excluding the high and low year) of the state (for the state revenue measure) and the farm (for the farm revenue measure).

In making the choice between the DCP and ACRE programs, producers should consider the place of each program in their overall risk management strategy. For example, the DCP program provides no yield risk protection at any time or at any price (i.e., the DCP program is a price-based program that does not provide any form of protection for a decrease in yield). Because the ACRE program is a revenue-based program, it does provide partial protection against losses in yields. Second, DCP does provide greater price risk protection at very low prices (for example, below \$1.95 for corn), but ACRE provides greater price risk protection at higher prices (such as today's prices) than does the DCP program. This result occurs because the ACRE program provides protection against the risk of prices falling below the average price of the last two years. The DCP program does not provide protection until today's prices fall below the effective target price (for example, \$2.35 for corn). Thus, in the gap between the average of the last two years' price and \$2.35, the DCP program provides no price risk

protection. Given commodity prices during the last two years, ACRE provides much more price risk protection than does the DCP program. Producers seeking more information about the choice of the DCP or ACRE programs should visit their local Farm Service Agency office or visit the website at: <https://www.msu.edu/user/betz/>

International Trade Agreements

Congress may consider trade agreements with South Korea, Colombia, and Panama in 2011. The negotiation of these agreements is complete (South Korea by the Obama administration and the others by the Bush administration), and they are awaiting Congressional approval. Among these countries, Korea is the fifth largest agricultural trade partner of the U.S., with \$4.9 billion in agricultural imports from the U.S. in 2010. The largest U.S. exports to Korea in 2010 were coarse grains (\$1.3 billion), red meats (\$641 million), hides and skins (\$382 million), soybeans (\$337 million), and feeds and fodders (\$323 million). The U.S. bought \$287 million in agricultural products from Korea in 2010, with snack foods (\$27 million) being the largest product category of imports. The U.S.-Korea trade agreement would eliminate all tariffs within 10 years, with tariffs on most products being eliminated in five years or less.

The U.S. exported \$829 million of agricultural products to Colombia in 2010, making Colombia the 24th largest market for U.S. agricultural exports. Coarse grains (\$150 million) and wheat (\$147 million) were the largest U.S. exports. The U.S. imported \$1.8 billion in agricultural products from Colombia, with coffee (\$774 million), nursery products (\$551 million), and bananas (\$265 million) being the largest U.S. imports. The U.S.-Colombian agreement would eliminate all of Colombia's tariffs on U.S. exports within 15 years. Most tariffs would be eliminated in five years or less (with tariffs on 52% of agricultural products being eliminated immediately). Because nearly 99% of Colombia's agricultural exports enter the U.S. on a duty-free (zero tariff) basis, tariffs on the remaining products would be eliminated immediately.

The U.S. sold \$402 million in agricultural product exports to Panama in 2010, with soybean meal (\$53 million), coarse grains (\$51 million), and rice (\$49 million) being the largest products. The U.S. imported \$63 million in agricultural products from Panama in 2010, with raw sugar cane (\$30 million), bananas (\$8 million), and other fresh fruit (\$8.5 million) being the largest products. The U.S.-Panama agreement would eliminate all tariffs on agricultural products within 15 years, with most being eliminated in five years or less (50% of U.S. agricultural products will have the Panamanian tariff removed immediately). Because 99% of Panama's agricultural exports to the U.S. enter on a duty free basis, the remaining tariffs would be eliminated immediately.

If Congress and the Obama administration decide to consider these agreements, the political process is likely to be very unclear. On the one hand, some political analysts see these agreements as an opportunity for the White House and the Congress to work on a bipartisan basis. On the other hand, only Korea is a major trading partner of the United States. Trade agreements usually require the political advocacy by export industries that envision significant benefits to result from such agreements. If such support is not forthcoming because some of the agreements are seen as "too small to matter," then the political process of approving such agreements could become especially complicated.

Outlook for 2011

Though there will likely be no formal action on the farm bill in 2011, much activity in preparation for the 2012 bill will be ongoing during 2011. The hearings and other input

opportunities planned for 2011 are an important opportunity for producers. In writing past farm bills, the preparation undertaken in the year prior to the bill has been important to the final outcome of the bill. Proposals for changes in policy or for new programs are often made during the year prior to the writing of a farm bill, and the agenda for the farm bill is often shaped by such proposals. Thus, producers should take advantage of opportunities to provide input during the 2011 deliberations if they intend to have their policy preferences reflected by the final version of the farm bill.

2011 INPUT COSTS

Bill Knudson

Commodity prices continue to be strong. It also appears that input prices have also increased. Fertilizer prices are up from 2010. An increase in the price of oil has put upward pressure on diesel prices. Interest rates will remain low; and credit might be somewhat easier to obtain as farm balance sheets improve.

Fertilizer

Fertilizer prices have finally begun to retreat to more rational levels. Table 1 shows the retail prices for some typical fertilizers in January of 2009 and January of 2010.

Table 1.

Retail Fertilizer Prices - January 5-8 2010 and January 3-7, 2011			
	2010	2011	% Change
MAP	463.24	695.78	50.2
Potash	518.39	566.06	9.1
Urea	408.50	485.75	18.9
Anhydrous	454.73	726.16	59.7
UAN 28	226.69	347.22	53.1

Source: DTN.

Phosphate prices have increased by about 50% compared to a year earlier. Potash prices have increase by about 9%. The price of urea is up by more than 15% compared to 2010. Anhydrous ammonia and UAN 28 are up by more than 50%.

There are two things to consider when analyzing these figures. The first is that prices are likely to rise as farmers make their purchases as planting season approaches. The second is that these figures are national figures. Prices in Michigan may vary somewhat.

Seed

Seed prices continue to increase, although the increase has moderated a little bit. In October of 2010, Purdue University estimated the per acre cost of soybean seed to be \$59, an increase of 13.5% over the 2010 estimate; the per acre cost of corn seed to be \$99 a 5.3% increase over the 2010 estimate; and the per acre cost of wheat seed to be \$39 a 14.7% increase over the 2010 estimate.

Fuel

Diesel fuel prices have declined from their highs 2008, but are increasing and are likely to increase more as the year progresses. According to the U.S. Energy Information Administration, the retail price of diesel was \$3.38 per gallon in the Midwest on January 17th. This is 54 cents per gallon higher than the previous year. If the global economic recovery continues, or for whatever reason there is a disruption in global oil supplies, the price of diesel will increase even more.

Interest Rates

Interest rates remained low throughout 2010, and will likely remain low in 2011. Credit conditions might improve somewhat, making access to credit easier. According to the Federal Reserve Bank of Chicago, interest rates in the region, which includes the Lower Peninsula, most of Indiana and Illinois, Iowa and the southern and western part of Wisconsin, were 6.04% for operating loans and 5.81% for real estate loans in the third quarter of 2010.

Interest rates are likely to remain stable in 2011. While the economic recovery is underway, it remains feeble and the Federal Reserve will continue its expansionary monetary policy until at least the latter part of 2011. Recent activity by the Fed has left interest rates unchanged.

MICHIGAN FARMLAND VALUES GAINING MOMENTUM

Eric Wittenberg and Steve Hanson

Michigan farmland values appear to be on the rise again after experiencing a decline in the previous year. Last year's drop in prices was the first decline in agricultural-use land values since the annual Michigan Land Value Survey began in 1992. The annual Michigan Land Value survey conducted in the spring of 2010 by the Department of Agricultural, Food, and Resource Economics at Michigan State University collects information on the value of different types of land across the State of Michigan. The 2010 survey reported land values, when compared with 2009, increased 1.4% statewide. The strength in the market was concentrated in sugar beet, irrigated, and fruit land while crop land showed relative weakness. Average farmland values in spring 2010 were reported to be:

	Southern Lower Peninsula	Michigan
Tiled field crop land	\$3,348	\$3,176
Non-Tiled field crop land	\$2,782	\$2,544
Sugar Beet land	\$3,764	\$3,643
Irrigated land	\$3,944	\$3,799
Fruit Trees	\$7,531	\$7,326

The USDA reported in its "Land Values and Cash Rents 2010 Summary" that Michigan's agricultural cropland prices decreased for the second year in a row (2.1% in calendar year 2009) to an average price of \$3,300 per acre. According to the USDA, the back-to-back annual decline continues after the first drop in farmland values in Michigan since 1987.

