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Staff Paper

2009 ANNUAL AGRICULTURAL OUTLOOK

Coordinated by
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2009 Annual Agricultural Outlook

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THE GENERAL ECONOMY

Les Manderscheid and Bob Myers

The U.S. economy is in a severe recession, the likes of which has not been seen for some time. Output of goods and services fell during the third quarter of 2008 and all indications are for further falls during at least the first half of 2009. Non-farm payroll employment also fell dramatically during the final four months of 2008, and has continued its decline in 2009. The unemployment rate has increased from 4.9% in December 2007 to 7.2% in December 2008. Sales of cars and light trucks dropped from 16.1 million units in 2007 to 13.3 in 2008 with much of the downturn in the fourth quarter when sales were off by more than 30% compared to a year earlier. Michigan was particularly hard hit by the auto industry decline and has an unemployment rate of 10.6%, much higher than for the U.S. as a whole.

The importance of the auto industry to Michigan is highlighted by a calculation done by George Fulton and Associates at the University of Michigan. In their base forecast through 2010, there is a loss of 132,000 non-farm jobs in Michigan. They then asked what would happen if auto and light truck sales were higher than in the base forecast, and in fact, rose to 16 million units in 2009 and 2010 (sales in 2007 were 16.1 million), and if the Detroit Three's share was 50%, similar to their share in 2007. The result is an increase of 133,000 non-farm jobs over the base forecast. In other words, non-farm employment in Michigan would be steady rather than declining.

The consensus is that the root cause of the current crisis is the collapse of the real estate market, which has had a domino effect on the value of loan portfolios held by financial institutions. Many mortgages approved during the boom in house prices were of low quality, and are now leading to foreclosures as house values drop below loan balances and borrowers can no longer afford to make payments. "Securitizing" these mortgages in large packages and selling them off created serious risks for the purchasing financial institutions—risks that were clearly not understood or appreciated at the time. With the balance sheets of financial institutions decimated, they stopped making new loans and credit markets "froze." As banks and financial firms were forced into mergers or bankruptcy, credit became either unavailable or carried an increasingly high interest rate to compensate for the unknown risk. The Government tried stimulus packages and bank bailouts to "unfreeze" the markets, but continuing uncertainty has left credit markets tight causing difficulties for potential borrowers.

What then is the outlook for 2009? There are some positives. Inventories have been reduced. Inflation has slowed. Oil prices are far below the levels of last spring. The Government appears to be willing to try stimulus and regulatory policies to find an approach that will restore confidence and trust in the economy. But serious headwinds remain. Major issues include the continuing reluctance of banks to make new loans, coupled with a negative spiral in consumer and business confidence which is reducing incentives to borrow and invest. Furthermore, the glut of foreclosed houses coming onto the market continues to curtail the incentive for new construction. There are also major concerns being expressed about the long-run consequences of the huge amounts of government borrowing that is underway to fund policy responses to the crisis.

When will the recession end? Optimists expect a turnaround about mid year. They believe that Government policies will restore trust and confidence enough to "unfreeze" the credit markets and get credit flowing again. In turn, this should encourage

consumers and businesses to buy and invest so the economy will pick up steam. But other forecasters are expecting the recession to continue all year with hope for a turnaround delayed until 2010. A few pessimists believe that we have crossed a threshold into desperation and that it will take a decade before the recession (depression) ends. They point to the U.S. experience of the 1930's and the more recent decade long recession in Japan. We view this doomsday scenario as unlikely. The U.S. economy is resilient, has been through recessions before, and will go through recessions again.

The important issue now is making the right policy choices to end this recession and restore confidence as soon as possible, without creating future inflation and structural government deficits that we have to deal with further down the road. Clearly, we are in for a rough ride ahead.

POLICY OUTLOOK

David Schweikhardt, Sandra Batie and Roger Betz

The passage of the Food, Conservation and Energy Act of 2008 (FCE) marked the end of one of the longest Farm Bill debates in history. When the debate on the FCE began in 2007, the proposals for a new Farm Bill ranged from a simple extension of the existing programs to a major overhaul of commodity and conservation programs. The final version of the FCE included both the existing programs and a set of new programs. Consequently, farmers will need to be prepared to choose between the existing programs and some new program alternatives in 2009. As the economic outlook for 2009 continues to evolve, it will be particularly important for farmers to understand their program alternatives in the coming year.

Commodity Programs

The final version of the FCE provides program crop producers with a new alternative that will become available for the 2009 crop year. Under the Direct and Countercyclical Payment (DCP) program provided by the 2002 Farm Bill and continued in the FCE, eligible producers receive a direct payment of a fixed amount that is received regardless of the prevailing market price and a countercyclical payment if the market price falls below the effective target price (the Target Price minus the Direct Payment). Producers are also eligible for marketing loans under the DCP program. The FCE continues the existing Target Price for corn (\$2.63 per bushel) for the entire life of the Farm Bill (2009-2012 crop years). The Target Price for soybeans will continue at \$5.80 for the 2009 crop year and then increase to \$6.00 by 2012. The Target Price for wheat will continue at \$3.92 for 2009 and will increase to \$4.17 by 2012. Direct payments for corn (28 cents per bushel), wheat (52 cents), and soybeans (44 cents) will remain at the existing levels established by the 2002 Farm Bill. The maximum loan rates for corn (\$1.95 per bushel) and soybeans (\$5.00) will remain unchanged for the life of the FCE. The loan rate for wheat will be \$2.75 for 2009 and increase to \$2.94 by 2012.

The most important change in commodity programs under the FCE is the introduction of the Average Crop Revenue Election (ACRE) program. The ACRE program is a voluntary alternative that program crop producers are permitted to choose as an alternative to the DCP program during the life of the FCE. The basic rules for the ACRE program include:

- The ACRE program is voluntary – program participants who do not enroll in ACRE will continue to receive DCP payments.
- The decision to enroll in ACRE may be made in any crop year during the life of the FCE (2009-12).
- The decision to enroll in ACRE is irreversible for the life of the FCE.
- A producer who enrolls in ACRE must forego 20 percent of his Direct Payment, 30 percent of the Loan Rate, and 100 percent of his Countercyclical Payment.

In exchange for the foregone Direct and Countercyclical Payments, producers who enroll in ACRE would be eligible to receive an ACRE Revenue Protection Payment if (a) the farm's actual revenue per acre falls below the ACRE benchmark revenue for the farm and (b) the state's actual revenue per acre falls below the ACRE benchmark for the state. If both of these revenue "triggers" are met, then the producer would be eligible to

receive the ACRE Revenue Payment--equal to the difference between the benchmark revenue and the actual revenue adjusted to the individual farms' actual yield history.

At first sight, producers might decide that the choice of existing DCP payments is better than a decision to enroll in the ACRE and forego 20% of the DCP payments. Producers should be aware, however, that some details of the ACRE program could favor enrollment in ACRE, given the current economic outlook. For example, the ACRE program specifies that the benchmark revenue at both the farm and the state level will be calculated using the national average market price for the two most recent years. Thus, the benchmark revenue estimates for the 2009 crop year will be based on the unusually high prices of 2007 and 2008. The use of these high prices could increase the benchmark revenue estimates significantly. Such an increase would provide some price protection for producers above the existing Target Prices for corn, wheat, and soybeans. Such an outcome would favor the decision to enroll in ACRE because ACRE would provide more protection against downside price risk. Second, the ACRE program does provide some downside yield risk protection, while the DCP program provides no such yield protection. It must be noted, however, that the producer's relevant choice is between the ACRE program and the DCP program. ACRE is not intended to act as a substitute for any form of crop insurance.

Thus, a producer's decision whether to enroll in ACRE must compare the loss of 20% of the Direct Payment and the entire low potential Countercyclical Payment (i.e., corn price below \$2.35) with the possible gain of an ACRE Payment when revenue falls below 90% of the two-year State average revenue. When this situation occurs, producers would receive greater protection from the ACRE program than the DCP program. Moreover, given prices that prevailed in the 2007 and 2008 crop years, the 2009 and 2010 crop could be particularly advantageous for enrollment in ACRE.

