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PROSPECTS FOR THE U.S. FARM ECONOMY

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Good morning and welcome to the USDA annual Agricultural Outlook Forum. Ellen Terpstra has covered the global prospects for agriculture, and I will briefly focus on the U.S. prospects.

Several dominant forces are shaping the prospects for U.S. agriculture: global population growth, higher global per capita incomes, and new product markets, such as energy. If these forces do come together, as we anticipate they will, the next few years look very promising.

Prospect #1: World Income Growth Remains High, Maintaining Food Demand, Exports

Strong global economic growth ultimately drives higher food consumption, and global Gross Domestic Product, or GDP, looks strikingly good. This chart (figure 1) indicates foreign economies grew by 4 percent in 2006. As recently as 2002, foreign GDP grew by less than 2 percent, with 27 out of 189 countries in our database having negative economic growth in that year. By 2006, foreign economies grew 4.0 percent and only 2 out of 189 countries had negative growth. This year, we expect foreign economies to grow by 3.7 percent with no country having negative growth.

Developing economies are the real story behind the expanding world economy. Economic growth in developing countries is projected to average between 5 and 6 percent annually for the next few years. Mexico, Brazil, Argentina, China, India, Russia and many other countries all have strong growth prospects.

Developed economies of course count heavily in world and foreign economic growth rates and the story there is quite good as well. The EU had a nice rebound in 2006 that is expected to carry into 2007. In Japan, average annual growth languished at 1.5 percent during the past 6 years, but is forecast to grow by 2.3 percent this year, after surging to 3.0 percent last year.

The U.S. economy grew at 3.3 percent in 2006. Perhaps what is most amazing is the resiliency of the U.S. economy over the past couple of years. Growth has been solid despite high oil prices, rising short term interest rates, inflationary concerns, slow downs in housing and domestic auto sales, the continuing budget deficit, and heavy defense expenditures. These factors continue to present a risk to the U.S. economy, contributed to slowing in the second half of 2006 and will likely mean growth of under 3 percent this year. Growth in food spending is also expected to slow below the strong growth rates of the past 2 years.

Most importantly for U.S. agriculture is that the global economy is likely to continue expanding at a strong enough pace to support growing demand for food, particularly meats, dairy products, fruits and vegetables and processed products.

In high-income nations, consumers spend less than 10 cents of each additional dollar on food. In developing countries like Indonesia and Vietnam, each additional dollar of income increases food purchases by between 30 and 40 cents.

Consider the 250 million middle class households in developing countries, with an average income of $10,000 and current food expenditures of $3,000. If their incomes grow at an

annual rate of 5 percent and food demand grows 2 percent annually, in 15 years, these households would be spending $250 *billion* more on food per year.

The prospect of expanding U.S. agricultural exports continues to look favorable (Figure 2). Our forecast for U.S. exports for FY 2007 (to be updated this morning) is a record high $77 billion, and the value of U.S. agricultural exports is expected to continue to grow, with high value products accounting for much of the growth. The U.S. agricultural trade surplus is expected to continue but narrow over time.

Prospect #2: Large Adjustments in Field Crop Production in Store

Add the demand for biofuels to the strong foundation for demand for food, and U.S. agriculture faces very profound shifts in crop production in 2007. Driving this change is the remarkable increase in corn prices, as the market revalues corn from its traditional feed and food uses to its value in biofuel production. Figure 3 shows the quantity of corn used in ethanol production since 1980. For the current marketing year, we expect corn ethanol use will reach 2.15 billion bushels and increase 50 percent to 3.2 billion bushels in 2007/08. This sharp increase in corn demand is reducing corn carryover and driving up corn prices.

While global oilseed stocks are expected to be up at the end of this marketing year, mainly due to the record U.S. soybean crop, global grain stocks at the end of the 2006/07 marketing year are forecast to be the lowest in 30 years. Strong export and fuel demand, combined with declining grain stocks has led to a dramatic rise in grain prices, as indicated in figure 4, which shows the sharp rise since September in new-crop corn futures prices. Rising prices have boosted net returns per acre for both grains and oilseeds.

Let's look at how expected net returns for major crops are changing (figure 5). For example, the figure shows average corn net returns above operating costs of $125 per acre for 2006 at this time a year ago. For 2007 (figure 6), corn net returns are projected at $334 per acre, up $209, or over 60 percent from last year at this time. Net returns for soybeans, wheat, and rice are also up ($75, $42, and $115 per acre, respectively), while upland cotton net returns are down year-to-year ($12 per acre). These incentives are expected to boost corn area, with acres coming from soybeans in the Midwest, spring wheat in the Northern Plains, and upland cotton throughout the South.

Corn planted area for 2007 is now expected to increase 8.7 million acres to 87 million, slightly above the level reported in USDA Agricultural Projections to 2016, released February 14, 2007. This would be the highest corn plantings in more than 60 years (since 1946) (figure 7). Soybean planted area is projected 5 million acres lower at 70.5 million, the lowest in more than 10 years (since 1997). Wheat planted area is also expected higher this year as higher prices last fall boosted winter wheat seedings. U.S. wheat planted area is forecast at 60 million acres, up 2.7 million acres from 2006.

Part of the expansion in total grain and soybean area increase will come from upland cotton plantings which are expected to fall to the lowest level since 1990. Plantings of other feed grains are also expected to drop in 2007.

Corn production is expected to reach a record 12.2 billion bushels in 2007. Nevertheless, production could once again fall short of demand pulling ending stocks down further in 2007/08 and propelling corn farm prices even higher. Farm prices are expected to average a record-high $3.60 per bushel for the 2007 crop, up $0.40 per bushel from this year's expected price.

With less planted area, soybean production is expected to decline 300 million bushels from last year's record level. That will reduce the very high U.S. soybean carryover expected at

the end of this year. Soybean prices, supported by higher corn prices, are projected at $7.10 per bushel in 2007/08, up from $6.20 per bushel expected this year.

Wheat production, with higher area and a return to trend yields, is forecast at 2.2 billion bushels, up 360 million from 2006. We expect more wheat feeding this year reflecting higher corn prices and increasing competition in international markets. Higher wheat feeding will support wheat prices, which are projected at $4.30 per bushel for the 2007 crop, $0.05 per bushel higher than this year's price forecast.

While grains and oilseeds are experiencing tight markets and strong prices, cotton faces just the opposite. Soaring carryover stocks projected at over 8 million bales and low expected returns will reduce planted area in 2007. Production is expected to drop 8 percent to 20.0 million bales, but supplies could still be the second largest in 40 years. Although U.S. textile mill use is expected to continue its steady decline, exports are projected at 18.0 million bales, equal to the record set in 2005/06, due to strong foreign import demand, especially by China. If that occurs, ending stocks would fall sharply, and restore the cotton market to a more balanced position.

Long grain rice area in the South is expected to decline as producers shift to corn and soybeans. But, medium grain area is expected to expand. On balance, rice production is projected to increase 4 percent to 202.0 million cwt.

Prospect #3: Higher Feed Costs to Slow Meat Production and Raise Prices

Over the next several years, the livestock industry will face the challenge of dealing with higher feed costs. Fortunately, livestock markets are in pretty good balance today, with firm domestic demand and exports continuing to expand. Figure 8 indicates the expected increases in meat and poultry exports in 2007 to another record high.

Market forces will cause the higher feed costs to be passed back to input suppliers, such as feeder calf or feeder pig producers, and along to meat consumers. The effects of higher corn prices on livestock producers will vary depending on the ability of animals to use DDGs and the costs of drying and hauling DDGs.

Meat production is forecast to increase just under 2 percent in 2007, with pork up 3 percent, beef up 2 percent and broilers up less than 1 percent. Increased dressed weights, which have been common over the past several years, are expected to slow or stop as producers market animals at lighter weights to offset higher feed costs.