The most recent data on land prices from the Federal Reserve Bank of Chicago found Michigan land prices increased about 10 % from October 1, 2009 to October 1, 2010. All other states in the Federal Reserve's Seventh District showed increases between 3% and 13% during this same reporting the period.

Cash rent rates declined slightly for tilled cropland, non-tiled cropland and irrigated cropland while sugar beet cropland showed a strong increase. Fifty-two percent of the crop acres were controlled through leasing arrangements, with 81% of those on a cash rent basis. Average Michigan cash rent levels in spring 2010 were:

	Southern Lower Peninsula	Michigan
Tiled field crop land	\$111 per acre	\$106 per acre
Non-Tiled field crop land	\$ 84 per acre	\$ 76 per acre
Sugar Beet land	\$165 per acre	\$158 per acre
Irrigated land	\$171 per acre	\$165 per acre

Additional details on land values and cash rents across the state are reported in the Department of Agricultural, Food, and Resource Economics Selected Agricultural Economics Reports that can be found on the web at <http://www.aec.msu.edu/aecreports/index.htm>.

Michigan farmland values are influenced by both the agriculture and non-agriculture sectors. Land values are influenced by a combination of factors including the ethanol industry, commodity markets, interest rates, and commercial and residential development. While Michigan agriculture is very diverse, major commodity crops, along with livestock, continue to

play an important role in determining the value of farmland in many areas of the state. Last year crop prices for cash grain farmers looked favorable but low milk prices for dairy farmers helped soften farmland values. The current economic conditions suggest the outlook for crop producer earnings remain very strong while dairy producer earnings in 2011 should be better than 2010.

Energy and oil prices have become a major factor impacting agriculture profitability and are affecting land prices in complex ways. The actual impacts are difficult to predict because, while higher energy costs increase the cost of production, they also increase the demand for bio-based fuel alternatives such as ethanol and bio-diesel which could increase demand for agricultural outputs (e.g., corn for ethanol production). At the same time, increased demand for corn and soybeans increases the cost to dairy and livestock producers. While energy prices have dropped from record 2007-08 levels, they still remain historically high with crude oil futures prices currently close to \$100 per barrel. Many investors are anticipating continued acceleration in the recovery of the global economy that will support strong prices for oil and energy.

Interest rates also impact land values in a variety of ways. As interest rates decline, the cost of borrowed funds for land purchases decreases. The Federal Reserve has continued to hold the Federal Funds Rate (the interest rate banks charge each other for overnight loans) constant at 3.25% in an effort to stimulate the weakened economy. The WSJ Prime Rate (the base rate on corporate loans posted by at least 75% of the nation's 30 largest banks) is also currently 3.25%. Interestingly, long-term agricultural interest rates have not followed the steep drop in short-term rates. GreenStone Farm Credit Services reports 30-year fixed rate loans for agricultural real estate are currently ranging from 7.15 to 8.45%. It should be noted throughout 2009 and 2010 the prime has been constant. The linkage between long-term and short-term interest rates seems to have weakened as today's globalized financial markets work to assess long-term lending risks. This means the cost to finance land purchases has not provided the investment stimulus that lower rates have created in some other sectors.

Historically, a strong agriculture market in the 1970s ended sharply in 1981 and land prices softened dramatically until the late 1980s. Between 1987 and 2008, the price for farmland in Michigan has increased each year thanks to the combined effect of a strong agricultural sector and demand from the non-agricultural sector for uses such as residential development, recreational use, and commercial development. The demand for non-farm agricultural use has declined as the Michigan economy has continued to weaken. The 2010 MSU survey found the average non-agricultural-use value for undeveloped land in Michigan to be \$5,475 per acre for residential development, \$12,929 per acre for commercial/industrial development, and \$2,611 per acre for recreational development. Residential, recreational, and commercial/industrial land values each declined last year. A decline in non-agricultural-use values for land tends to soften the demand for farm land in surrounding areas.

The U.S. economic crisis helped to pause the growth of agricultural land values. The softening of agricultural land values appears to have been concentrated on "marginal" tracts such as those with poorer soil characteristics or drainage issues. The value of quality land in good locations continues to have resumed its upward movement in most markets. Agricultural producers wanting to expand their operations and outside investors will likely continue to focus on the quality and location factors continuing to put upward pressure on "good" farm land in prime locations. Overall, Michigan agricultural land values should increase again during 2011.

2011 ANNUAL CROP OUTLOOK

Jim Hilker

CORN

The 2011 annual corn outlook presented here is a baseline. However, there are a multitude of factors that could change the price result of both the 2010-11 and the 2011-12 marketing years dramatically from those presented in Table 1. The corn ending stocks-to-use ratios for both marketing years are so tight, that very small changes in the numbers could cause significant shifts in prices. In fact, that is the one forecast I am most sure of, prices over the next few years will remain extremely volatile. What makes this period different from previous high price years is that I am projecting two extremely tight stocks-to-use ratios in a row. We have not had that before. And, when we are out of the range of our historical data, we really don't "know" what the price "should be." At this point, the market is projecting an 80% chance that December 2011 futures will be between \$3.60 and \$8.60 per bushel.

2010-11

The 2010 planting season started off very well; for the most part, corn was planted early across the Corn Belt, and there was adequate moisture. As we went into July, it appeared we would have record corn yields across the U.S. and, given the planted acres, a record corn crop. However, at that point the spigot turned off and/or slowed down for much of the Corn Belt, especially through the mid-section; and the average yield turned out to be 152.8 bushels per acre, the fourth highest yield ever, but about five to seven bushels below trend, and 10-12 bushels below one-time expectations. Production turned out to be 12,447 million bushels, the third largest U.S. corn crop ever, but again, about 500 million less than a trend yield, and almost a billion bushels below mid-summer expectations.

Michigan ended up with a record yield for the second year in a row at 150 bushels per acre, two bushels higher and a much better quality than last year's record yield. However, Michigan also had a number of dryer areas later in the growing season, and the yield ended up 6 bushels per acre lower than earlier 2010 Michigan yield projections, but still 6-8 bushels per acre above trend. Michigan also set a record for corn production at 315 million bushels, six million more than last year.

On the use side, demand has been strong so far in the 2010-11 marketing year. Use in the first quarter was a record, and total use for the year is projected to be a record as well, at 13,430 million bushels, over 360 million more than last year's record use. Feed use is expected to be 5,200 million bushels, a bit above last year, as we fed a lot of animal units this fall to heavier weights than last fall. While we have a lot of cattle on feed that will come to market over the next few months, I expect placements and marketings to drop off toward the end of the year. The other wild card, the market weights of both cattle and hogs, the price of corn versus the market price for livestock could shift final use for corn 50-100 million bushels in either direction. Usually 50-100 million bushels doesn't mean a lot, but when projected ending stocks are only 745 million bushels, it becomes significant. Hog production is expected to be down just a little as will be discussed in the hog outlook.