Because many details of the ACRE program have not been announced, producers should be particularly attentive to the announcement of final program provisions and the sign-up period for ACRE in 2009. Producers need to gain an understanding of the basics of how the program works and how it could benefit their operation. Most producers will probably want to enroll in ACRE, given the level of risk protection provided. However, additional production records and reporting requirements are needed under ACRE. There is also a new Supplemental Revenue Assistance Program (SURE) which is designed to help protect crop losses resulting from adverse weather such as floods or drought. To qualify, a producer has to buy insurance for insurable crops on the farm and pay the Noninsured Crop Assistance Program (NAP) fee for all non-insurable crops and practices on the farm. NAP includes hay and pasture.

Below are links to webcams giving general information on how the new ACRE and SURE programs work.

2008 FARM BILL - OVERVIEW

http://storemedia.vudat.msu.edu/public/flv_player.php?file=storemedia/download/reesel/FarmBill/FarmBillOverview.flv

2008 FARM BILL - DAIRY

http://storemedia.vudat.msu.edu/public/flv_player.php?file=storemedia/download/reesel/FarmBill/2008FarmBillDairy.flv

2008 FARM BILL – DIRECT AND COUNTER-CYCLICAL

http://storemedia.vudat.msu.edu/public/flv_player.php?file=storemedia/download/reesel/FarmBill/2008FarmBillDCP.flv

2008 FARM BILL - ACRE CALCULATIONS

http://storemedia.vudat.msu.edu/public/flv_player.php?file=storemedia/download/reesel/FarmBill/2008FarmBillACRECalc.flv

2008 FARM BILL – THE ACRE DECISION

http://storemedia.vudat.msu.edu/public/flv_player.php?file=storemedia/download/reesel/FarmBill/2008FarmBillACREDecision.flv

2008 FARM BILL CROP INSURANCE OVERVIEW

http://storemedia.vudat.msu.edu/public/flv_player.php?file=storemedia/download/reesel/FarmBill/2008FarmBillCroplns.flv

2008 FARM BILL SURE CROP PROTECTION

http://storemedia.vudat.msu.edu/public/flv_player.php?file=storemedia/download/reesel/FarmBill/2008FarmBillSURE.flv

Conservation Programs

The FCE continued and enlarged many of the conservation programs provided in the 2002 Farm Bill, but the FCE also contained conservation provisions that signal the continued evolution of conservation programs. Indeed, the final version of the FCE clearly demonstrated that conservation programs, especially those programs aimed on ongoing production on working lands, will remain a centerpiece for Farm Bills in the foreseeable future. As the political coalition supporting farm bills evolves and the environmental consequences of agricultural production remain visible, no farm bill is likely to pass in future years without meaningful conservation programs for active agricultural production.

The FCE does provide funding for a continuation of the Conservation Reserve Program (CRP) land retirement program. An enrollment cap of 39.2 million acres is established for CRP, and authority is provided to amend CRP contracts to permit production of biofuels, wind energy, and grazing under certain conditions. Thus, the CRP, which was established by the 1985 Farm Bill, will continue largely unchanged. The enrollment cap for the Wetlands Reserve Program (WRP) land retirement program is increased by one-third to 3.041 million acres.

While land retirement programs will continue at their existing level, working lands conservation programs, which serve agricultural land that is active in farm production, will increase significantly under the FCE. Funding for the Environmental Quality Incentives Program (EQIP) will total \$7.23 billion during the life of the FCE, or 74% more in 2012 than in 2007. EQIP payments are expanded to provide assistance for transition to organic production, forest management, and water conservation.

The Conservation Security Program is reconstituted as the Conservation Stewardship Program (CSP) with \$3.79 billion in new funding. The CSP is provided an enrollment

cap of 12.679 million acres per year for the life of the Farm Bill and intended to provide assistance for producers of virtually all agricultural products. The Wildlife Habitat Incentives Program (WHIP) is continued with \$85 million in funding, and the Farm and Ranchlands Preservation Program (FRPP) is increased from \$97 to \$200 million per year.

Whereas some past land retirement programs were only targeted at program crop producers, now within the FCE, both program crop and non-program crop (e.g., fruits or vegetables) producers are eligible for enrollment in many new conservation programs. Producers should remain informed about new alternatives that will become available under these new or expanded conservation programs.

Planting Flexibility and Specialty Crops

Since at least 1990, USDA commodity programs have prohibited the planting of fruits and vegetables on program crop base acres. Program participants faced a reduction in program payments for the violation of this restriction. In recent years, this planting prohibition, now called the Fruit, Vegetable and Wild Rice Planting Prohibition (FAVR) has become the focus of attention in both domestic and international trade debates.

Though some participants in the recent Farm Bill debate advocated the abolition of the FAVR, thereby permitting the planting of non-program crops on program base acres without a payment in penalties, Congress retained the FAVR in the same form that has existed since 2002. However, Congress provided a pilot planting flexibility project in a limited number of Midwestern states, including Michigan. Under this pilot project, the production of non-program crops is permitted. Though the program payments are reduced on an acre-for-acre basis for each acre planted in non-program crops, the producer will not lose program payments for the remaining base acreage (as is done with the existing FAVR provisions). Producers must produce vegetables for processing on acreage enrolled in this pilot program. Many program details for this pilot project have not yet been announced. Thus, producers who are interested in participating in the program should remain informed about the provisions of this program.

Conclusion

The Food, Conservation and Energy Act of 2008 provides several opportunities for producers in Michigan. Both program and non-program crop producers will have new or enlarged choices that will affect the profitability and sustainability of their operations. In the existing economic environment, producers should remain informed about all such opportunities.

2009 INPUT COSTS

Bill Knudson

The crop price outlook appears far more uncertain in 2009 compared to 2008. This uncertainty has affected some input costs; this is especially true for fertilizer. The general economic situation has also impacted input costs. The global recession has put downward pressure on diesel fuel prices as well as interest rates. While interest rates have been trending downward access to credit may be more difficult to obtain.

Fertilizer

A decline in crop prices, global demand, and a reduction in natural gas prices has put downward pressure on most fertilizer prices. Nitrogen and phosphorous prices have declined since 2008, but potash prices remain relatively high.

Wholesale phosphate prices peaked at about \$1,090 a ton in October, and fell to approximately \$360 a ton in December of 2008. Wholesale nitrogen prices also peaked in October at a price of approximately \$725 a ton, and fell to approximately \$200 in December. It is likely that these prices will increase somewhat as planting season approaches. Wholesale potash prices remain very high with a price of approximately \$725 a ton.

There are several drivers affecting the price of fertilizer. Lower grain prices have reduced farmers' willingness to pay high prices for fertilizer and have created expectations that fertilizer prices will decline. Market uncertainty with respect to both input costs and crop prices has also impacted fertilizer prices. Reduced credit availability has also put downward pressure on fertilizer prices.

Seed

Compared to last year, there appears to be sufficient supplies of seeds, although prices are trending upward. Roundup Ready Cruiser Max Soybeans are selling for approximately \$50 a 50 pound bag. Dry bean seed is approximately \$75 for a 50 pound bag. Triple Stacked Roundup Ready corn is in the range \$205 a bag, and wheat seed is selling for approximately \$15 a 50 pound bag. There does seem to be some stress on some popular varieties and supplies may be limited. These factors mean that it will be difficult to alter planning decisions in the spring.

Fuel

Fuel prices have declined dramatically from their peak in the summer of 2008. According to the Michigan Agricultural Statistics Service, diesel prices increased from \$1.28 to \$3.61 a gallon from 2003, to 2008, an increase of 182%. It should be noted that diesel prices have been declining since the summer of 2008. The current retail price for diesel fuel is about \$2.29 a gallon. However, further reductions in the value of the dollar, or a disruption of global fuel supplies, could push the price higher. Conversely, if the global economic slowdown continues, fuel prices could continue to decline. There is a great deal of uncertainty as these cross-currents are likely to continue to affect prices. However, it is likely that fuel prices will be lower in 2009 than they were in 2008.