Recent returns to hog producers have been favorable, but with continued strong corn prices, hog returns will compress, which likely will constrain any expansion for 2008.

Supplies of cattle outside feedlots are above last year, but as these animals move into feedlots, supplies could tighten. Cattle feeders are facing low returns and have been trying to reduce costs by bidding less for feeder calves. Thus, cow-calf producers are facing lower prices, in addition to higher hay prices and poor forage conditions, which constrained herd expansion in 2006. Figure 9 shows that there was very little expansion in cattle inventories during 2006, and producers were holding fewer cows and replacement heifers on January 1, 2007. A key to continuing the expansion will be improved forage conditions in 2007.

Broiler producers reduced production in response to weak returns early in 2006 and production is expected to remain below a year earlier through the first half of 2007 before expanding in the second half . However, the expansion in broiler production in 2007 will be limited by higher corn and soybean meal prices.

Livestock prices in 2007 are expected to be about the same for fed cattle as in 2006, down slightly for hogs and up slightly for broilers. The effect on the CPI for food is expected to

be slight. The CPI for food rose 2.3 percent in 2006, with meat and poultry up less than 1 percent. However, looking beyond 2007, with higher feed costs curtailing meat and poultry production expansion, consumer meat prices could rise in the range of 3.5-4.0 percent in 2008 and 2009

Prospect #4: Fruit and Vegetable Production and Consumption Slows

Growth in demand for fruits and vegetables may slow in 2006/07, as strong fresh fruit and vegetable prices reduce per-capita consumption. Consumer prices for fruits and vegetables have been rising much faster than other foods over the past 5 years and are forecast to increase 3-4 percent in 2007, compared with 2-3 percent for other foods.

Per-capita consumption of fresh fruits and vegetables could decline in 2006/07, as lower domestic production, especially tree fruits, more than offsets higher imports. In recent years, U.S. production of fresh fruits and vegetables has been flat, in part reflecting the high cost of expanding production in California, Arizona, and Florida. Meanwhile, imports have risen sharply. Horticultural product imports are forecast at $32 billion in FY 2007, up nearly $3 billion from last year, led by fresh and frozen fruits and vegetables, wine, and beer.

Prospect # 5: Aggregate U.S. Farm Income Looks Supportive in 2007 and Beyond

Not surprisingly, since we expect income, population, and energy demand all to increase, the financial condition of U.S. farmers and other agricultural stakeholders is expected to remain solid in 2007 and beyond (figure 10). Net cash farm income, a measure of farm cash flow, is forecast to be $67 billion in 2007, slightly above last year. Both crop and livestock receipts are forecast to be record-high in 2007 and their combined total is forecast to be up $16 billion over last year.

Despite an expected blowout performance for farm cash receipts, the modest increase in net cash income reflects lower government payments and higher production expenses. Government payments are forecast to decline to $12.4 billion in 2007, down nearly a fourth from 2006, and half the level of 2 years ago, when Hurricanes Katrina and Rita drove down crop prices in the fall of 2005. The reduction in payments is almost fully accounted for by counter-cyclical and marketing loan benefits, which shrink when program crop prices rise.

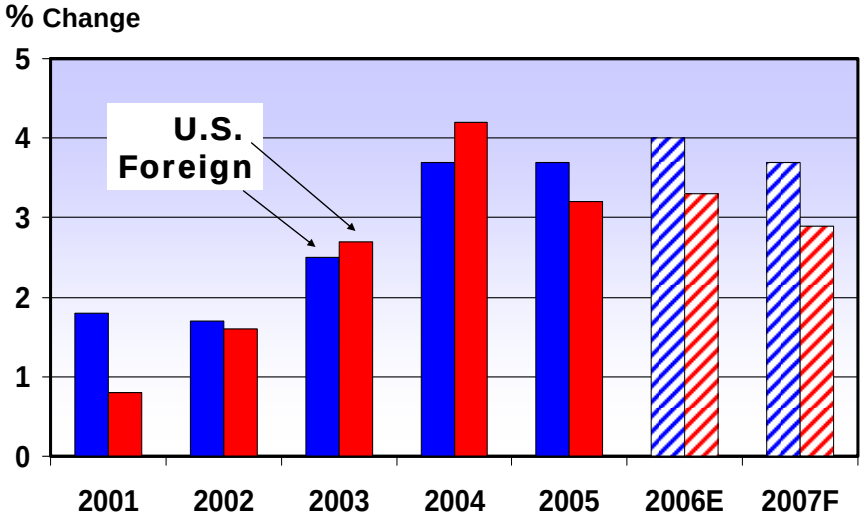
Farm cash production expenses are forecast to rise for the sixth consecutive year to a record $223 billion. Over the past 4 years, cash expenses have increased by an average of $11 billion per year. Energy-based inputs like fertilizer and fuel account for one-quarter of the increase over the period, and labor, feed costs, and interest expenses are other major contributors.

Consistent with recent trends, increases in debt are forecast to be offset by larger increases in farm asset values, although farm real estate values are expected to slow for the torrid pace of the past several years. As a result, the sector's debt-to-asset ratio should remain at a historic low level of 11.8 percent in 2007 (figure 11).

As we begin 2007, the farm economy is coming off unprecedented increases in income and asset values the past several years. With strong food and fuel demand, prospects overall look bright. Perhaps the biggest challenges will be dealing with higher production expenses, especially feed availability and costs, continuing the efforts to restore beef exports, dealing with whatever curve balls weather might throw, securing global market access for U.S. farm products and negotiating a new farm bill—all key topics for discussion today and tomorrow.

1--U.S. & Foreign GDP Growth…

positive for ag demand



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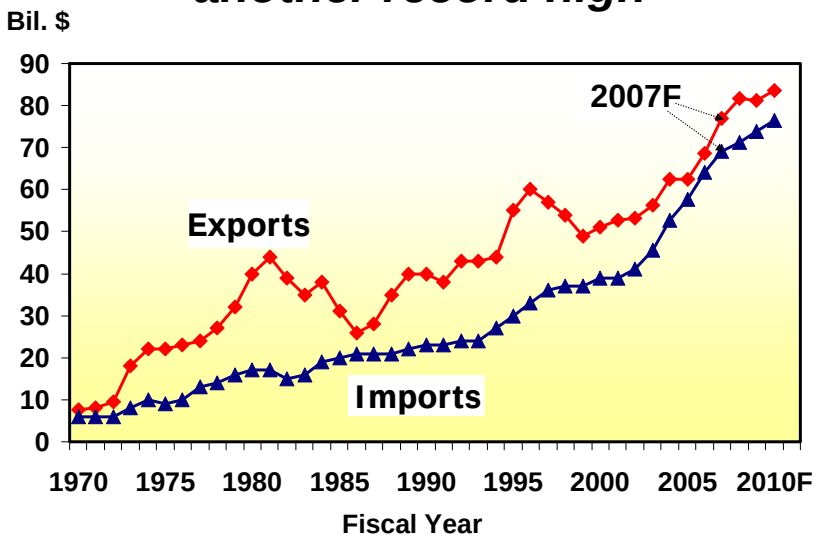
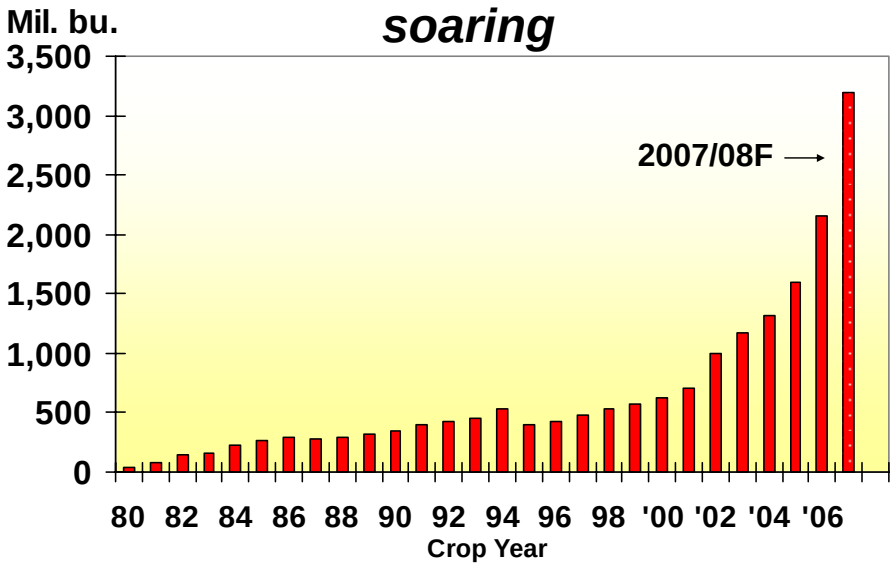
another record high



