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Net Farm Income Down 35% From Last Year's Record; Brighter 2010 Outlook

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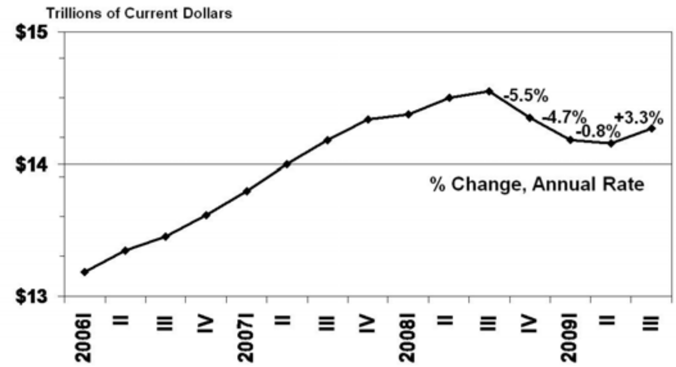
We wish everyone a very Merry Christmas and a Happy New Year. As the year rapidly comes to a close, it is time to reflect on the difficult 2009 and look forward to a better 2010. USDA's November '09 estimate of net U.S. farm income is down 34.5 percent from 2008's record high.

This past year was clouded with uncertainty related to political transition, a severe drought in most of Texas, record high mid-summer temperatures, one of the worst recessions since the 1930's, a significant drop in commodity prices, and tight credit markets. The situation was difficult for the entire agriculture sector, but especially for beef, dairy, hog, and poultry producers as the global recession cut demand. While the U.S. recession is technically over (Fig. 1), the agricultural sector will probably be the last to rebound from the slow, jobless, recovery underway as demand will be slow to improve. NOTE: Jobless recovery is used here in the sense that the U.S. unemployment rate will likely remain high for some time. An improving employment situation would improve the outlook for many sectors of the agricultural economy.

Figure 1: U.S. Gross Domestic Product
2006-2009, By Quarters



Quarterly data at seasonally adjusted annual rates
Source: Department of Commerce, Bureau of Economic Analysis

USDA's November $57.0 billion estimate of 2009 U.S. net farm income is up $3.1 billion from the August 2009 estimate, but down $30.1 billion (34.5 percent) from 2008's record of $87.1 billion. The 2009 forecast is $6.5 billion below the average of $63.6 billion in net farm income during the past 10 years. Last year's (2008) record net farm income was driven by a large increase in the value of crop production which was partially offset by higher production costs. Commodity prices increased at a higher rate than input costs. In 2009, commodity prices were down significantly, while input costs remained relatively high.

While crop agriculture experienced lower, but relatively attractive commodity prices in 2009, the livestock industry has suffered from high feed costs over the past three years and the recession weakened demand. Consumers cut back on purchasing high value steaks and other higher priced protein sources, both in restaurants and at home. While USDA's November estimate of U.S. crop receipts in 2009 dropped to $164.2 billion, down $18.3 billion (10%) from $182.5 in 2008, the estimate of livestock receipts declined to $117.4 billion, down $22.3 billion (16%) from $139.7 billion in 2008.

Slow Recovery

Early signs of improvements in the U.S. and global economic situation will stimulate improvement in demand for farm products in 2010. It may take several months/years to restore lost jobs and increase demand as the recovery will be slow.

Reduced livestock inventories have been reducing meat supplies. Along with the economic recovery underway, which may improve demand, large grain crops may serve to lower feed costs to more manageable levels. These factors may combine to improve the economic situation of the protein sector.

A weak U.S. dollar will encourage more agricultural exports and help restore demand. A weak dollar makes U.S. commodities cheaper in terms of local currencies of importing countries and favors increased U.S exports. Also, lower energy costs mean lower production cost for both livestock and crop production. However, a weaker dollar makes imports, such as oil, fertilizer, etc. more expensive to U.S. producers.

Increased domestic demand and increased exports will fuel improved market prices. Ethanol production continues as the single most significant activity affecting agricultural production. U.S. interest in renewable fuels has boomed during the last three years. Corn is the prime beneficiary of the increased production of biofuels, but all feed grains have benefitted.

Improved markets for grain may mean a brighter outlook for crop agriculture, but they also mean high feed costs for livestock agriculture. Even as grain prices improve from 2009's lows, livestock feed prices should remain significantly lower than 2008's record highs.

What's Ahead

- As the U.S. financial crisis ends, the agricultural situation will improve. The future of agriculture will be based on how producers manage risks.
- The recent improvement in commodity markets, especially cotton, is expected to continue, but will not approximate 2008's highs.
- Producers in all the protein sectors such as beef, dairy, hogs and poultry will probably continue to carry higher financial risk in 2010 than crop producers.
- The recent improved moisture situation will probably continue through spring '10. The national weather service predicts that El Niño will maintain moderate strength or grow stronger during the remainder of the winter. The effects of El Niño favors above average precipitation in the southern tier of the U.S.
- Since market prices are likely to remain above the target price for most farm program commodities, except maybe cotton, commodity provisions in Farm bill 2007 are less effective as a price risk safety net. This means increased reliance on existing price discovery tools, such as forward contracts and the futures market. This is particularly important since the farm sector is carrying more risk as production costs

have increased about 20 percent since 2006. Also, with commodity prices at a higher level, markets carry increased volatility.

- More food safety regulations with trace back audit trails, will probably be implemented as a result of the recent series of E. coli contaminated food products.
- Increased demand for organic products.
- Increased demand for source and processed verified livestock.
- Increased use of Genetically Modified Organisms (GMOs) as producers attempt to reduce energy/labor intensive production costs related to weeds and pests. In addition, GMO's are adding substantial attribute enhancement features for consumers and industrial applications, such as drought resistant varieties.
- A slight improvement in the availability of farm labor as unemployment rates remain high.
- Passage of immigration reform legislation will probably be delayed until after health care and climate change bills are negotiated.
- Increased reliance on technology, the Internet and electronic market linkages. For example, traditional open bid commodity markets for animals are fading in importance and most animals are marketed through contracts, cooperatives and a variety of arrangements that link production with processing and retailing of final products.

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