Interest Rates

Interest rates declined in 2008, but the outlook for 2009 is more uncertain. According to the Federal Reserve Bank of Chicago (whose district includes the Lower Peninsula), the average interest rates on operating loans was 6.74% in the third quarter of 2008, a decline of 168 basis points from the third quarter of 2007. The interest rate on farm real estate was 6.56% in the third quarter of 2008, a decline of 97 basis points from the third quarter of 2007. The difference between the interest rate for operating loans and the interest rate for real estate loans is getting smaller. This may be a reflection of the uncertainty in real estate markets.

While interest rates were lower in late 2008, it may be more difficult to secure a loan, and some borrowers may face higher interest rates. Concerns about the economy and the potential for default may make banks more wary about lending money to farmers with poor credit or less than desirable balance sheets. While some borrowers may find interest rates to be lower in early 2009, the trend for later in the year is more uncertain. If the credit crisis continues, all borrowers could face higher interest rates later in the year.

MICHIGN FARMLAND VALUES CONTINUE TO CLIMB
Eric Wittenberg and Steve Hanson

Michigan farmland values continued their steady upward march in 2008 marking the 21st year in a row that land values have increased. The annual Michigan Land Value survey, conducted in the spring of 2008 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 2008 survey reported land values, when compared with 2007, increasing around 9.1% across the state. Average farmland values in spring 2008 were reported to be:

	Southern Lower Peninsula	Michigan
Tiled field crop land	\$3,631	\$3,376
Non-Tiled field crop land	\$3,144	\$2,800
Sugar Beet land	\$3,608	\$3,460
Irrigated land	\$4,101	\$3,875
Fruit Trees	\$7,357	\$7,246

The USDA reported in its “Agricultural Land Values and Cash Rents” that Michigan’s agricultural cropland prices increased over 7.2% during the 2008 calendar year to an average price of \$3,700 per acre. The most recent data on land prices comes from the Federal Reserve Bank of Chicago report which found Michigan land prices increased 13% from October 1, 2007 to October 1, 2008. According to USDA statistics, the last time farmland values in Michigan experienced a year-to-year decline was January 1987.

Cash rent rates rose for tilled and non-tilled crop land by \$15 and \$9 per acres, respectively. While the cash rent for sugar beet crop land rose by \$15 per acres and irrigated land cash rent increased by \$34 per acre. Fifty-eight percent of total crop acres were controlled through leasing arrangements, with 83% of those on a cash rent basis. Average Michigan cash rent levels in spring 2008 were:

	Southern Lower Peninsula	Michigan
Tiled field crop land	\$116 per acre	\$107 per acre
Non-Tiled field crop land	\$ 87 per acre	\$ 75 per acre
Sugar Beet land	\$152 per acre	\$148 per acre
Irrigated land	\$182 per acre	\$177 per acre

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

Michigan farmland values are influenced by both the agriculture and non-agriculture sectors. Michigan agriculture is very diverse, but major commodity crops, along with livestock, continue to play an important role in determining the value of farmland in many areas of the state. Strong crop prices for cash grain farmers and strong milk prices for dairy farmers in 2008 helped push farmland values up. Land values have been driven by a combination of factors including the expanding ethanol industry, demand for wheat, strong soybean market, strong dairy markets, relative low interest rates, and continued commercial and residential development. However, current economic conditions suggest the earnings for crop and dairy producers in 2009 will soften. New crop and milk prices are currently at or close to variable costs which will soften land prices.

Energy and oil prices have been 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). The current drop in energy prices has largely been due to the rapid slow down in the economy, but adjustment in supply (e.g., through OPEC production targets) and demand (as the global economy stabilizes) will continue to create volatility in the cost of energy and its impact on land prices.

Interest rates also impact land values in a variety of ways- the most obvious being that as interest rates goes down, the cost to borrow money for land purchases goes down. Through 2008, the Federal Reserve decreased the Federal Funds Rate (the interest rate banks charge each other for overnight loans) seven times in response to the turmoil in the financial housing markets and the slowing economy. The WSJ Prime Rate (the base rate on corporate loans posted by at least 75% of the nation's 30 largest banks) is currently 3.25%. Interestingly, long-term mortgage rates have not followed the drop in short-term rates. 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. GreenStone Farm Credit Services reports 30-year fixed rate loans for agricultural real estate are currently ranging 8.40-9.65%. In some cases, access to long-term credit may become more limited and borrower qualification standards will be more restrictive than in recent years.

Historically, a strong agriculture market in the 1970s ended sharply in 1981 and land prices softened dramatically until the late 1980s. Since 1987, 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 2008 MSU survey found the average non-agricultural-use value for undeveloped land in Michigan to be \$8,100 per acre for residential development, \$27,841 per acre for commercial/industrial development, and \$3,432 per acre for recreational development. All three categories declined in value- 15%, 21%, and 4%, respectively.

The effect of this softening in non-agricultural demand was generally offset by the exceptionally strong performance in the agriculture sector during 2008. If agricultural returns soften in 2009, expect downward pressure on land prices. It is possible that Michigan could see the first decline in land values in over 20 years during 2009.

2009 ANNUAL CROP OUTLOOK

Jim Hilker

Corn

The year 2008 is the year corn became oil/gas/ethanol, i.e., know the price of fuel, know the price of corn. The year 2009 is likely to be much the same, other than when the oil price is below \$50/barrel the ethanol mandates appear to put a semi floor on corn prices. Will 2010 be the year we run into blending walls, or will the economy recover enough to increase oil prices enough that E-85 will help move ethanol? Or, will the rules change and allow more than a 10% blend in regular gasoline, or will this, or will that, etc? The primary forecast in this outlook is that corn prices will very likely remain very volatile. However, the longer the economy stays in a funk, the more likely corn prices will stabilize. Stability is not always good.

2008-09

After a terrible start, flooding, etc, the U.S. corn crop recorded the second highest U.S. average corn yield on record, 153.9 bushels per acre. And note, the U.S. has had the six highest corn yields ever in the last six years. Nonetheless, with the poor start, 7.5 million fewer planted corn acres, and oil prices going to \$147 per barrel, and we had \$8.00 corn in early July. But just as quickly as the floods came, the growing weather became almost ideal over most of the Corn Belt. And it not to much longer, it was clear we were going to have large 2007-08 ending stocks. The world was having good coarse grain and wheat crops, and while corn acres were down 7.5 million in 2008-09, they were still 7.7 million acres higher than 2006-07. On top of that, the economy started to tank, and most of all, oil prices dropped sharply, and all of a sudden we have corn prices back in the mid to high \$3.00 range as we plow into 2009. Or, in other words, while not as high as last year, supply for the 2008-09 (Sept-Aug) corn marketing year appears to be plentiful, as can be seen in the second column of Table 1 below.

Michigan recorded a record corn crop - as it did last year. And, has had the four largest corn crops on record in the past four years. Last year, Michigan had a very poor average yield of 123 bushels per acre, but the 450,000 acre increase in planted acres more than made up for the yield drop off. And, even though Michigan cut corn plantings 250,000 acres this year, the trend yield of 138 bushels per acre led us to the record crop. However, not all areas of Michigan shared equally. There was everything from some astounding corn yields in the Thumb, to some quite poor yield in parts of southern Michigan, and everything in between through other parts of the state.

As we enter February, the sixth month of the marketing year, we are getting a pretty good handle on projected use, other than exports. The Quarterly Stocks Report gave us a pretty good idea of the feeding rate in the first quarter, that along with livestock slaughter to date, the last Hogs and Pigs Report, along with the latest Cattle-on-Feed and Cattle Inventory Reports, gives us a pretty good idea of the annual use of corn for feed. The USDA projected 2008-09 corn used for feed to be down 638 million bushels, 10.7%. More of this is due to lower amounts of feed fed per animal than fewer animals being fed.