3--Corn Used in Ethanol… *soaring*



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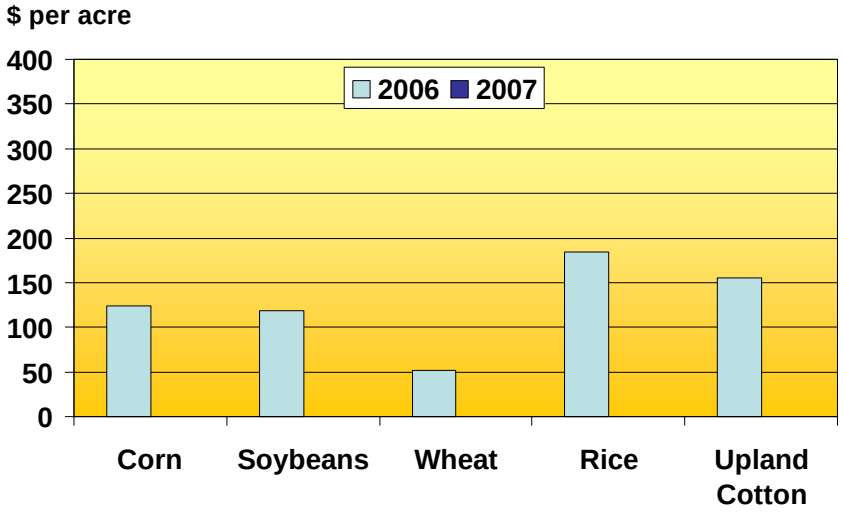

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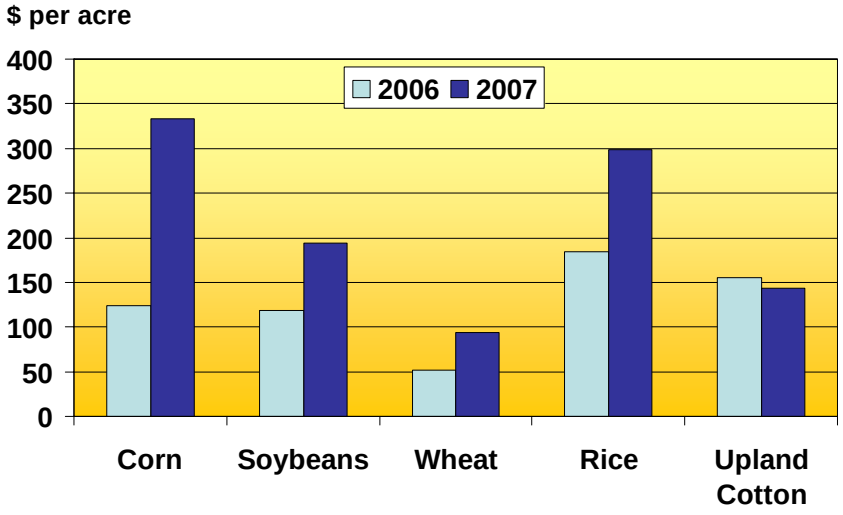

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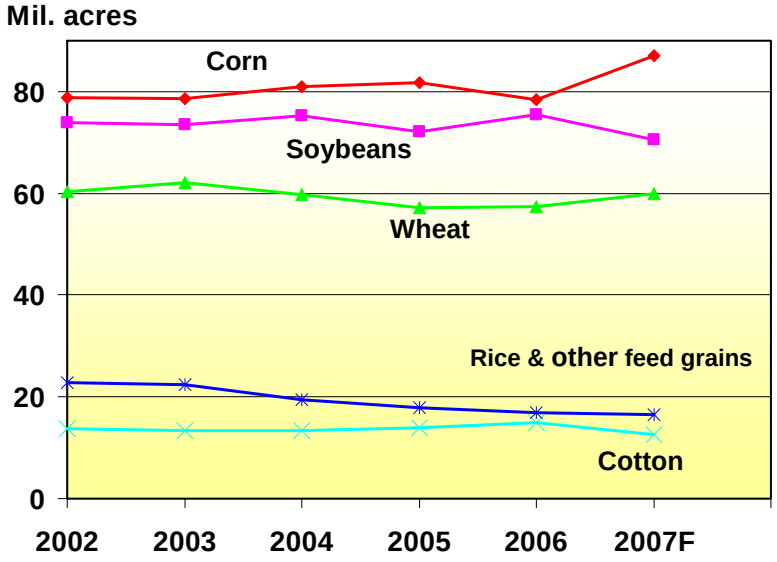

8--Meat & Poultry Exports …

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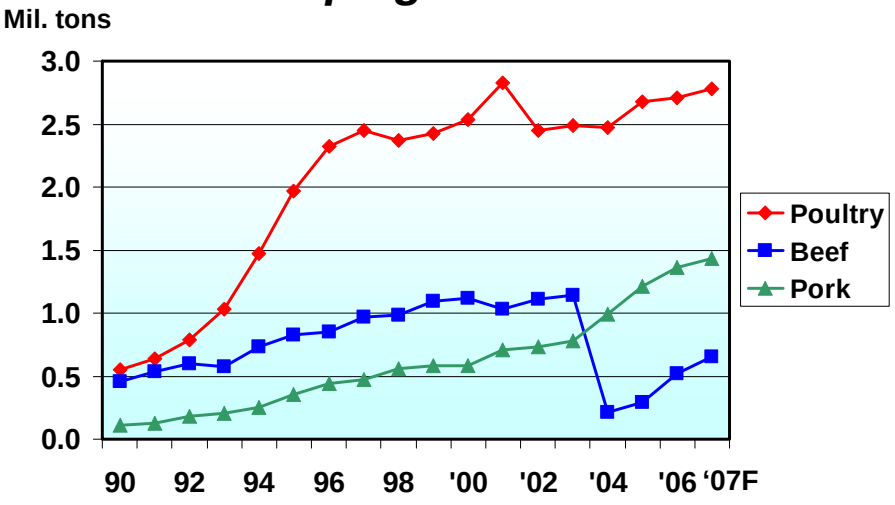