Then we have food, seed, and industrial uses. While I expect seed to be up a couple million bushels as I expect more planted acres next year, corn used for food and industrial uses other than ethanol are expected to remain level. We expect 332 million of the 341 million bushel

increase in FSI is ethanol for fuel as shown in Table 1. The 4.9 billion bushels of corn to be used for ethanol is above the amount required to meet the mandate this year. Being ahead of schedule is driven by a profitable environment; however, they are not making excess profits. It's helped that the sugar price is high and Brazil is not exporting ethanol at levels seen in the past; in fact, the U.S. is exporting some ethanol.

In total, the U.S. will use 400 million bushels more domestically in 2010-11 than 2009-10. Exports in 2010-11 are expected to fall just short of a year ago as shown in Table 1. In total, both the world corn crop and all inclusive coarse grain crops were larger than last year, despite the U.S. being down. However, world coarse grain use is up more than world supplies, making world ending stocks only 14% of use. This is down from 18% the last two years, and the tightest world coarse grains stocks-to-use in 30 years.

When you add domestic use and exports you have total use, and yes, 2010-11 will have record use. And, when you take third largest U.S. total corn supplies on record and subtract the largest U.S. corn disappearance on record, what do you have? In this case, you end up with very tight ending stocks despite the huge beginning supplies. Ending stocks are projected to be 745 million bushels, only 5.5% of use. The only other time in my data that ending stocks as a percent of use were that tight was in the 1995-96 marketing year, and most of us remember that year. The projected price of \$5.30 is a weighted annual average price. Remember, a lot of 2010 corn was sold for a lot less than today's prices. But one year of very tight ending stocks does not take us out of the range of our data, it is this year's situation combined with expectations for next year that makes this a unique situation, read on.

2011-12

My projection for the 2011-12 corn marketing year is built around the story of what is a reasonable scenario that will keep the corn market from exploding. I am assuming that if we can build a reasonable story for a 2011-12 ending stocks-to-use ratio of near 7%, it could get the job done, but will leave **no room for error**. To summarize, given a reasonable use level for \$5.00 plus corn, what supply will it take to keep the ending stocks-to-use ratio above the 5.5% level we are projecting for 2010-11, say near 7%, and can we attain it.

As you can see in Table 1 for 2011-12, I am projecting a four million acre increase in corn planted acres. I am also projecting a 161.7 bushel per acre trend yield for a projected 2011 U.S. corn crop of 13,744 million bushels. This is what it would take to give me a projected ending stocks-to-use ratio of 6.9% given the use levels I will describe below, which should keep the annual average corn price in the low \$5.00 range. Both of these are attainable, but neither are sure things, especially the trend yield. Remember, in just the last two years, yield has varied from 164.7 to 152.8 bushels per acre; could we see a yield of 168, yes. And, we could also see a good of yield of 156 which wouldn't be enough without either a great world coarse grain crop or an unexpected drop in world demand, ie, the world economy slumps again.

So, where will we get four million more acres of corn? With difficulty! But once the market realizes the need, the market will provide the relative price needed. But you question, where is the physical land? We already planted 3.7 million more acres of wheat, and later I will show we need just under a million more acres of soybeans. It is never clear where producers come up with the land, but we planted close to this many total acres just five years ago, and we have another 1-2 million acres from CRP land that came out in the past few years, plus the increase in soybean acres could all come from more double cropping. And, we may even see a

few wheat acres shifted to soybeans or a feed grain. At this point, the soybean/corn price ratio is sending conflicting signals and will have to change to get the extra corn acres. Relative old crop prices will bring the extra corn acres, but relative new crop bids point to few corn acres and perhaps to many soybean acres.

I expect feed use to drop off a bit with fewer beef animals available, pork producers still not out of the woods and therefore not expanding, and more DDGS available to U.S. livestock producers. I expect FSI uses other than ethanol for fuel to stay relatively constant. I expect the growth in corn ethanol used for fuel to grow at a slower rate, like 150 million more bushels of corn for several reasons. Brazil will probably come back into the world markets, perhaps temporary blending walls, and if we use much more than that without bigger supplies, the corn price could explode which would limit the growth of corn used for ethanol.

I expect corn exports will remain about the same given a "normal" world coarse grain crop, and we need at least a normal world coarse grain crop. Back to that volatility thing! As shown in Table 1, this story would give us projected ending stocks of 936 million bushels, 6.9% of use, and an average price in the low \$5.00 range, I think. As you can see, there is no room for error! And, I can't see much progress being made with respect to growing ending stocks in 2012-13 without a bigger than expected crop in both 2011 and 2012.

TABLE 1										
SUPPLY/DEMAND BALANCE SHEET FOR CORN										
								Est.	Proj.	Hilker
	2002-	2003-	2004-	2005-	2006-	2007-	2008-	2009-	2010-	2011-
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
(million acres)										
Acres Planted	78.9	78.6	80.9	81.8	78.3	93.5	86.0	86.4	88.2	92.2
Acres Harvested	69.3	70.9	73.6	75.1	70.6	86.5	78.6	79.5	81.4	85.0
Yield/Bushels	129.3	142.2	160.4	148	149.1	150.7	153.9	164.7	152.8	161.7
(million bushels)										
Beginning Stocks	1596	1087	958	2114	1967	1304	1624	1673	1708	745
Production	8967	10089	11807	11114	10531	13038	12092	13092	12447	13744
Imports	14	14	11	9	12	20	14	8	20	12
Total Supply	10578	11190	12776	13237	12510	14362	13729	14774	14175	14501
Use:										
Feed & Residual	5563	5798	6158	6155	5591	5913	5182	5140	5200	5150
Food, Seed & Ind	2340	2537	2686	2981	3490	4387	5025	5939	6280	6440
Ethanol for fuel	996	1168	1323	1603	2119	3049	3709	4568	4900	5050
Total Domestic	7903	8335	8844	9136	9081	10300	10207	11080	11480	11590
Exports	1588	1897	1818	2134	2125	2437	1849	1987	1950	1975
Total Use	9491	10232	10662	11270	11206	12737	12056	13066	13430	13565
Ending Stocks	1087	958	2114	1967	1304	1624	1673	1708	745	936
Ending Stocks, %of Use	11.5	9.4	19.8	17.5	11.6	12.8	13.9	13.1	5.5	6.9
U.S. Loan Rate	\$1.98	\$1.98	\$1.95	\$1.95	\$1.95	\$1.95	\$1.95	\$1.95	\$1.95	\$1.95
U.S. Season Ave Farm Price, \$/Bu.	\$2.32	\$2.42	\$2.06	\$2.00	\$3.04	\$4.20	\$4.06	\$3.55	\$5.30	\$5.05

Source: USDA and Jim Hilker. (1 - 12 - 11)

WHEAT

The 2010-11 U.S. wheat marketing year is eight months in, and while we will briefly discuss the projections, it appears the present projections will hold for the most part. The more interesting part is discussing the 2011-12 prospects. While the wheat story differs significantly from corn in many ways, the volatility in wheat prices will be there.

2010-11

We planted 53.6 million acres of wheat for 2010, down 5.6 million acres from 2009. The decrease largely came from the decrease in winter wheat acres, much of it soft red. The 37.3 million acres of winter wheat planted was lower than any time in any of the data I find useful, so that takes you way back. There were two primary reasons for the low plantings, relatively lower prices and late harvest fall crops. When you take your soybeans off in late November, it is hard to get the wheat planted.

Harvested wheat acres were only down 2.3 million acres as we had great weather conditions over the growing period and the percentage of harvested to planted acres was way above normal. This carried into wheat yields, where the U.S. set a new record of 46.4 bushels per acre, 1.5 bushels per acre above the previous record set in 2008, and 2 bushels per acre above the trend yield. The combination of high harvested acres and a record yield in 2010 almost returned the U.S. to the previous year's production level as can be seen in the first two columns of Table 2.