The USDA is projecting corn use for ethanol during 2008-09 at 3.6 billion bushels, about 9.7 billion gallons of ethanol. And, while the projections of corn used for ethanol has

been dropping as use of capacity has dropped off, a few plants have shut down, and plants are not being finished as quickly, we are getting to where we have to meet the present projections due to the ethanol use mandates. Corn used for other industrial uses is also dropping as the economy has slowed, putting total FSI use at 4.9 billion bushels. This puts total domestic use at 10.2 billion bushels, 100 million bushels below the previous year, as shown below.

It is exports that are hard to figure out, with respect to where they will end up. Five months into the marketing year exports are running 40% behind last year and export sales to date are running 49% behind. And, while exports were expected to be down with larger coarse grains and wheat crops in the rest of the world, the pace will have to pick up to even meet the lowered USDA estimate. Last year at this time corn exports were running 50-60 plus million bushels per week; lately they have been running around 27 million bushels per week. In order to reach the export estimate of 1750 million bushels, weekly exports will need to average nearly 38 million bushels a week from now through the end of August.

As can be seen in Table 1, 2008-09 corn exports are expected to be down 686 million bushels, 36%, from 2007-08. One reason corn exports were up so much last year was the lack of feed wheat around the world after two poor world wheat crops in a row. One reason that corn exports are down this year, even below the long-term average of 1900 million bushels per year, is the record world wheat crop this year that has a higher than normal amount being feed wheat. The world economy is not helping matters either. Nor is the fact China had a monster corn crop, and it's fourth record corn crop in a row.

There are several things that could change the export picture. One is a smaller than expected corn crop out of Argentina, which is in the mist of a nasty drought. Another is that the world knows we have plenty of corn, and is bidding it's time purchasing it. What the world and U.S. crops look like in late June and July could also greatly affect the final export number.

The 2008-09 ending stocks are projected to be 1790 million bushels, 15% of use. In the old days, prior to fall 2006, this would mean corn prices in the \$2.25 per bushel range. But in the oil/gas/ethanol days we are now in, it appears between the price of fuel and the ethanol mandates, the weighted average price of corn this marketing year will be in the \$3.90 range, plus or minus a "bunch".

2009-10

So how many corn acres will U.S. corn farmers plant this year? To come up with that forecast we need to look at how many acres may be available, and what are the expected returns over variable cash costs of corn and soybeans. We already know from the Winter Wheat Seeding Report that 4.1 million less acres of winter wheat were planted, and the non-planted wheat acres can all grow corn and soybeans. However, some of those unplanted wheat acres may mean less wheat/soybean double cropping. And, while they may be a few cotton acres and CRP acres available, the extra four million acres will tell the story.

The second consideration is which crop will give you the highest return to fixed costs. So, using today's new crop bids for corn and soybeans, and input prices you could have paid over the past several weeks, and low and behold, it's about a toss up for much of

Michigan. Corn appears to have a very slight advantage on prime corn land across the Corn Belt. What does this tell me? The extra 4 million acres will likely be split evenly between corn and soybeans. This will become clearer after you have read the soybean outlook. The USDA will release the Planting Intentions Report on March 31, based on a first week of March survey. And, while the Planting Intentions Report provides very good information, over the last several years farmers have not hesitated to change their planting intentions based on what the market/weather is telling them until the last planter has pulled out of the field, after the double crop planting time period has passed.

From these two factors, always subject to change, I am projecting that planted corn acres for 2009 will be 88 million acres, up two million from 2008. At this point, we have to go with the U.S. trend yield for 2009, which in my analysis is 155.4 bushels per acre. After subtracting off the average numbers of acres used for silage and average acres not harvested due to some disaster, I project 80.6 million acres of corn will be harvested for grain. These numbers would indicate a 12.525 billion bushel corn crop, which would be the second largest corn crop on record. And, when we add the plentiful beginning stocks to that figure, we come up with a total supply of 14.33 billion bushels, as shown in the third column of Table 1.

Michigan farmers planted 160,000 less acres of wheat this past fall. My best analysis is that these acres will be split between corn and soybeans as well. If that is the case, and we get near our 2009 trend corn yield of 139 bushels per acre, Michigan will be looking at another record corn crop.

Total feed use is expected to be about the same to a little less in 2009-10 relative to 2008-09. The last Hogs and Pigs Report indicated the pork sector is cutting back, and I project that will continue into at least early 2010 if not for the whole 2009-10 marketing year. The Cattle Inventory Report showed beef cows down 2% as well. There will also be more distiller grain available. On the positive side, livestock returns should improve by 2009-10 which should keep feed use from dropping to much.

The next biggest user of corn will continue to be ethanol, it is expected to increase enough to meet the mandates, plus a bit. While returns to ethanol producers are not likely to go back to the glory days, the corn crop should be big enough to keep the spread profitable.

Exports are expected to return to "normal" with normal world crops. There is a danger the world economy will still be struggling, but the consensus opinion is we will begin to see a turn around in the world economy over the 2009-10 time period.

Total use is expected to grow more than production, lowering ending stocks, as show in Table 1. Ending stocks as a percent of use is expected to be 12%. However, rather than having prices in the \$2.50 range, where they would have been at these levels prior to fall 2006, oil prices in the \$50-60 range and the ethanol mandates will likely keep the prices in the high \$3.00 range.

**TABLE 1
SUPPLY/DEMAND BALANCE SHEET FOR CORN**

	2002- 2003	2003- 2004	2004- 2005	2005- 2006	2006- 2007	Est. 2007- 2008	Proj. 2008- 2009	Hilker 2009- 2010
(Million Acres)								
Acres Planted	78.9	78.6	80.9	81.8	78.3	93.5	86.0	88.0
Acres Harvested	69.3	70.9	73.6	75.1	70.6	86.5	78.6	80.6
Bu./Harvested Acre	129.3	142.2	160.4	148	149.1	150.7	153.9	155.4
(Million Bushels)								
Beginning Stocks	1596	1087	958	2114	1967	1304	1624	1790
Production	8967	10089	11807	11114	10531	13038	12101	12525
Imports	14	14	11	9	12	20	15	15
Total Supply	10578	11190	12776	13237	12510	14362	13740	14330
Use:								
Feed and Residual Food, Seed and Ind.	5563	5798	6158	6155	5591	5938	5300	5275
Ethanol for fuel	996	1168	1323	1603	2119	3026	3600	4250
Total Domestic	7903	8335	8844	9136	9081	10301	10200	10870
Exports	1588	1897	1818	2134	2125	2436	1750	1925
Total Use	9491	10232	10662	11270	11206	12737	11950	12795
Ending Stocks	1087	958	2114	1967	1304	1624	1790	1535
Ending Stocks, %of Use	11.5	9.4	19.8	17.5	11.6	12.8	15.0	12.0
U.S. Loan Rate	\$1.98	\$1.98	\$1.95	\$1.95	\$1.95	\$1.95	\$1.95	\$1.95
U.S. Season Average Farm Price, \$/Bu.	\$2.32	\$2.42	\$2.06	\$2.00	\$3.04	\$4.20	\$3.90	\$3.90

Source: USDA and Jim Hilker. (2/2/09)

Wheat

The U.S. winter wheat producers have spoken. They planted 4.1 million less acres of winter wheat last fall, down 9%. Michigan producers cut back wheat acres from 730,000 for the 2008 wheat crop to 570,000 planted acres for the 2009 crop, a reduction of 22%. Michigan planted 530,000 acres of winter wheat for the 2007 wheat crop.

2008-09

After two poor wheat crops across the world, including the U.S., in the 2006-07 and 2007-08 marketing years (June-May), both the U.S. and world wheat crops rebounded sharply in 2008-09. In fact, the world set a new wheat production record of 683 MMT, 25.1 billion bushels. This was almost 2.7 billion bushels larger than the 2007-08 world wheat crop, and over 3 billion bushels larger than the 2006-07 world wheat crop. To put this in perspective, the U.S. produced it's largest wheat crop since back-to-back large crops in 1997 and 1998, and at 2.5 billion bushels is one-tenth of the world wheat crop.