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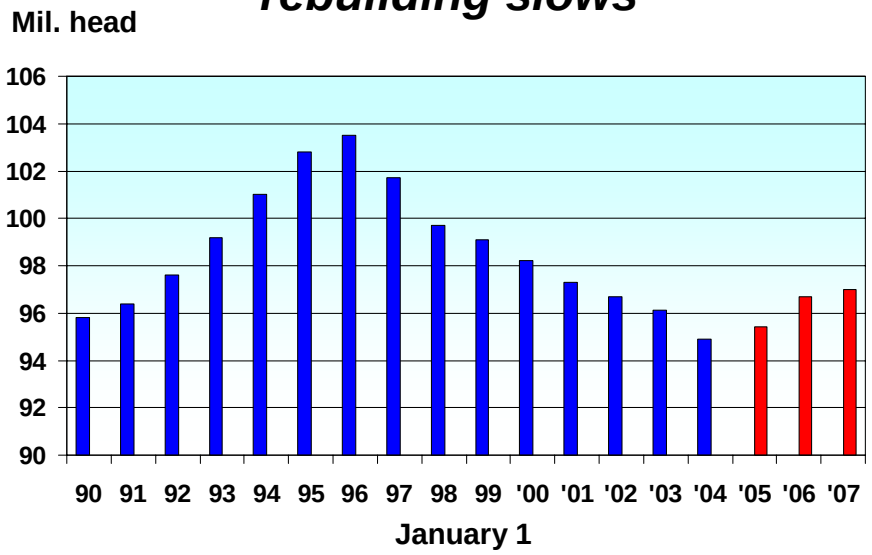

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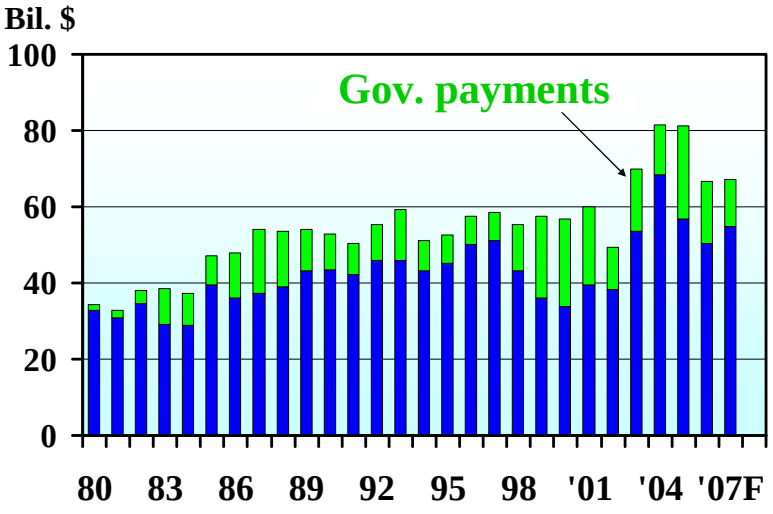

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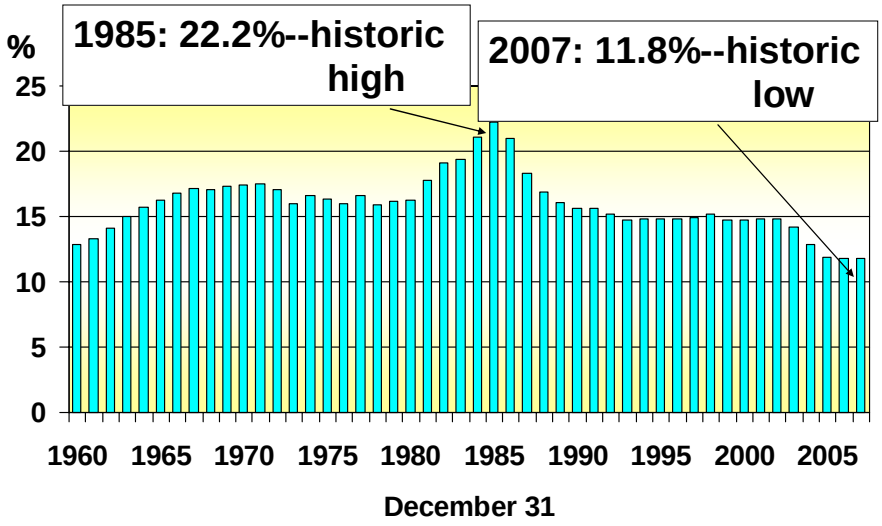

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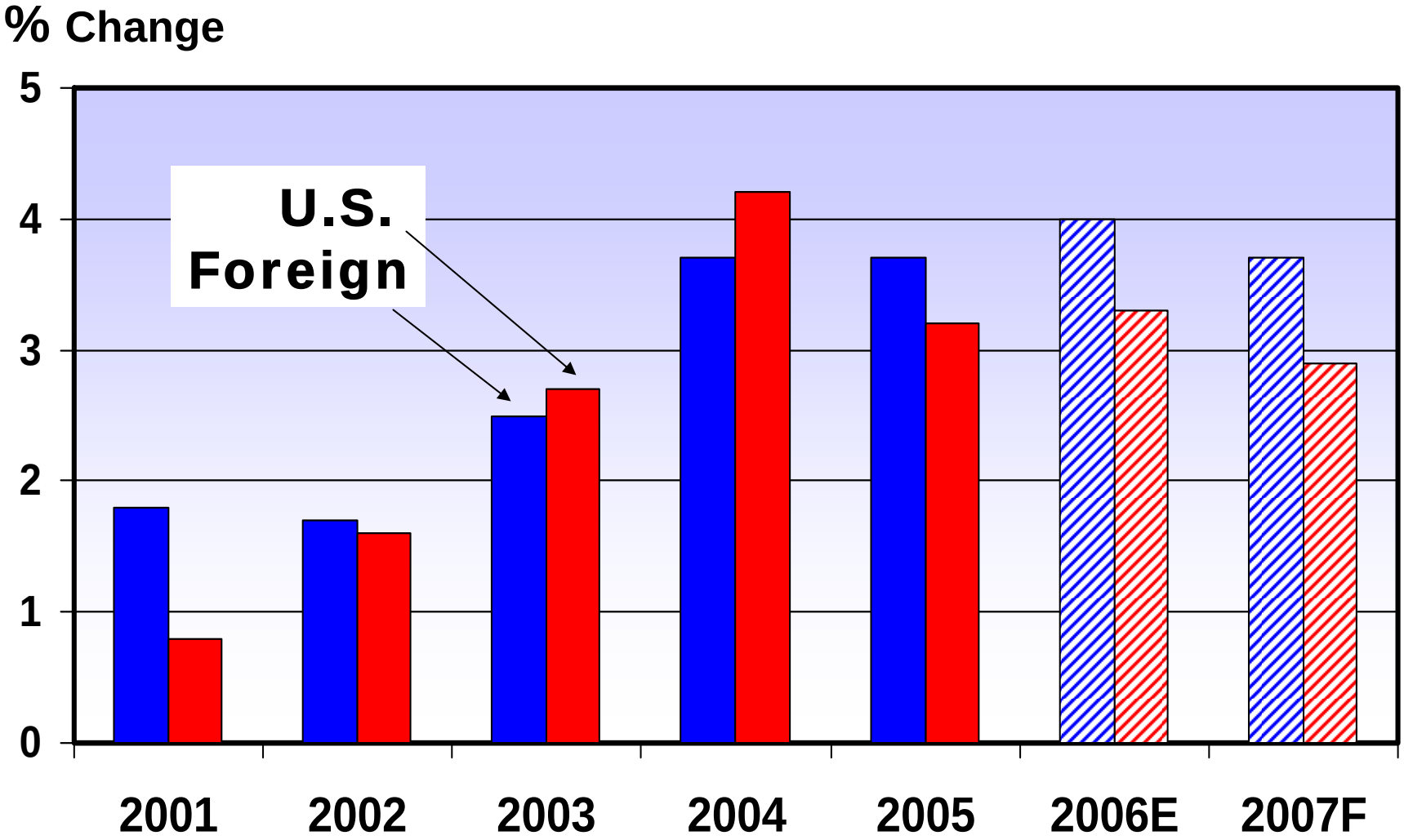