Michigan planted only 530,000 acres of wheat for 2010, down 100,000 acres from 2009 and 200,000 acres less than 2008. Again, much of that was due to the late harvest of soybeans the fall of 2009. Michigan 2010 wheat yield was 70 bushels per acre, not a record, but a good yield and one bushel higher than in 2008.

However, even though wheat production was down 10 million bushels in 2010, when you bring in basically half of your previous year's needs as beginning stocks, you have large supplies. The total supply for the 2010-11 wheat crop was 3,294 million bushels, up 300 million bushels, 10%, and the largest total supply of wheat in the U.S. since the 1980's.

Domestic use of wheat in the U.S. for 2010-11 is projected to be up 30 million bushels from 2009-10, with food use growing some with the population and feed use up 20 million bushels. Exports are projected to increase dramatically and have to this point in the marketing year. World wheat production dropped 36.8 MMT, 5.4% in 2010-11, with most of that decrease coming from the 32.5 MMT decrease in production in the Former Soviet Union countries. The FSU-12's production dropped from 113.8 MMT to 81.3 MMT, a whopping 28%, with the terrible drought last summer. U.S. wheat exports are projected to be 1,300 million bushels, up 420 million bushels, 47.6%. The increase is due to both the shortfall in the normally exporting FSU-12 and an increase in world use. U.S. wheat export levels will be the highest since 1992.

U.S. ending stocks for 2010-11 are projected to be 818 million bushels, a drop from an overwhelming 48.3% of use to just a huge 33% of use. On top of this, the world stocks-to-use ratio is expected to drop from an okay 30.3% to a relatively tight 25.5%.

2011-12

The Winter Wheat Seedings Report showed 41 million acres of winter wheat were planted for the 2011 U.S. wheat crop, an increase of 3.7 million acres. Assuming spring wheat acres stay the same, which had not been down the previous year, I expect wheat planted acres to be 57.3 million for 2011-12 as shown in Table 2. However, given the condition the wheat went into dormancy in the hard red winter areas, I am projecting a return to a more normal percent harvested, and am projecting harvested acres to be 48.3, not even up a million acres. Michigan planted 710,000 acres, just under the 730,000 planted for the 2008 crop.

Using a trend yield of 44 bushels per acre, expected 2011 U.S. wheat production would be 2,125 million bushels, down about 80 million bushels. When added to a large but smaller beginning stocks, total 2011-12 supplies are expected to be 3,053 million bushels, down about 240 million bushels.

I expect domestic use to be about the same in 2011-12 as 2010-11. Food use may grow some with the population, but wheat for feed will be tempered by relative prices. I expect the world crop to go back to normal, but there is considerable risk here given the FSU-12 countries haven't really gained back the subsoil moisture. They will need timely rains to have a normal yield. Therefore, I have pulled back expected U.S. exports back to a more normal level.

This scenario would leave us with smaller total ending stocks of 751 million bushels. However, due to the smaller total use due to the decreased exports, the projected stocks-to-use ration remains a fairly high 32.5%, barely down from this year.

**TABLE 2
SUPPLY/DEMAND BALANCE SHEET FOR WHEAT**

	2003- 2004	2004- 2005	2005- 2006	2006- 2007	2007- 2008	2008- 2009	Est. 2009- 2010	Proj. 2010- 2011	Hilker 2011- 2012
(Million Acres)									
Acres Planted	62.1	59.7	57.2	57.3	60.5	63.2	59.2	53.6	57.3
Acres Harvested	53.1	50.0	50.1	46.8	51.0	55.7	49.9	47.6	48.3
Bu./Harvested Acre	44.2	43.2	42.0	38.6	40.2	44.9	44.5	46.4	44.0
(Million Bushels)									
Beginning Stocks	491	546	540	571	456	306	657	976	818
Production	2345	2158	2105	1808	2051	2499	2218	2208	2125
Imports	68	71	82	122	113	127	119	110	110
Total Supply	2904	2775	2727	2501	2620	2932	2993	3294	3053
Use:									
Food	907	910	915	938	948	927	917	930	940
Seed	80	78	78	82	88	78	69	76	77
Feed and Residual	212	182	160	117	16	255	150	170	160
Total Domestic	1194	1169	1152	1137	1051	1260	1137	1176	1177
Exports	1159	1066	1003	908	1263	1015	881	1300	1125
Total Use	2353	2235	2155	2045	2314	2275	2018	2476	2302
Ending Stocks	546	540	571	456	306	657	976	818	751
Ending Stocks, %of Use	23.2	24.2	26.5	22.3	13.2	28.9	48.3	33.0	32.6
U.S. Loan Rate	\$2.80	\$2.75	\$2.75	\$2.75	\$2.75	\$2.75	\$2.75	\$2.75	\$2.75
U.S. Season Ave									
U.S. \$/Bu.	\$3.40	\$3.40	\$3.42	\$4.26	\$6.48	\$6.78	\$4.87	\$5.65	\$5.75
Michigan \$/Bu.	\$3.35	\$3.01	\$3.13	\$3.41	\$5.01	\$5.65	\$4.00	\$5.10	\$5.70
Source: USDA and Jim Hilker. (1 - 12 - 2011)									

SOYBEANS

While the world soybean situation is not projected to be as tight as corn, the U.S. situation is expected to be very tight. And, due to South America being in the middle of their growing season, and Argentina's crop being far from a sure thing, the soybean situation is expected to stay volatile as well. The fight for acres this spring will just add to the uncertainty.

2010-11

The U.S. planted about the same number of acres last spring as the record planted acres in 2009. And, a record number of acres were harvested for the 2010 soybean crop. When you combine record harvested acres with 43.5 bushels per acre (about trend yield), down a half bushel from last year's record yield and the second highest yield ever, and you have the second largest U.S. soybean crop. The 2010 soybean production of 3,329 million bushels was just 30 million bushels under the record 2009 soybean crop. Total supplies for 2010-11 came in at 3,490 million bushels, see Table 3.

Projected domestic use for soybeans is expected to be down, entirely due to lower projected crush. U.S. crush was up close to 100 million bushels in 2009-10 due to the poor soybean crops in South America harvested the spring of 2009. Crush is expected to drop a like amount this year as South America harvested a record crop the spring of 2010. Although this year's South American crop may adjust our 2010-11 projected soybean crush.

U.S. 2010-11 exports are expected to grow almost 90 million bushels. The entire increase is due to an increase in world demand for soybeans, South America's export are expected to stay the same to be up a little. Most of that new demand continues to come from China, which takes over half of our soybean exports and close to 60% of the world exports. At this point, Argentina's crop is expected to be down 4 MMT from their record crop of 54.5 MMT last year, and many expect it to be closer to down 6 MMT. Brazil is projected to harvest 67.5 MMT, down 1.5 MMT from their record last year, but still their second highest ever. However, many expect Brazil crop this year to be closer to 70 MMT.

Projected ending stocks are 140 million bushels, a very tight 4.2% of use, even tighter than last year's very tight 4.5%. Again, tight stocks breed volatility. There is a difference from corn. World stocks are not expected to be overly tight, unless of course the South American crop deteriorates, and it is not made yet. World stocks-to-use were 20% in 2008-09 after the poor South American crop, 25% of use after South America's record 2009-10 crop, and are projected to be 22.7% for 2010-11. Prices are up accordingly, tighter stocks, tight stocks projected again for next year, and worries that things can get worse.

2011-12

My projections for 2011-12 are in the same vain as corn, what is a reasonable scenario that will keep the soybean prices from exploding, i.e., stocks not getting any tighter, especially given the tight land availability. Again, there will be no room for error.

We will need about .5-1 million more planted acres; I am projecting an increase of 600,000 acres. This will give us 78 million planted acres with an expected 77 million harvested acres. Much or all of these added acres could come from double cropping, especially with the increase in soft red wheat planted. When combined with a trend yield of 43.8 bushels per acre,

this will put 2011-12 soybean production at a record 3,370 million bushels, see Table 3. Total supply will only be 140 million bushels higher given the very small beginning stocks.