The large U.S. wheat crop came from a 2.6 million acre increase in acres planted, and a record U.S. average wheat yield of 44.9 bushels per acre. This beat the previous 2003 record yield of 44.2 bushels per acre. As shown in Table 2, the projected 2008-09 total U.S. supply was up almost 300 million bushels, 11.4%, despite fairly small beginning stocks.

Michigan harvested 69 bushels per acre in 2008 on the 710,000 acres harvested of the 730,000 acres of wheat planted. This was 4 bushels per acre higher than 2007, but 4 bushels per acre lower than the great 2006 state average yield of 74 bushels/acre.

Eight months into the marketing year it appears wheat used for food will barely top last year. And, seed use is projected to down with the lower plantings. Wheat used for feed is up sharply, like from almost nothing to a lot, this is due to the larger wheat supply and the high summer corn/feed prices. This leaves estimated total domestic use up 210 million bushels, which would use up a good chunk of the 300 million bushel increase in U.S. supply.

Then comes projecting 2008-09 wheat exports. While we have plenty of wheat, so does the rest of the world. Wheat export inspections and export sales to date, again eight months into the wheat marketing year, gives us a pretty clear indication that wheat exports are, and will be, down significantly. The USDA projected 2008-09 exports to be 1000 million bushels, down 264 million bushels, or 21%. Total use is projected to be down 54 million bushels.

Increase supply, decrease use, makes for larger ending stocks. Larger ending stocks and lower use makes for a higher ending stocks-to-use ratio, 29%, which usually means lower prices. And, since late summer, wheat prices have fallen off sharply as we all know. Then why is the 2008-09 price higher than the 2007-08 price, as shown on Table 2? The prices in Table 2 are weighted average prices, i.e., an average of the prices that wheat was actually sold for, accounting for how much was sold at various prices. And, remember, most of the wheat sold occurred during summer when prices were much higher.

2009-10

To project 2009-10 wheat planted acres, I will start with the 42.1 million acres that was reported planted in the Winter Wheat Seeding report. Then I will assume the same amount of spring and durum wheat will be planted as last year. While that is not always the case, I don't see a lot of competition for those acres. That would put 2009-10 wheat planted acres at 59 million. From that I will subtract the average number of acres not harvested, and project 50 million acres of wheat will be planted.

The trend wheat yield for 2009 is 42.8 bushels per acre. This would be the fifth highest yield on record - if it occurs. Lower yield, fewer harvested acres, means lower production. The problem is extremely high beginning stocks, left over from this year. When you add these two together, total supply is projected to be only a tad lower than this year.

I expect food use to go up a couple of percent with population growth and more expensive meats. And, if the world returns to a trend yields, I expect exports to go up about 5%, albeit from a low level. This would put total use up 70 million bushels, 3%, as shown in Table 2.

Slightly smaller total supply, and a little bit more use, adds up to a 90 million bushel decrease in ending stocks and a healthy reduction in the stock-to-use ratio. Generally, a lower ending stock-to-use ratio means higher prices, but I don't expect to have \$7.00 corn prices this summer holding wheat prices up, and that is the reason why my wheat price forecast is lower for 2009-10. Check out all of the numbers in Table 2.

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

	2003 – 04	2004 - 05	2005 - 06	2006 - 07	Est. 2007- 08	Proj. 2008- 09	Hilker 2009- 10
(Million Acres)							
Acres Planted	62.1	59.7	57.2	57.3	60.5	63.1	59.0
Acres Harvested	53.1	50.0	50.1	46.8	51.0	55.7	50.0
Bu./Harvested Acre	44.2	43.2	42.0	38.6	40.2	44.9	42.8
(Million Bushels)							
Beginning Stocks	491	546	540	571	456	306	655
Production	2345	2158	2105	1808	2051	2500	2140
Imports	68	71	82	122	113	110	100
Total Supply	2904	2775	2727	2501	2620	2915	2895
Use:							
Food	907	910	915	938	947	950	970
Seed	80	78	78	82	88	80	82
Feed and Residual	212	182	160	117	15	230	230
Total Domestic	1194	1169	1152	1137	1050	1260	1282
Exports	1159	1066	1003	908	1264	1000	1050
Total Use	2353	2235	2155	2045	2314	2260	2332
Ending Stocks	546	540	571	456	306	655	563
Ending Stocks, %of Use	23.2	24.2	26.5	22.3	13.2	29.0	24.2
U.S. Loan Rate	\$2.80	\$2.75	\$2.75	\$2.75	\$2.75	\$2.75	\$2.75
U.S. Season							
Average							
U.S. \$/Bu.	\$3.40	\$3.40	\$3.42	\$4.26	\$6.48	\$6.70	\$6.30
Michigan \$/Bu.	\$3.35	\$2.95	\$3.05	\$3.40	\$5.30	\$6.10	\$5.50

Source: USDA and Jim Hilker (2/2/09).

Soybeans

How quickly can we switch from a situation where we are tight soybeans, presently, to a situation where we have too many soybeans? With trend yields in 2009, it could be one year. What will the March 31 Planting Intentions Report suggest? How many soybean acres will U.S. farmers actually plant this spring? I see the final soybean planting number being a moving target until the last planter pulls out of the field this summer after double cropping is complete. Oops, I jumped ahead of myself, how will the 2008-09 South American soybean crops develop, especially with the severe drought in Argentina?

2008-09

In one sense, given all the flooding last spring, a U.S. soybean yield of 39.6 bushels per acre, about three bushels below the trend yield, seems pretty good. In another sense, given the way corn yield recovered, and the negative deviation from trend, and the U.S. soybean yield was quite poor. However, when you plant 11 million more acres than the year before (see Table 3), it makes up for some of the shortfall, although soybean stocks remain fairly tight. The 2008-09 total supply of soybeans is down from 2007-08 even with the extra acres, due to the low yield and beginning stocks being small.

Michigan planted 1.9 million acres of soybeans in 2008, up 100,000 acres from 2007, but 100,000 less than 2006. Despite some excellent soybean yields in the Thumb, the state of Michigan averaged 37 bushels per acre, three bushels below our trend yield. As we all know, it is really hard to get a good soybean yield with no rain in August, and dry coming into August.

Crush has been dismal in the 2008-09 marketing year (Sept-Aug) to date, and is not expected to pick up a whole lot. Crush is projected to be 1685 million bushels, down 116 million bushels, 6.5%, as both domestic and especially foreign demand for U.S. soy oil and soy meal are down. The USDA is expecting seed use to be about the same; that may be nudged up after the Planting Intentions Report, and feed and residual use are expected to return to more normal levels.

Exports are the big driver for soybeans. Export inspections year-to-date, those bushels already shipped, are running 12% ahead of last year, five months into the 2008-09 marketing year. Export sales year-to-date, the above bushels plus those contracted for export at a later date, are running 4.5% ahead of the 2007-08 when we had record exports. However, soybean exports for 2008-09 are projected to be down 5%. While this export projection will likely be increased a bit, U.S. projected ending stocks don't allow for to big of an increase in the export projection. On top of that, the world does have the soybeans needed, but the world ending stocks are still hard to project with the Argentina situation.

World demand for soybeans continues to grow. The world used 8.29 billion bushels in 2006-07, 8.44 billion bushels in 2007-08, and is projected to use 8.49 billion bushels in 2008-09. World oilseeds used for uses other than food has been increasing at a steady rate for the past 10 years, much of that being used for soy diesel. China will account for 45% of U.S. soybean exports this year.

While ending stocks for 2008-09 will virtually be the same as 2007-08 at around 1.98 billion bushels, it's down from the 2006-07 ending stocks of 2.3 billion bushels. However, while ending stocks may remain the same this year, the ending stocks-to-use ratio will drop due to greater use. Pending the outcome in Argentina, the world situation for soybeans is the opposite of corn. For soybeans, ending stocks are tight in the U.S., but not a real problem on the world front; while with corn, the U.S. ending stocks are plentiful, and the world coarse grain stocks are relatively tight.