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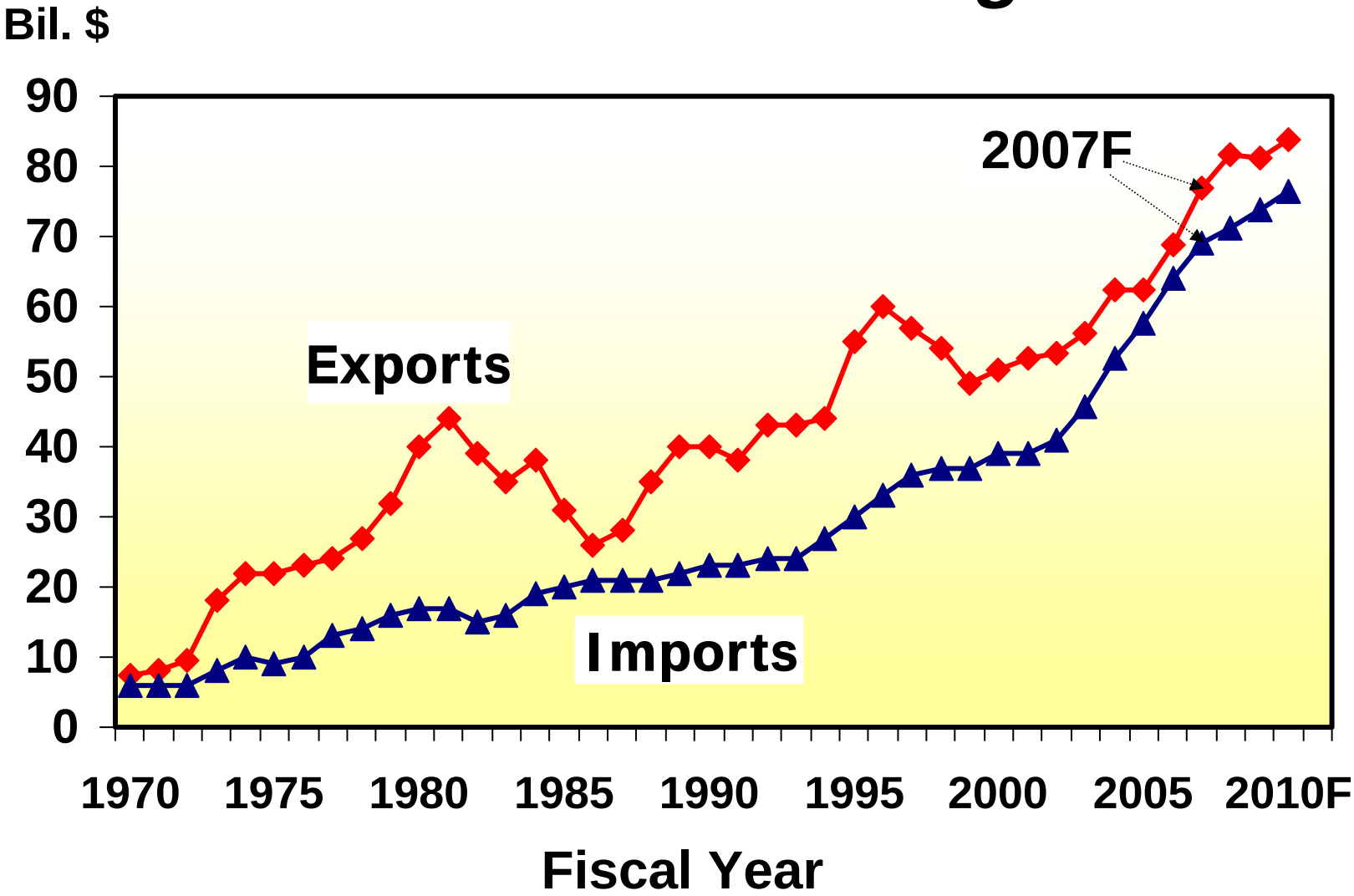

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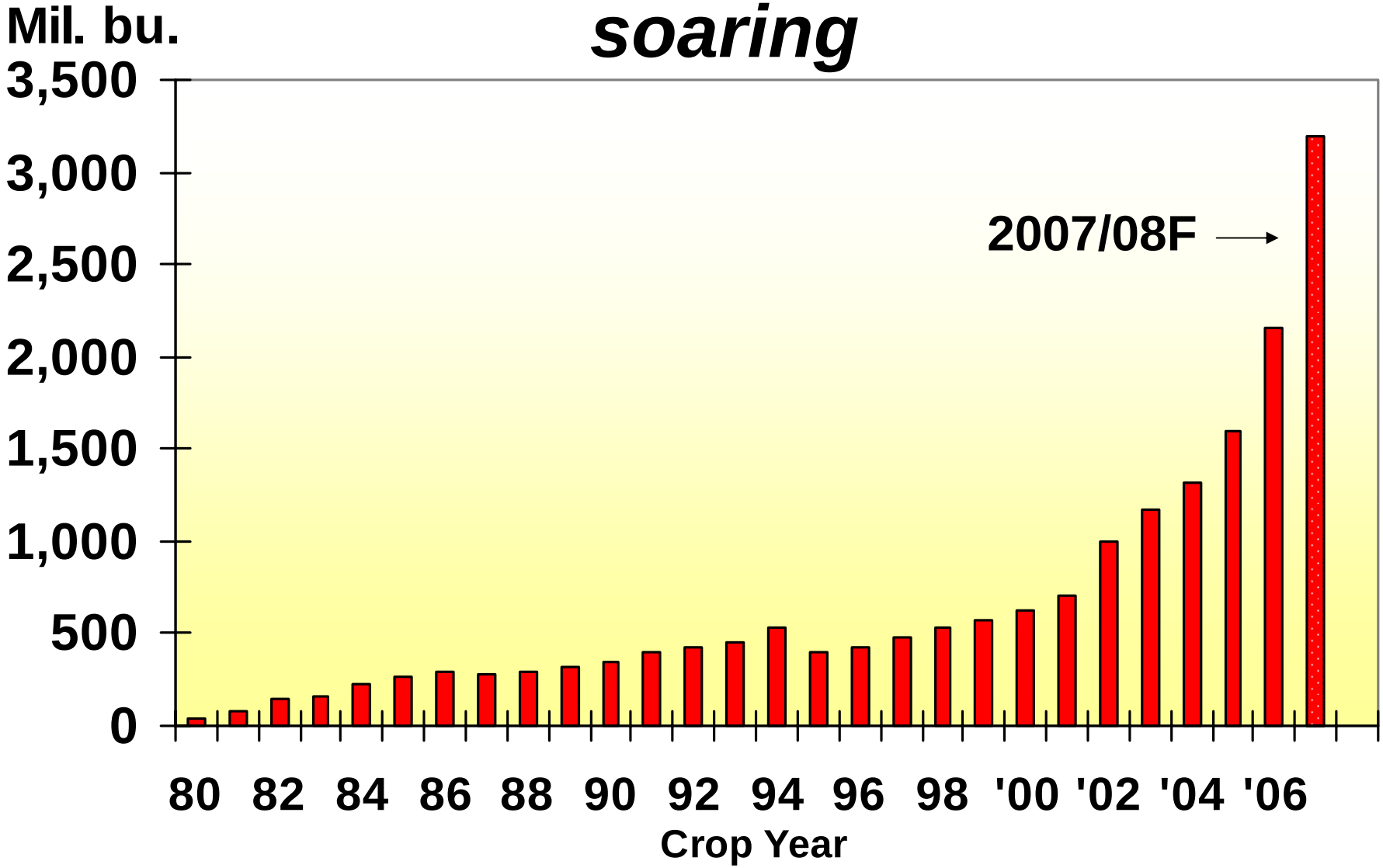