Given near normal South American crops, I expect 2011-12 crush to remain about the same. I expect exports to grow about 25 million bushels. I expect world demand to grow at a faster rate than that, but I expect South America to pick up more of the increase. These projections would put total use at 3,373 million bushels. This would keep ending stocks at a tight 150 million bushels, only 4.4%, and keep soybean prices in the same range as this year. But, no room for error, which means continued high volatility.

TABLE 3										
SUPPLY/DEMAND BALANCE SHEET FOR SOYBEANS										
								Est.	Proj.	Hilker
	2002-	2003-	2004-	2005-	2006-	2007-	2008-	2009-	2010-	2011-
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
(Million Acres)										
Acres Planted	74	73.4	75.2	72	75.5	64.7	75.7	77.5	77.4	78.0
Acres Harvested	72.5	72.3	74.0	71.3	74.6	64.1	74.7	76.4	76.6	77.0
Yield/Bushels	38.0	33.9	42.2	43.0	42.9	41.7	39.7	44.0	43.5	43.8
(Million Bushels)										
Beginning Stocks	208	178	112	256	449	574	205	138	151	140
Production	2756	2454	3124	3063	3197	2677	2967	3359	3329	3373
Imports	5	6	6	3	9	10	13	15	10	10
Total Supply	2969	2638	3242	3322	3656	3261	3185	3512	3490	3523
Use:										
Crushings	1615	1530	1696	1739	1808	1803	1662	1752	1655	1650
Exports	1045	885	1097	940	1116	1159	1279	1501	1590	1615
Seed	89	92	88	93	80	93	90	90	88	88
Residual	41	19	105	101	77	0	16	18	22	20
Total Use	2791	2526	2986	2873	3081	3056	3047	3361	3355	3373
Ending Stocks	178	112	256	449	574	205	138	151	140	150
Ending Stocks, %of Use	6.4	4.4	8.6	15.6	18.6	6.7	4.5	4.5	4.2	4.4
U.S. Loan Rate	\$5.00	\$5.00	\$5.00	\$5.00	\$5.00	\$5.00	\$5.00	\$5.00	\$5.00	\$5.00
U.S. Season Ave Farm Price, \$/Bu.	\$5.53	\$7.34	\$5.74	\$5.66	\$6.43	\$10.10	\$9.97	\$9.59	\$11.70	\$11.20

Source: USDA and Jim Hilker. (1 - 12 - 11)

2011 ANNUAL LIVESTOCK OUTLOOK

Jim Hilker

CATTLE

Feedlots had a mixed 2010, finally ending the 33 consecutive months of feedlot losses in February. However, after five profitable months, they returned to monthly losses for the remainder of the year, albeit not as bad as 2008 and 2009. January 2011 appears to have been breakeven. These numbers are calculated assuming the feed is bought monthly; those who bought feed early did okay on their January 2011 sales. Cow calf returns were positive in 2010, after being negative in 2008 and 2009.

The January 1, 2011, Cattle Inventory Report reported the U.S. had 92.6 million head of cattle and calves as of January 1, 1.4% below a year ago, and the smallest since the late 1950's. USDA estimated the total U.S. cowherd at 40.0 million head, 1.1% smaller than a year ago, with the beef cowherd at 30.86 million head, 1.4% smaller than a year ago, and the dairy cowherd at 9.1 million head was up 0.7%.

Beef cow replacements on January 1, 2011, were 5.16 million, down a huge 5.4%. For several reasons, I expect the beef cow herd to be down a bit next year as well, despite expected 2011 positive profits for cow calf producers. One is the above, at the present time cow calf producers are not holding back replacements. Another is, it would take about a 14% cut in cow slaughter and a 2% increase in beef heifer replacements to turn it around. And then we still have the extremely hard decision, I can sell my heifer calves for \$140 per cwt. or keep them for expected profits two years down the road from their calf sales.

USDA reported the 2010 calf crop at 35.7 million head, 0.7 percent smaller than 2008's, the smallest calf crop since 1950. As of January 1st, the calculated available supply of feeder cattle outside feedlots was 26.68 million head, down 860,000 head (3.1%) from last year. At first these numbers don't seem to add up, until you realize that cattle on feed January 1 were 14.0 million head, up 2.8% relative to last January 1.

All cattle and calves in Michigan on January 1 were at 1,090,000 head, down 1% from the previous year. All cows that had calved were at 460,000 head, up 2%. Beef cows were up 3%, at 99,000, after being up 4% last year. Dairy cows numbers were put at 361,000, up 2%. Beef cow replacements were even at 27,000, while dairy cow replacements were down 6.3% at 148,000 head. Michigan's 2010 calf crop was 385,000, up 1% from the previous year. The survey does not distinguish between beef and dairy calves. Michigan had 170,000 cattle on feed January 1, even with last year.

The following estimates are made in conjunction with the Livestock Marketing Information Center, which I belong to; it is a group supported by Universities to provide efficiencies, i.e., less duplication of work by folks such as myself. U.S. beef production is expected to be down 1.4% for 2011, as slaughter is expected to be down 2.6% with dressed weights being up 1.2%. Steer prices are expected to average in the \$103-107 per cwt. range for all of 2011, after averaging \$95.38 for 2010. With 700-800# feeder steers averaging \$121-127, up from \$110.89, and 500-600# feeder calves averaging \$134-142 per cwt., versus \$122.84 in 2010.

In the first quarter of 2011, beef production is expected to be up 1.9%, remember the high cattle on feed number above. Steer prices are expected to average \$104-106, with feeder steers averaging \$122-125, and feeder calves averaging \$136-139. In the second quarter, production is expected to be even, with steer prices averaging \$104-108, feeder steers averaging \$122-127, and feeder calves averaging \$137-143.

In the third quarter, production is expected to be down 1.8%, with steer prices averaging \$99-104, feeder steers averaging \$124-130, and feeder calves averaging \$137-144. In the fourth quarter, production is expected to be down 5.7%, with steer prices averaging \$104-110, feeder steers averaging \$118-125, and feeder calves averaging \$130-140. Remember the low feeder cattle supplies discussed above.

The above forecast indicate a profitable year for cow calf producers, given they have adequate grass and reasonable hay prices. However, it is hard to see positive feedlot returns given the steer, feeder, and feed prices we expect to see.

HOGS

Farrow-to-finish hog operations had a mixed year in 2010 with regard to profits, after taking a beating in 2009 and 2008. The losses continued into the first two months of the year, and then we had seven profitable months before dropping back into the loss column as feed prices jumped. And, I expect the same kind of profit picture this year, mixed. Pork production was down 0.5% and per capita consumption was down 2.1 pounds in 2010 versus 2009.

All hogs and pigs on December 1 were 99% of last year. The breeding herd was down 1.0% and is now the smallest breeding herd since the 1800s. Hogs kept for marketing, were down 1%. The number of market hogs weighing 180 pounds or more on December 1 was even compared to 12 months earlier. The 120-179 pound group was down 1.0%; the 50-179 pound inventory was down 2.0%; and the inventory of pigs weighing less than 50 pounds was down 1.0% compared to a year earlier.

The fall September-November farrowings, this spring's production, were down 2%, but the fall pig crop was even as pigs per litter were up 2.0%. The continued climb in pigs saved per litter is remarkable. December-February winter farrowing intentions, next summer's production, were down 1.0% and March-May farrowing intentions, next fall's production, were 2.0%. If we continue to climb in pigs saved per litter, we may not see as much of a cutback in production.

The Michigan breeding herd stayed even at 110,000 head, relative to December 1, 2009. Our hogs kept for market were down 4%, putting our total numbers down 4%. Pigs saved per litter for Michigan were up to 9.82 from 9.69.