The 2008-09 soybean ending stocks are projected to be 225 million bushels, and while that is up a little from last year, it is still relatively tight. The ending stocks-to-use ratio of 7.6% matches up fairly well historically, perhaps a touch high, with the projected average weighted price of \$9.00 per bushel, especially given the projected corn price.

2009-10

Please go back and read the first three paragraphs of the corn, under the subtitle 2009-10. In that section I discuss why I think both corn and soybean planted acreage will be up about two million acres this spring. That would have U.S. producers planting around 77.8 million acres of soybeans. The 2009-10 trend yield for U.S. soybeans is 42.5 bushels per acre. The outcome of these assumptions would be 2009 U.S. soybean production at 3.26 billion bushels, which would be a record. However, due to much smaller beginning stocks in 2006-07, total supply will be 130 million bushels below the record supply in 2006-07. Check out the third column of Table 3.

As stated earlier, Michigan farmers planted 160,000 less acres of wheat this past fall. My best analysis is that these acres will be split between soybeans and corn as well, for the same reasons discussed with corn, about the same expected returns per acre. If that is the case, and we get near our 2009 trend soybean yield of 40 bushels per acre, Michigan will be looking at a very large Michigan soybean crop.

On the 2009-10 use side, my projection calls for U.S. crush returning back to a more normal level, but not quite to the previous highs. This is based on a projected leveling out to a slight improvement of the nasty situation in the livestock industries, and the world economy as we move into 2010. As long as we have trend world soybean yields in 2009, I would expect U.S. exports to remain about the same to some improvement as shown. This suggests that the South American Soybean crop will be larger next year, and that while the world may again increase soybean use, I suspect it will be at a much slower rate of increase for the next two years or so.

The 2009-10 soybean total use projection is a healthy 117 million bushels above this year, and if it occurs, will be a record disappearance, slightly edging out the 2006-07 use level. However, due to the much larger increase in total supply relative to total use, the projected ending stocks almost double in size. In the "old" days, this would probably mean a soybean price in the \$6-7 per bushel range. However, given the high correlation of corn and soybean prices, I am forecasting an average annual price of \$8.00 per bushel, hardly two times that of corn. However, in order for my forecast to have an 80% chance of being accurate, I will forecast that prices will be between \$5.00 and \$13.00 dollars per bushels this fall. The point being, the soybean, wheat, and corn markets are likely to stay extremely volatile.

**TABLE 3
SUPPLY/DEMAND BALANCE SHEET FOR SOYBEANS**

	2002- 03	2003- 04	2004- 05	2005- 06	2006- 07	Est. 2007- 08	Proj. 2008- 09	Hilker 2009- 10
(Million Acres)								
Acres Planted	74	73.4	75.2	72	75.5	64.7	75.7	77.8
Acres Harvested	72.5	72.3	74.0	71.3	74.6	64.1	74.6	76.7
Bu./Harvested Acre	38.0	33.9	42.2	43.0	42.9	41.7	39.6	42.5
(Million Bushels)								
Beginning Stocks	208	178	112	256	449	574	205	225
Production	2756	2454	3124	3063	3197	2677	2959	3260
Imports	5	6	6	3	9	10	9	4
Total Supply	2969	2638	3242	3322	3656	3261	3173	3489
Use:								
Crushings	1615	1530	1696	1739	1808	1801	1685	1780
Exports	1045	885	1097	940	1116	1161	1100	1110
Seed	89	92	88	93	80	93	90	90
Residual	41	19	105	101	77	0	73	85
Total Use	2791	2526	2986	2873	3081	3056	2948	3065
Ending Stocks	178	112	256	449	574	205	225	424
Ending Stocks, %of Use	6.4	4.4	8.6	15.6	18.6	6.7	7.6	13.8
U.S. Loan Rate	\$5.00	\$5.00	\$5.00	\$5.00	\$5.00	\$5.00	\$5.00	\$5.00
U.S. Season Average								
Farm Price, \$/Bu.	\$5.53	\$7.34	\$5.74	\$5.66	\$6.43	\$10.10	\$9.00	\$8.00

Source: USDA and Jim Hilker. (2/2/09)

2009 ANNUAL LIVESTOCK OUTLOOK

Jim Hilker

Cattle

Feedlots took a bloodbath in 2008, the Livestock Marketing Information Center calculated that commercial feedlots feeding out 750 pound feeder steers lost about \$130.00 per head, the most since the 1970's. December 2008 was the 19th consecutive month of feedlot losses. This of course forces down calf prices leading to a declining beef cow herd, which we expect to decline again during 2009, and likely into 2010.

The January 1 Cattle Inventory Report reported the U.S. had 94.49 million head of cattle and calves as of January 1, 1.6 percent below a year ago. USDA estimated the U.S. beef cowherd at 31.67 million head, 2.4 percent smaller than a year ago, while the dairy cowherd at 9.33 million head was up about one percent.

USDA made some downward revisions to prior years number's, however given the completion of the Census of Agriculture some adjustments were expected. The U.S. inventory of all cattle and calves for January 1, 2008 was reduced by over 600,000 head with the beef cow inventory reduced by over 100,000 head. The January 1, 2009 beef cow inventory is the smallest reported since 1963, while the number of operations with cattle and calves continued on its downward trend in 2008. The number of heifers held as beef cow replacements at 5.53 million head was 2 percent below a year ago, and the smallest reported since 2004. Given the decline in calf prices, regional droughts, and surging fertilizer costs last year, downward trending beef cattle numbers were expected.

USDA reported the 2008 calf crop at 36.1 million head, 2 percent smaller than 2007's. Given higher feedstuff prices in 2008 and the placement of calves at heavier weights, the estimated number of cattle outside of feedlots was expected to be larger than last year. As of January 1st, the calculated available supply of feeder cattle outside feedlots was 27.6 million head, up about 261,000 head (1 percent) from last year.

All cattle and calves in Michigan on January 1 were at 1,070,000 head, the same as the previous year. All cows that had calved were at 445,000 head, down 1%. However, beef cows were down 13%, at 92,000. It was the dairy cows that kept the number up, at 353,000, up 3%. Beef cow replacements were down 12.9%, at 27,000, while dairy cow replacements were up 8% at 148,000 head. Michigan's 2008 calf crop was 375,000, equal to the previous year. The survey does not distinguish between beef and dairy calves. Michigan had 165,000 cattle on feed January 1, down 3%.

Beef production is expected to be down over 1% next year as slaughter is expected to be down 1.5% with weights being up just a tad. Steers prices are expected to average in the \$89-92/cwt range for all of 2009. With 7-800# feeder steers averaging \$101-105 and 5-600# feeder calves averaging \$111-115/cwt.

In the first quarter, beef production is expected to be down 2.6%, with steer prices averaging \$85-87, feeder steers averaging \$97-99, and feeder calves averaging \$108-110. In the second quarter, production is expected to be down 3.5%, with steer prices averaging \$91-93, feeder steers averaging \$102-105, and feeder calves averaging \$111-114.

In the third quarter, production is expected to be up 1%, with steer prices averaging \$85-90, feeder steers averaging \$105-109, and feeder calves averaging \$114-118. In the fourth quarter, production is expected to be up a bit, with steer prices averaging \$92-96, feeder steers averaging \$103-106, and feeder calves averaging \$113-118.

Hogs

Farrow-to-finish hog operations averaged over a \$30 loss per head in 2008. The reaction to those losses is starting to show up in declining numbers as indicated below. Pork production in 2008 was up 6.5%, being up over 9% for the first nine months of the year, and then ending the year by being down 1% in the fourth quarter. Thank goodness exports exploded during the first 11 months of 2008, being up over 50%. While hog prices were still not high enough to overcome high feed prices, the increase in exports certainly supported prices and lessened the blood bath. Due to the strong exports, per capita consumption in the U.S. actually fell over 2%, even with the sharp production increase. However, we are already seeing a drop off in pork exports, which are expected to be down 14% in 2009 as the world economy struggles.