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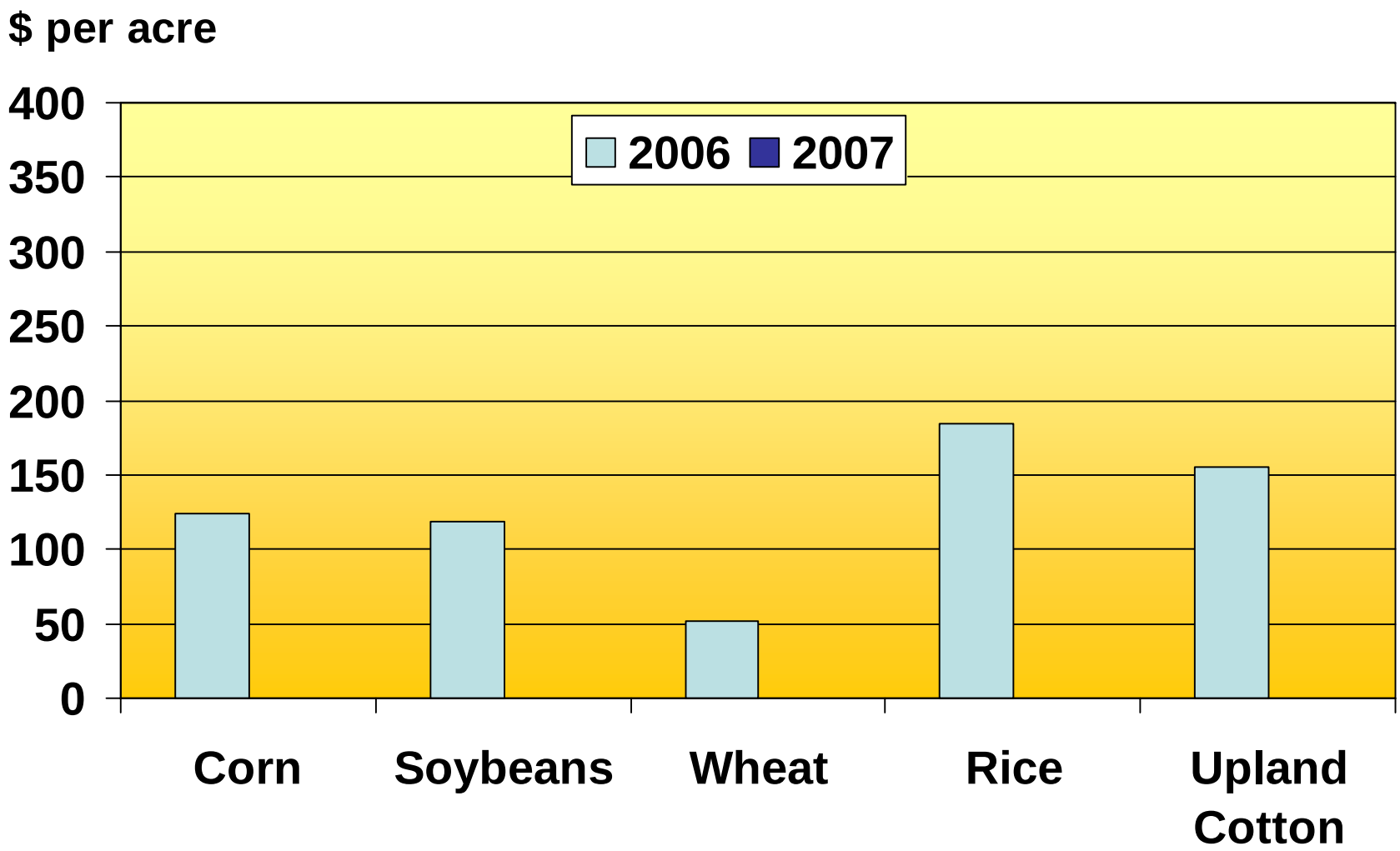

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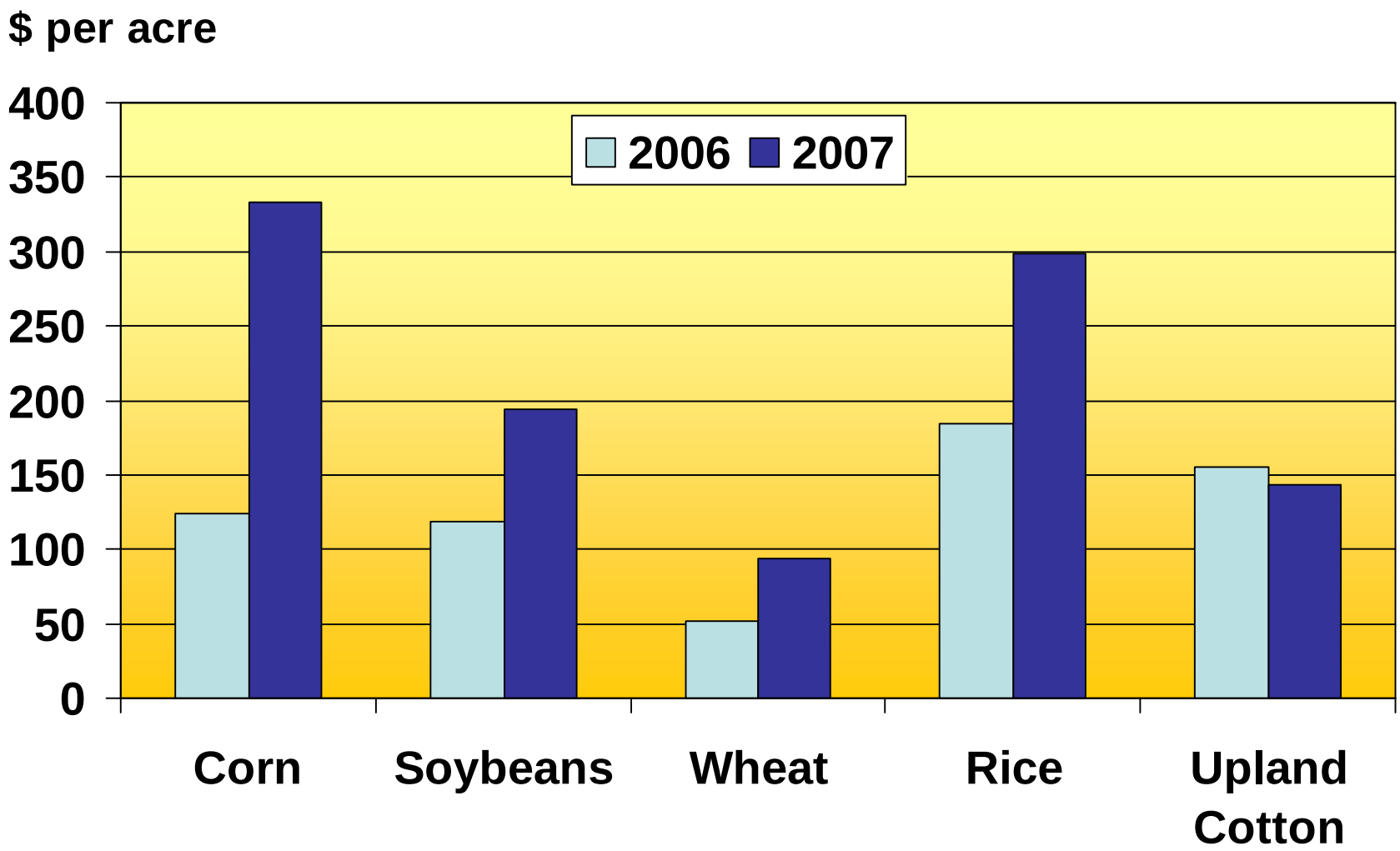