Pork production is expected to be down 1.3% in 2011, as slaughter is expected to be down 1.1%, with weights being down a bit in the last three quarters. Carcass prices (multiply by .72 to have live price projections) are expected to average in the \$76-81 per cwt. range for all of 2011, up 9.0% relative to 2010. This price assumes the USDA's projected increase in exports occurs and demand levels off to strengthen a bit.

In the first quarter of 2011, pork production is expected to be down 0.7%, with carcass prices averaging \$74.-78, up 15.3%. In the second quarter, production is expected to be down 1.4%, with carcass prices averaging \$80-85 per cwt., up 7.1%. In the third quarter, production

is expected to be down 0.8%, with carcass prices averaging \$79-84, up 4.2%. In the fourth quarter, production is expected to be down 2.0%, with carcass prices averaging \$70-76, up 8.5%. Maybe we will see some profits in the third quarter.

Per capita consumption in 2011 is expected to drop another 4.2% with the above production slowdown, and is an important factor in the higher prices shown above. Cutbacks in beef production also factors in. While these higher prices will help, they will not completely offset the relatively high feed prices, and I expect the breeding herd to continue to shrink into 2012. However, continued efficiency gains, and an eventual return to breakeven returns are expected to keep 2012 production only marginally lower than 2011 and that means a continuation in the drop in per capita consumption.

2011 DAIRY OUTLOOK

Christopher Wolf

Several factors hung over the U.S. milk market as 2010 ended: one billion pounds of cheese, booming exports, and expensive feed grain. The former reflects a large inventory of cheese that accumulated over the past couple of years with the total stocks exceeding one billion pounds today. In recent years, the average value of total natural cheese stocks has been about 800 million pounds, so the current value is about 25% above the average for recent years. Despite these relatively large cheese stocks, the milk price has rallied in early 2011 with the futures market posting many months around \$17.00 per cwt. These prices are a great improvement over 2010 levels (although matched by an increase in feed grain prices). The U.S. dairy product price rally is largely driven by international dairy product prices.

Following decades of using export markets only to dump surplus products, U.S. dairy exports have become increasingly important in recent years. The growth in U.S. dairy exports began in earnest in 2004 (Figure 1). For many years, the total amount of dairy product exported was less than 5% of production on a total solids basis. In 2004, about 7.5% of total dairy solids were exported at a total value of \$1.36 billion. Growth was fairly steady for 2005 through the middle of 2008, with 11% of total dairy solids exported in 2008. The total value of U.S. dairy exports in 2008 (and again in 2010) was about \$3.5 billion.

The global economic crisis that began in the fall of 2008 shrank the demand for dairy products world-wide. Demand for U.S. exports fell off sharply. The result was that both the quantity and price of exports collapsed (Figure 1). World prices for dairy products dropped by 50% or more between late summer and the end of 2008. International dairy product prices have since recovered and with them U.S. dairy exports.

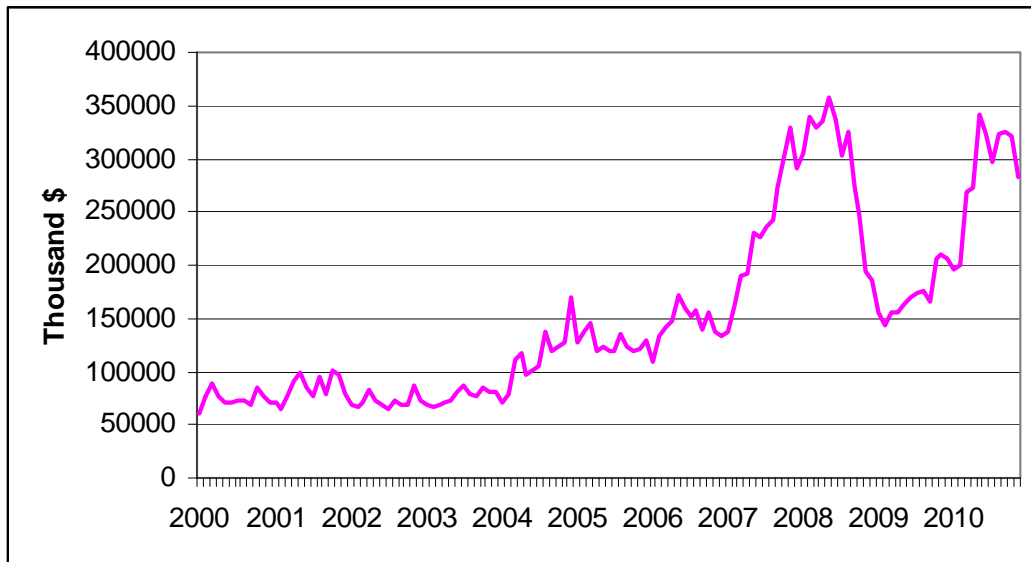


Figure 1. Value of US Dairy Exports, Monthly 2000-2010

As the U.S. dairy industry has increased its export share, the correlation between domestic and international product prices has also increased. Figure 2 illustrates the international and domestic cheese prices from 2002 through 2010. The international price is f.o.b. Oceania which has historically been the dairy surplus area that importing countries could rely on. The figure illustrates the increasing correlation between domestic and international prices as the value of U.S. exports increases. International prices are largely responsible for the recent increase in domestic dairy product prices.

Export markets, then can be a boom to domestic dairy producers in times of growing demand. However, they can also be a source of volatility. If the U.S. is to be a significant player in world dairy markets, there are several dairy issues that must be addressed. This includes producing product that meets international standards (e.g., the U.S. generally produces 80% fat, salted butter while international markets prefer 82% fat, unsalted butter). It also means being a reliable source of product rather than a place to dump surpluses. The direction of the next farm bill is likely to influence whether the U.S. moves more boldly into international markets or back towards protectionism.

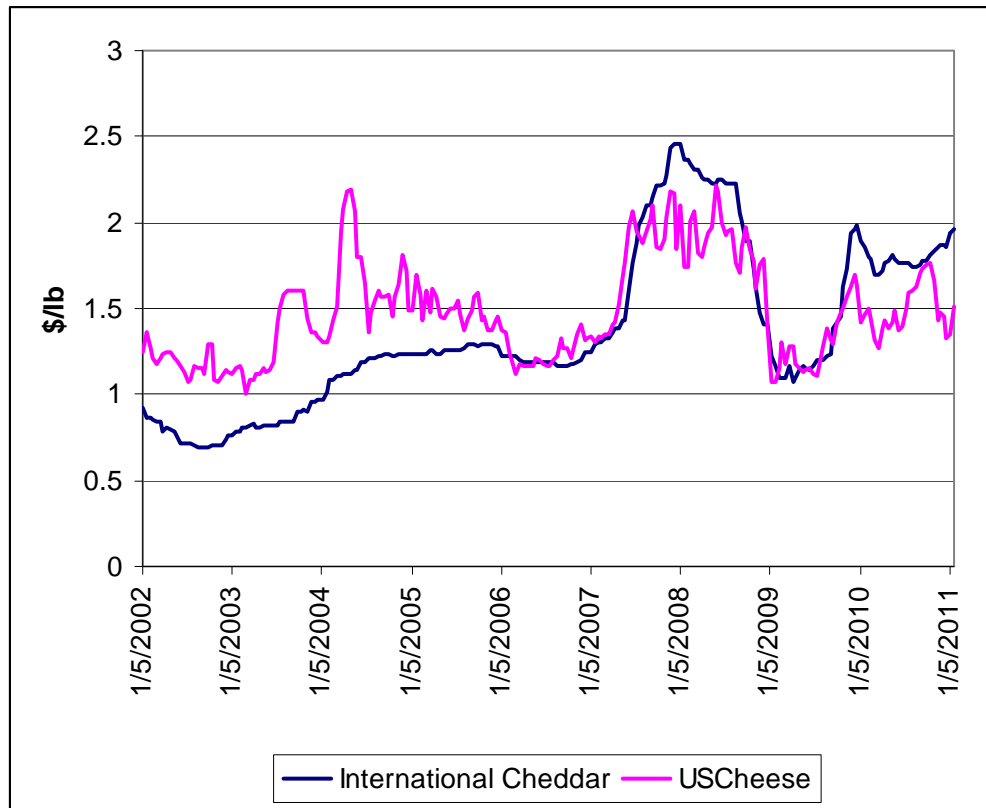


Figure 2.