All hogs and pigs on Dec 1 were 98% of last year. The breeding herd was down 2%. Hogs kept for marketing were down 2%. The entire decrease in hogs kept for marketing was due to the smaller fall pig crop. Heavier weight hogs kept for marketing were near year ago levels. Pigs under 60 pounds were down 6%.

The Sept-Nov farrowings, this spring's production, were down 6%, but the fall pig crop was down only 4%, as pigs per litter were up 2%. The continued climb in pigs saved per litter is remarkable. Dec-Feb and Mar-May farrowing intentions, next summer and next fall's production, were both 98% of the previous year. If we continue to climb in pigs saved per litter, we may not see that much cutback in production.

Michigan did not seem to fit the mold. Michigan's breeding herd was up 10%, at 110,000 head, relative to December 1, 2007. However, our hogs kept for market were down 2%, and our total numbers were down 1%. Pigs saved per litter for Michigan were up to 9.51 from 9.11.

Pork production is expected to be down 3.2% in 2009, as slaughter is expected to be down 3% with weights being off a bit. Carcass prices are expected to average in the \$68-71 per cwt. range for all of 2009, up 6% relative to 2008.

In the first quarter, pork production is expected to be down 2.6%, with carcass prices averaging \$61-63, up 12%. In the second quarter, production is expected to be down 3.9%, with carcass prices averaging \$71-75 per cwt., up 4.5%. In the third quarter, production is expected to be down 3.5%, with carcass prices averaging \$75-78, about even with 2008. In the fourth quarter, production is expected to be down 3.0%, with carcass prices averaging \$64-68, up 11%.

Per capita consumption in 2009 is expected to drop another 2.6% with the above production slowdown, and is an important factor in the higher prices shown above. Cutbacks in broiler and beef production also factor in. While these higher prices will help, they will not completely offset the still historically high feed prices, and I expect the breeding herd to continue to shrink into 2010. However, continued efficiency gains, and

an eventual return to breakeven returns, are expected to keep 2010 production about the same as 2009, but that means a continuation in the drop in per capita consumption.

2009 DAIRY SITUATION AND OUTLOOK

Christopher Wolf

Review of 2008

The high milk prices of 2007 and early 2008 came crashing down at the end of last year. Cheese prices on the National Cheese Exchange dropped about 75 cents per pound in the month of December, finishing the year below support price.

2008 U.S. milk production increased 2.2% from 2007 to total 189.7 billion pounds. Cow numbers finished 2008 up 113,000 head from December 2007, while production per cow was essentially flat finishing just 195 pounds per cow above 2007. Milk production is forecast to increase very modestly in 2009.

The high milk prices of the past couple of years were driven in part by U.S. dairy export growth. In 2007, the value of US dairy exports was 48% higher than 2006. Thanks to a strong first half-year U.S. dairy export value through November 2008 was up another 32% over 2007, but the value declined sharply in November. The dollar strengthened against other currencies making U.S. exports relatively more expensive. The collapse in prices at the end of 2008 was on the demand side driven by panic about the U.S. and world economic situation that will likely continue to lead to fewer meals away from home and less exports.

Dairy Policy

The 2008 Farm Bill contained several important dairy provisions, but perhaps the most important was a continuation of the Milk Income Loss Contract (MILC) program with an added feed cost adjuster. Under this program, when the USDA cost of a hundred pounds of dairy ration consisting of corn, soybeans, and hay exceeds \$7.35, the target price for the MILC payment is adjusted by 45% of that difference. With feed costs remaining relatively high and milk prices collapsing, the MILC payments are likely to be large and essential for many farms in 2009.

The payment limit for MILC is 2.985 million pounds of production which equates to about 150 milk cows. As in the previous versions, once a producer begins payments in the federal fiscal year of October-September, those payments continue until the payment limit is reached or the year ends. For large producers, the sign-up date can be an important decision. National Milk Producers Federation has weekly forecasts of the milk payments on their web-site to assist in this decision.

Cooperatives Working Together had two herd buyouts in a single year for the first time in 2008. The first, in May, purchased 24,585 cows and removed an estimated 431.7 million pounds of milk production. The second, in November, purchased approximately 61,000 cows and removed 1.2 billion pounds of milk production.

Outlook for 2009

The January U.S. milk-to-feed price ratio was 1.69, meaning that a pound of milk could purchase only 1.69 pounds of feed. This was the lowest value since the USDA began reporting the ratio in 1985 indicating the current financial stress that milk producers face. Some forecasts are looking for a recovery in the second half of 2009. Class III futures

are below support for February and March and peak later in the year above \$14.00 per cwt. If feed prices remain at current levels, even \$14 per cwt. will not be profitable for many producers. A real recovery in milk prices depends on a resumption of normal levels of demand for dairy products or a significant milk supply decline. If we do not get the former, we may get the latter in the form of farm exits.

TRADE OUTLOOK

David Schweikhardt and Sandra Batie

Agricultural exports reached a record value during fiscal year 2008 (the October 1, 2007 to September 30, 2008 period) on the strength of both the volume and price of exports. This strength was driven by continued economic growth in several importing countries, the weakness of the U.S. dollar, and high oil prices during the first half of the year that supported the prices of corn and other commodities. The USDA's November 2008 outlook for agricultural exports projected a decline in exports for 2009, but several troubling signs emerged in the last quarter of 2008 that may signal that U.S. agricultural exports will decline much further than projected.

U.S. Agricultural Trade Outlook

Total U.S. agricultural exports are expected to decrease from a record level of \$115.5 billion in fiscal year 2008 to the second highest year on record, \$98.5 billion in 2009. This decrease is due largely to decreased grain and oilseed prices and slower worldwide growth in demand for most grain, oilseed, and livestock products. Among the major product categories, only exports of horticultural products are projected to increase.

The largest category of U.S. exports is expected to continue to be the grains and feeds category (\$28.3 billion), followed by horticultural products (\$21.5 billion), oilseeds and products (\$18.3 billion), livestock products (\$12.9 billion), poultry products (\$2.9 billion) and dairy products (\$3.1 billion). These trends continue to reflect the significant transformation in the composition of U.S. agricultural exports with rapid growth in worldwide consumer demand for horticultural products.

The destination of U.S. exports continues to evolve. In 2009, Western Hemisphere countries will continue to purchase the largest share of U.S. agricultural exports. The Western Hemisphere (\$39.2 billion) is projected to retain a lead over Asia (\$37.2 billion) as the largest regional market for U.S. exports.

On a country basis, Canada (\$16.4 billion) and Mexico (\$14.0 billion) continue to be the two largest customers for U.S. agricultural exports, followed by Japan (\$11.5 billion), China (\$10.4 billion) and the 27 nations of the European Union (\$8.4 billion). Mexico surpassed Japan to become the second largest market for U.S. agricultural exports in 2004, and could soon surpass Canada to become the largest buyer of U.S. agricultural exports. At the same time, export growth to China is likely to remain strong. Such trends likely set the stage for China to pass Japan as a buyer of U.S. agricultural products in the near future, but such a reordering will depend on China's ability to continue its economic growth in the face of the current deep worldwide recession.

Total U.S. agricultural imports are expected to increase to \$81.0 billion in 2009, a level \$1.7 billion higher than 2008. Horticultural product imports are expected to experience the largest change, with an increase of \$1.4 billion to a projected total of \$36.1 billion. The second largest category of imports is projected to be sugar and tropical products with \$17.4 billion in U.S. imports (including \$10.7 billion in imports of cocoa, coffee, and rubber). Canada (\$18.7 billion), the European Union (\$16.0 billion) and Mexico (\$11.0 billion) are projected to continue as the three largest suppliers of U.S. agricultural imports. As is the case with U.S. exports, changing consumer preferences are leading to a transformation of the type of food products that are being imported into the United States. Fresh and processed fruit (\$10.1 billion), fresh and processed vegetables (\$8.3

billion), wine (\$5.0 billion), and coffee (\$4.8 billion) constitute the largest U.S. imports of agricultural and food products.