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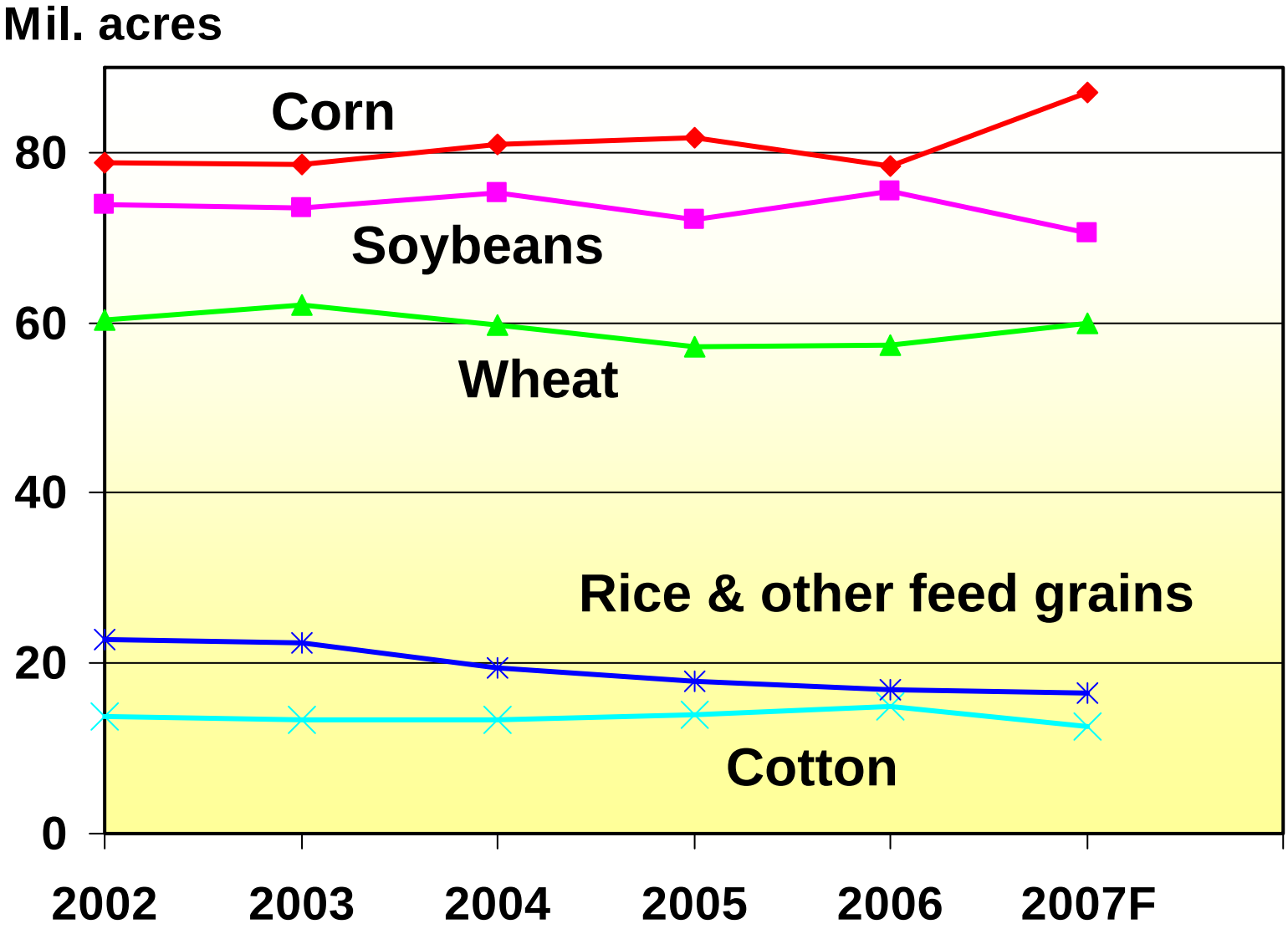

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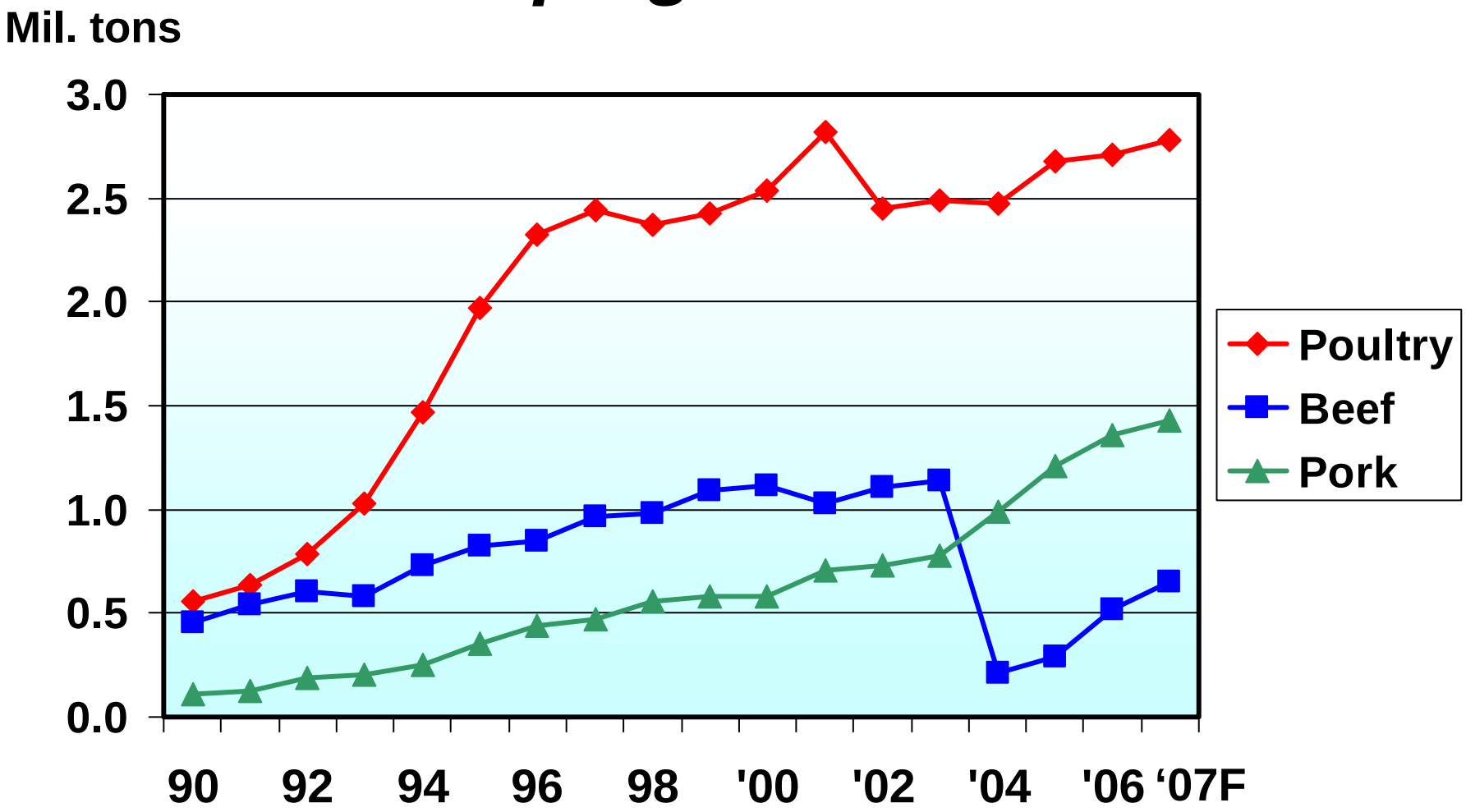