The dire financial consequences of low farm milk prices and high feed prices on dairy farms of the past four years has jump-started a dairy policy debate that might be part of the next farm bill. The major issues from a dairy farm perspective are price volatility and frequent negative profit margin. The price volatility that has occurred in recent years in both farm milk

and feed price is unprecedented. Unpredictable, large changes in milk price make it difficult for both producers and processors of milk to make appropriate managerial decisions.

While the current set of dairy policies may not have been directly responsible for causing milk and feed price volatility the fact of the matter is that these policies did little to prevent or offset the extended periods of very low prices in recent years. The inelastic supply and demand associated with milk and dairy products means that small changes in quantity (either supplied or demanded) can have large impacts on milk price.

There are three major types of proposals widely discussed—or even introduced as formal legislation at this point in time. The current proposals can be broadly categorized as: 1) managing milk supply through fees and rebates; 2) risk management programs to support the margin between milk and feed prices rather than the current price support programs; and 3) reform to marketing order price discovery mechanisms. These options will continue to be discussed and debated in 2011.

TAXES IN 2010 AND 2011

Larry Borton

A good crop year for many farmers often means sales of stored crops the following year. This pent-up income can be used to replace equipment and the best year from a tax standpoint to replace machinery is during years when income is in a higher tax bracket. Machinery purchases cost a taxpayer less if the government is taking one-third to one-half of each dollar of profit so each dollar of tax deductible expenses is less net money out of the checkbook. 2010 has been a good crop year for both yield and price for some farmers, so they may want to consider machinery replacement in 2011, especially if it has been delayed during years with lower income. We have outstanding options for immediate depreciation. On the other hand, instead of reducing taxable income, maybe it's time to push income through the tax system.

Taxable income can be increased by paying off debt. Paying down principal does not reduce taxes just like taking money out of the business does not reduce taxes. But do we expect income tax rates to go up or down in the future? In 2008, the bottom half of taxpayers by income paid only 3% of individual, federal income taxes, while the top half paid 97% of the collected taxes. Taxpayers with more than \$33,000 of income are in the top half. Will the federal government reduce deficits by decreasing spending or increasing taxes? Congress has kept rates nearly the same for 2010 to 2012 so we don't expect increased taxes during the next two years. These may be good years to get income through the tax system rather than just defer it to future years if rates go up after 2012.

Changes in 2010 federal income taxes occurred primarily in laws passed in March, September, and December. Let's review some of them. The 50% bonus or special depreciation is available for qualified items purchased through September 8, 2010. Items purchased after that date have 100% bonus. This bonus is required to be taken unless an election by class life (3, 5, 7, 10, 15, or 20 years) is made to not use it. The 100% continues in 2011. If taken, then all property placed into service for a class must take 50% through September 8, and must take 100% after September 8. There is no option to choose one or the other. This applies to virtually all original use farm property which has a life of 20 years or less. This is not available to fruit and vine producers who have elected out of the uniform capitalization rules and are required to use the Alternate Depreciation System (straight line, longer life). A farmer who elects to use ADS as an option may still use bonus depreciation.

Even without bonus depreciation, the section 179 direct expensing is \$500,000 of qualified property placed into service in each of 2010 or 2011. Phase-out begins at \$2,000,000 and this differs from bonus in that used, qualified property is eligible. It doesn't have to be original use and any amount of the boot or cash spent on the purchase may be elected from \$1 up to the maximum.

Filling out 1099s is an issue. In effect now in 2011 for rental property, anytime \$600 or more is spent on goods and/or services for the rental this year, a 1099 must be given next year. This requires obtaining the social security number or federal employer identification number from the recipient. If not received, then backup withholding by the rental property owner of 28% is required. Penalties for not filing the 1099 keep increasing also. My farmer neighbor, who cash rents land from me, already correctly gives me a 1099, but now I may also have to give out 1099s for my rental property when I make purchases of goods and services on it of over \$600 in a calendar year. For 2012 the current law goes far beyond rental property and will require a 1099 for anyone that a business pays \$600 or more in goods and services. There is significant

resistance to this and may result in a change in the law prior to implementation. There has been no indication that the rental property 1099 law might change.

A new Credit for Small Employer Health Care Premiums (Form 8941) began in 2010. Up to 35% credit of the premiums paid for employees' health care is available to employers with up to 10 full-time equivalent employees (FTE) whose average wages are not over \$25,000. Phase-out of the credit begins at those levels and is complete when FTEs reach 25 or wages reach \$50,000 and various combinations of the two. Employers must pay at least 50% of the cost using a qualified health care plan and most owners, shareholders or relatives are excluded from eligibility. The credit is a general business credit and labor health care expenses must be reduced by the amount of the credit. This makes the 35% credit essentially become about 23% for a taxpayer in the 33% marginal tax bracket, or 18% if approaching the 50% marginal tax bracket. For an employer with three employees paying \$2,500 each for half the cost of their health insurance, the credit might be 35% times \$7,500 or \$2,625. Then the expense deduction on Schedule F must be decreased by the amount of the credit and decreases the \$7,500 expense by \$2,625 to \$4,875.

Many items were extended for two years in the law passed in December 2010 including higher exemptions for the Alternative Minimum Tax (AMT) for both 2010 and 2011. Even with the higher exemptions similar to past years, this tax must be calculated before filing because it is a completely separate method for calculating the federal tax due. Software usually checks this for you. Other items extended include the American Opportunity Credit for college students, higher Earned Income Credits for lower income families with three children, the 10% tax bracket, the 0% and 15% long term capital gains rates, and the child tax credit stays at \$1,000 per child under age 17 instead of decreasing to \$500.

An important but temporary provision raises the estate tax exemption to \$5 million per person or \$10 million per couple with increased (or decreased) basis to fair market value or cost basis, whichever is lower. The top tax rate is 35% for estate, gift or generation skipping transfer taxes. It also allows the option for 2010 of choosing the new provision or using the prior law of no estate tax but limits on increasing basis.

An additional change reduces the amount of social security tax withheld from employees by 2.0% for 2011 only. While this doesn't reduce the amount paid by the employer, it puts more money in the pocket of workers. For those who pay self-employment (SE) tax it does reduce the cost by 2.0% for the 2011 calendar year. This reduction in taxes may be larger than the \$400 for single taxpayers (\$800 married) Making Work Pay credit which expired in 2010.

The 2010 Michigan income tax rate was 4.35% and this may change in the future. We currently have a Michigan Business Tax which production agriculture does not pay, but processing and non-production agriculture activities may have to pay. Michigan income tax laws currently follow the federal tax laws fairly closely which makes calculation of tax less problematic than some other states. Other states often don't keep up with the federal tax law changes because Congress passes them too late for states to react or plan.

Many farmers also were affected by requirements to electronically deposit withheld payroll taxes beginning in 2011. We can expect more of these types of requirements by the IRS. Further, the credit reduction of 0.6% of the Federal Unemployment taxes was a surprise for many employers when filling out Form 943 this year. This can be an extra \$42 per person when the form is filed.