Trade Outlook Uncertainties

As noted earlier, this USDA outlook for agricultural trade in 2009 was published in November 2008. Since that time, several trends have emerged that suggest the trade outlook for 2009 will worsen considerably as the year continues. At least four trends could affect U.S. agricultural exports in the coming months.

First, the worldwide recession continues to worsen at a rapid pace both in the United States and abroad. No country can escape the impact of the world credit crisis or the resulting recession. In its most recent projection, the International Monetary Fund projected that world economic output (GDP) would increase by on 0.3 percent in 2009, compared to output growth of 3.4 percent in 2008 and 5.3 percent in 2008 and 2007, respectively. Such a rapid slowdown in economic growth on a worldwide scale is almost certain to impact the transformation of diets that has occurred in some developing countries in recent years. As economic growth accelerated in those countries in recent years, the demand for meat (and grain to feed livestock) increased. As income growth slows, even in counties such as India and China, demand growth for agricultural products and for U.S. exports is likely to decline more than projected in 2009.

Second, the continuing credit crisis is likely to decrease the availability of export credit throughout 2009. Because most agricultural goods are traded on letters of credit, the decrease in the availability and increase in the cost of credit are likely to add additional downward pressure on U.S. export volumes in 2009.

Third, the uncertainty about exchange rates is likely to add at least two dimensions that could reduce trade in general and U.S. exports in particular. Large and rapid changes in exchange have occurred since September 2008, making the pricing of longer-term trade contracts more uncertain for traders. Moreover, as the credit crisis has unfolded, the U.S. dollar gained strength for a period of time, despite the concern about the stability of U.S. financial institutions. The reason for this is complex – as credit availability is reduced, many corporations are attempting to “deleverage” their balance sheets by paying off as much debt as possible. Since much of this debt is denominated in dollars, this massive drive to deleverage increased the demand for the U.S. dollar, and therefore the value of the U.S. dollar in exchange markets. As the value of the dollar increases, U.S. exports are more expensive for foreign buyers. Finally, it should be noted that exchange rates are typically driven by the differential in interest rates across countries. But what is the impact on exchange markets if the United States Federal Reserve and the central banks of other countries all reduce their interest rates to near zero and such interest rate differentials disappear? Such an event is unprecedented in modern history and is likely to add a large element of uncertainty to exchange markets throughout 2009, again leading to additional risk for traders and a likely reduction in trade.

Fourth, during times of economic stress such as will be witnessed in 2009, nations often resort to the use of increased import barriers in an attempt to achieve their domestic policy objective of increasing employment. In recent months, several countries, or groups of countries (the G-20 nations and the APEC nations) have issued statements reaffirming their commitment to maintain open markets. Early signs, however, are not as promising. For example, in the face of declining dairy prices, the European Union

announced its intention to restore its dairy export subsidies that had been eliminated in recent years. Similarly, the U.S. stimulus bill, now under consideration by Congress, has been criticized by other countries for containing a “buy American” requirement for steel purchases in new infrastructure projects. As the recession deepens in 2009, there is very likely to be an increase in trade frictions, with attempts to increase trade barriers. If this occurs, agriculture is likely to be one of the industries most affected and U.S. agricultural exports are likely to be reduced.

Though there are a few positive signs for the trade outlook in 2009 – reduced energy costs will help reduce transportation costs for trade goods and the availability of shipping vessels should be improved over recent years – the overall impact of the credit crisis is likely to have a negative effect on U.S. agricultural exports. This negative effect, and its effect on commodity prices, is likely to be larger than is expected at this time and could continue well into 2010.

FARM INCOME

David Schweikhardt

As farmers look toward 2009, much of the farm income outlook will be shaped by events that occurred in the last quarter of 2008. Commodity prices, interest expenses, and input costs are all likely to be affected by the credit crisis that reached full force in September 2008. Uncertainties about the direction the credit crisis will take in 2009, variations in income outlook across agricultural sectors (e.g., livestock versus crop sectors), and variations across farm structure (e.g., part-time versus full-time farms) all complicate the farm income picture in 2009.

During 2008, U.S. farmers achieved the highest net farm income on record, with net farm income in the U.S. reaching \$86.9 billion in 2008, slightly higher than the \$86.8 billion of 2007 and well above the 10-year average of \$61 billion. These aggregate numbers tend to obscure the widely divergent conditions that prevailed across the farm sector in 2008 and the continuing evolution of the individual industries within the farm sector that will likely occur in 2009.

The record net farm income of 2008 was based largely upon the high commodity prices that prevailed during the first three quarters of the year. The value of production of feed crops (\$60.2 billion), oilseeds (\$28.7 billion), food crops (\$19.2 billion), and fruit and vegetables (\$40.5 billion) were all significantly higher than the 2007 level. The value of livestock marketings also increased from \$138.1 billion in 2007 to \$143.4 billion in 2008. Only dairy production did not exceed its 2007 level. Much of the strength in livestock prices was based on the continued strength of U.S. exports of meat and dairy products.

The differing income outlook for the crop and livestock sectors was determined by the impact of high feed grain and oilseed prices in 2008. While crop producers benefited from high commodity prices, driven in part by high oil prices and their impact on ethanol, 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 \$38.1 billion for purchased feed in 2007. Purchased feed costs increased to a record \$46.9 billion in 2008. This trend may show some reversal in 2009. As oil prices decreased in late 2008 and early 2009, ethanol prices decreased, leading corn prices to retreat. Thus, livestock producers may see some relief from high feed costs in 2009.

At the same time, the worldwide recession is likely to lead to a decrease in the rate of growth in the demand for meat in some importing countries. If this occurs, declining demand for U.S. meat and dairy products would leave to lower prices for livestock and milk producers. Scattered reports indicated that such a decrease in export demand for meat and dairy products began to occur in November and December of 2008. Such an outcome would suggest that the improvement in the income outlook for livestock and dairy producers would not be as favorable as the decrease in feed costs might suggest.

Fertilizer and lime costs increased from \$16.7 billion in 2007 to \$27.5 billion in 2008, largely resulting from a significant increase in the price of natural gas and in the prices of phosphorus and potassium. As the international recession and the credit crisis puts increased downward pressure on the international demand for these inputs, fertilizer prices are likely to be a bright spot in the 2009 outlook for farm income. Similarly, producers purchased \$16.4 billion in fuels during 2008, an increase from the \$13.0

billion level of 2007 and nearly double the 10-year average for fuel expenditures. Decreases in oil prices are likely to reduce expenditures on fuels and oil in 2009.

The final major factor in the farm income outlook for 2009 is likely to be land rental rates and interest expenses on land and on operating loans. In 2008, farmers paid \$10.6 billion in land rents to non-operator landlords compared to \$8.8 billion in rent expenses during 2007. Presumably, this increase in land rents is a result of the high prices for grain and oilseeds in late 2007 and early 2008. If land rents are not adjusted downward in 2009 to reflect the recent decrease in commodity prices, the net farm outlook for 2009 will be adversely affected.

A large uncertainty in farm income outlook for 2009 is the outlook for interest rates. On one hand, the Federal Reserve has reduced the federal funds rate to nearly 0.0%, leading many analysts to conclude that interest rates should remain low for 2009. More importantly, the global credit crisis is resulting in higher interest rates or less favorable lending terms for many borrowers in other sectors of the economy. There appears to be little reason to believe that such factors will not affect the farm sector in 2009. At the least, borrowers are likely to face more demands for information, higher demands for collateral, or increased expectations for liquidity for the 2009 crop season.

If the credit crisis continues to linger throughout 2009, which is very likely to occur, credit availability will remain tight on a global level and higher interest rates for farmers are likely to occur later in 2009. While the aggregate balance sheet of the U.S. farm sector remains strong with a relatively low debt-to-asset ratio, that aggregate picture may be misleading. Many small or part-time farms have very low levels of debt, implying that the debt load of larger producers is higher than the sector average. Consequently, the impact of macroeconomic events in the economy is much more likely to affect commercial farms during 2009.