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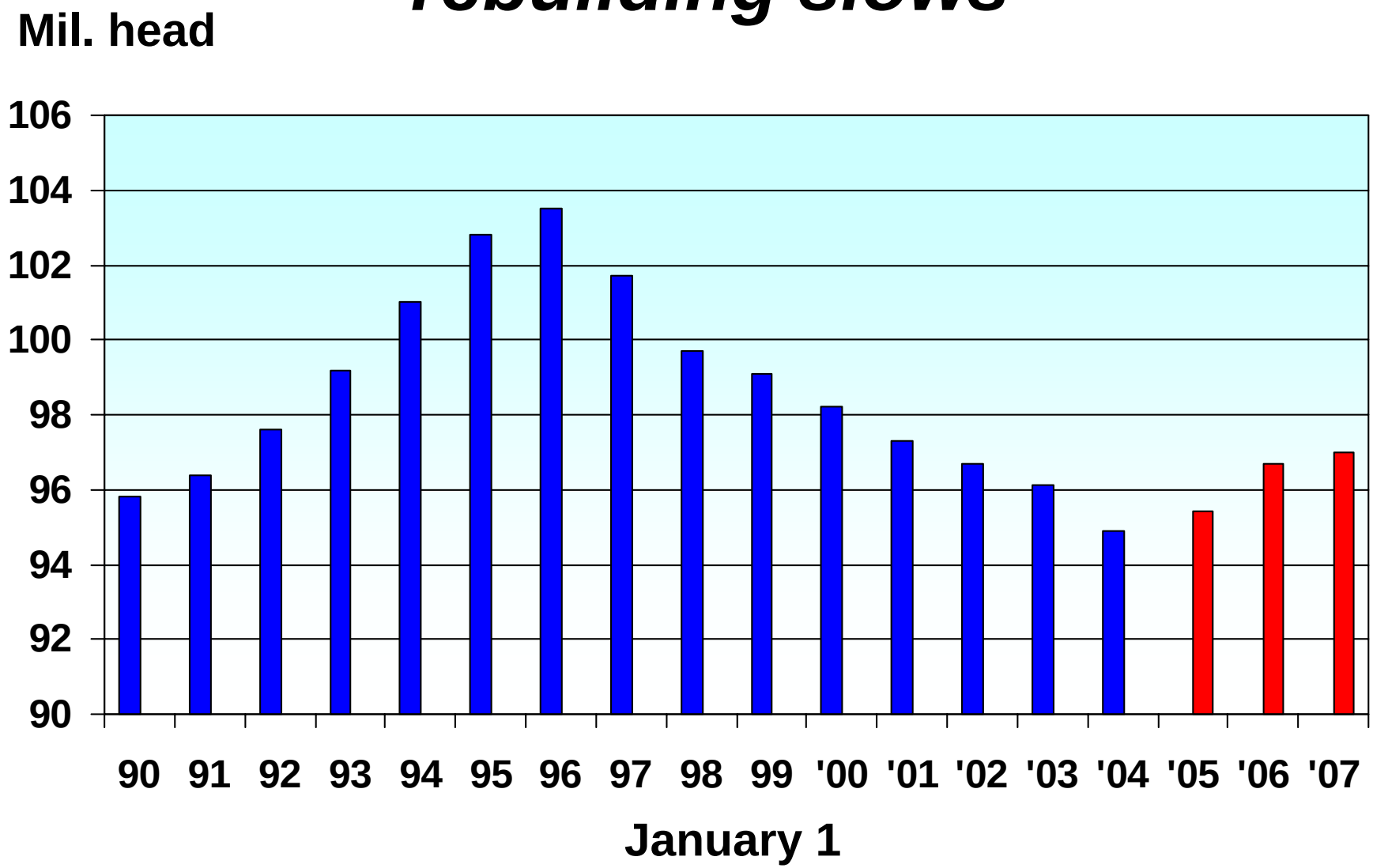

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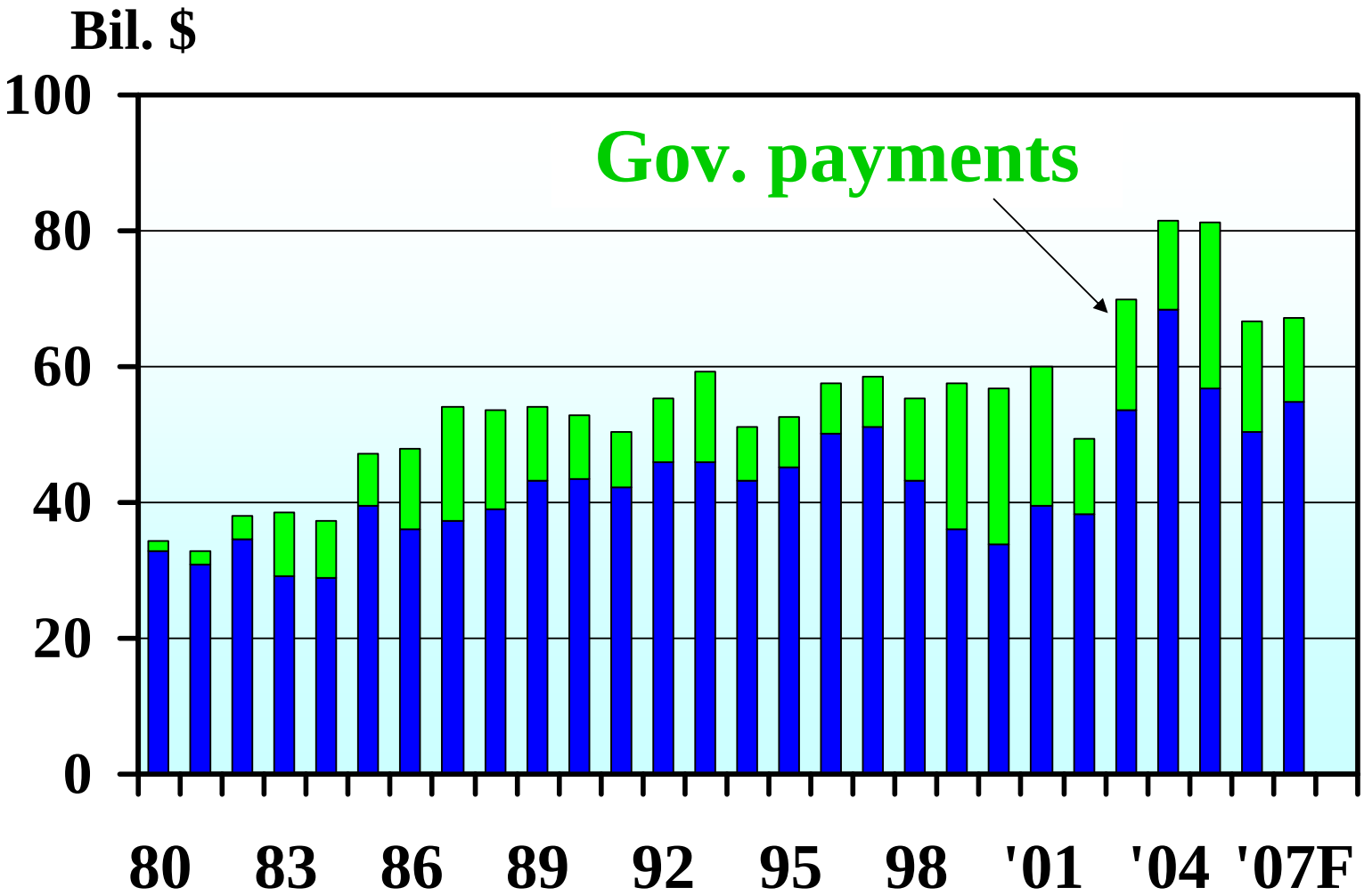

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