Tax preparers also have changing rules to follow. Generally, anyone who receives pay for filling out tax forms or signing the returns for others may have to be registered with the IRS. While most CPAs, Enrolled Agents, and tax preparers already attend continuing education classes to keep up with the changing tax laws, they will now all be subject to IRS policies. CPAs and Enrolled Agents have done this for years so there is no real change for them. However, the IRS is becoming increasingly vigilant in penalizing both preparers and taxpayers that take aggressive positions without substantial authority for their actions on returns.

The IRS has many new revenue agents in Michigan and they may not have much experience with production agriculture. Expect more audits by letter from the IRS because it is more efficient for them. Open the letter and then talk to your tax preparer promptly. If audited in person be sure to have your tax preparer represent you and let them do the talking.

FARM INCOME

David Schweikhardt

As producers plan for the 2011 crop year, much of the uncertainty about the farm income outlook will be determined by factors outside the agricultural sector in both the national and international economy. The continuation of the credit crisis that began in 2007, slow economic growth in the U.S. and other developed countries, and instability in oil prices are likely to have a significant impact on the farm income picture in 2011. At the same time, variations in income outlook across agricultural sectors (e.g., livestock versus crop sectors) are likely to continue in 2011.

For calendar year 2010, net farm income in the U.S. is estimated to have been \$77.1 billion, compared to \$62.2 billion in 2009, and the record level of \$86.6 billion in 2008. The 2010 level of farm income was well above the 10-year average figure of \$64.8 billion. The increase in net farm income was due to an increase in the value of livestock production sold (increased \$17.5 billion over 2009), a decrease in the cost of fertilizer and lime (decreased \$2.3 billion), and a decrease in interest expenses (decreased \$1.3 billion). While net farm income appears to be headed toward a similar level as 2010, two factors are notable in this outlook. First, considerable uncertainty about energy costs and interest expenses will continue in 2011. Second, aggregate farm income numbers will continue to obscure the widely divergent conditions that prevailed across the farm sector in 2008 to 2010. The performance of individual industries (i.e., crop versus livestock/dairy) is likely to be variable in 2011, as each industry continues to face its unique supply/demand outlook and production cost scenario.

The value of production of food crops (\$13.2 billion in 2010) and feed grains (\$48 billion) both saw a decline of approximately \$1-2 billion during 2010, while the value of oilseed crops (\$32.3 billion) had a \$400 million increase in the value of production in 2010. Fruit production (\$18.5 billion) and vegetable production (\$21.4 billion) were relatively constant in 2010. The value of livestock production increased from \$119.2 billion in 2009 to \$136.7 billion in 2010. This increase was led by \$8.6 billion increase in the value of meet animals sold, an increase of \$6.3 billion in dairy products sold, and a \$2.7 billion increase in poultry and eggs sold.

During the past two years, the differing income outlook for the crop and livestock sectors was determined by the impact of high feed grain and oilseed prices. Crop producers benefited from high commodity prices, driven in part by the high price of oil and its impact on ethanol production, while livestock producers were confronted by these same high prices as a significant increase in the cost of livestock or dairy production. For example, livestock and dairy producers paid \$43 billion for purchased feed in 2010, compared to \$45 billion in 2009 and the record of \$46.9 billion in 2008. This figure remains well above the 10-year average of \$32.5 billion spent on feed expenses (an average that would be even lower if the 2008 to 2010 period is excluded from calculation). As producers enter 2011, a potential reversal of this decline in feed costs appears to be a serious possibility. Oil prices and commodity prices rose during the fourth quarter of 2010, once again setting the stage for a potential increase in feed costs during 2011. Should this increase occur, the income prospects of crop and livestock producers are likely to diverge once again.

On the input cost side, the cost of fertilizer and lime decreased by \$2.3 billion to a level of \$17.8 billion in 2010, resulting from a continuing decrease in the price of natural gas. In particular, the Department of Energy projects that the Henry Hub Spot Price (a commonly quoted central location price) will remain below \$5 per thousand cubic foot until the end of 2012.

This compares to a price of nearly \$13 per cubic foot at its peak in 2008. This price outlook is the result of a significant increase in production and a steady to decreased outlook for the use of natural gas. This price outlook would be similar to the natural gas prices that have prevailed since mid-2009. Thus, the outlook for fertilizer prices is likely to remain steady in 2011.

Producers purchased \$15.5 billion in fuels during 2010, compared to \$12.7 billion in 2009 and a record fuel expense of \$16.2 billion in 2008. The U.S. Department of Energy is projecting that crude oil prices will range from \$89 to \$93 during the entire year of 2011, compared to an average of \$74 to \$81 during 2010. This oil price would translate into diesel fuel prices that average \$3.36 to \$3.45 per gallon (retail price, including taxes) during 2011, compared to the average prices of \$2.83 to \$3.15 during 2010. As noted earlier, an increase in oil prices in the fourth quarter of 2010 suggests that this outlook for higher fuel prices in 2011 is likely to occur. As noted below, such projections are also likely to be especially uncertain given world events outside the agricultural sector.

The longer-term upward trend in seed prices will also affect the farm income outlook for 2011. In 2010, farmers paid \$14.9 billion for seed. This compared to \$15.5 billion in 2009, but was well above the 10-year trend for annual seed expenditures of \$10.8 billion. Given the increasing use of “stacked” genetic traits in most seed products, and the increased cost of such products, it could be argued that seed now contains more of the “productive factors” that affect the use of other inputs and the level of final output. Viewed in this manner, it is likely that seed producers will retain pricing strategies that attempt to claim a larger share of the value of agricultural output. Thus, continuing increases, or at best, minor decreases in seed prices are likely to occur in 2011.

The final factor in farm income outlook for 2011 is likely to be land rental rates and interest expenses on land and on operating loans. In 2010, farmers paid \$10.2 billion in land rents to non-operator landlords, \$400 million more than in 2009. This increase is not unexpected, given the increases in commodity prices and crop income during the 2007 to 2009 period. Given the recovery of commodity prices in the fourth quarter of 2010, land rent prices are unlikely to decrease in 2011. Whether such land rents can be sustained in the future will depend on the longer-term trend in farm income and on macroeconomic policies that determine the direction of interest rates.

Farmers paid \$13.9 billion in interest expenses in 2010, a decrease of \$1.3 billion from 2009. Most analysts believe that the Federal Reserve will continue to hold the federal funds rate at 0.25 to 0.0 percent for much of 2011 in an effort to support the continuing weak economic recovery. Consequently, Federal Reserve policy is unlikely to result in higher interest rates for 2011. At the same time, borrowers are likely to face increased demands for information, higher demands for collateral, or increased expectations for liquidity for the 2011 crop season. Though some credit markets are showing some signs of improvement over the past two years, recovery of these markets is likely to be much slower than is commonly expected at this time. Because all credit markets are interconnected (investors rarely care about the industry that is using the credit, only on the ability of the borrower to repay) the “agricultural credit market” is not a market that stands apart from other credit markets. If borrowers in most other credit markets face higher underwriting standards for loans, agricultural borrowers should not expect to escape those standards.

Finally, the farm income outlook is particularly susceptible to events outside the agricultural sector in 2011. First, uncertainty about the strength and timing of a recovery in the

worldwide economy is likely to affect commodity prices throughout the year. Signs that the recovery is gaining or losing speed, and which countries are experiencing faster recoveries, are likely to affect international demand for commodities. Second, political events could become especially uncertain in the current environment. Recent events in the Middle East demonstrate how rapidly presumed political stability can come undone. The economic spillovers of such events into actual and rumored disruptions of trade (oil) are likely to be felt until a clearer picture of the political outcome is known. Finally, continuing issues with credit and financial institutions – such as the conditions of domestic and foreign banks – are likely to continue to affect credit markets and exchange markets throughout 2011.