

May 2007 Economic Analysis Team Market Update



The General Economy

By Bob Young, Chief Economist

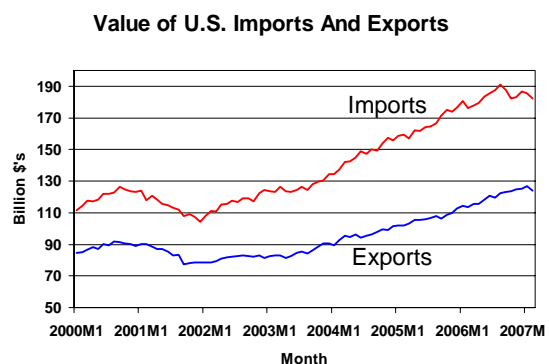
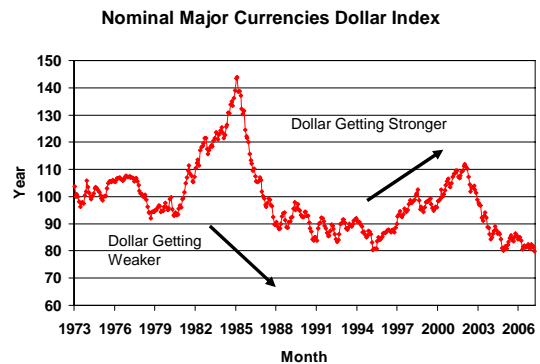
When you think about how the price for a product in the store changes over time, most of us recognize there are two components that drive these shifts. The first is the way the price for the product in question changes relative to other products. This can be driven by changes in demand or supply of the product. The other factor that moves prices over time is the underlying inflation rate. In other words, how much prices for all goods are changing, dragging the price of a particular product along with the overall tide.

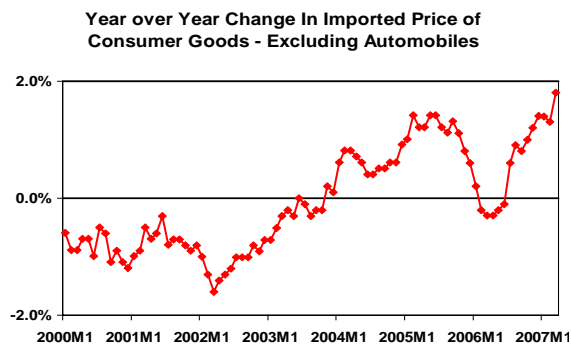
The same general issues drive exchange rates between countries. It is a bit of a stretch, but exchange rates are essentially how one currency is priced relative to others. Through time, the way currencies change relative to each other are driven by two main factors; the relative strength of one economy compared to the other and second, differences in the inflation rate in one country versus another. In other words, a real factor and an inflationary factor just like product prices discussed above.

The dollar trades against a number of other currencies. It is considered one of, if not the, base currency for the global economy. When you assign weights to the variety of countries we trade with based on the level of that trade, you end up with an index of the value of the dollar compared to these other countries. In April of this year, the index hit its lowest value. Ever. Since we started keeping this data. In 1973.

Last time I checked, the sky hasn't fallen, so this may not seem like a major issue, but it is a one of those things two handed economists like to consider.

On one hand, this drop in the value of our currency, relative others, is a very positive thing. It makes our goods that much cheaper in foreign currencies, making us that much more competitive. The data are reflecting that condition. Our total exports for the first two months of this year were up \$22 billion from the same time last year. Out of that figure, \$17 billion were in goods. For the same period, imports of goods rose only \$7 billion, suggesting that maybe we should not write off the manufacturing sector just yet. Total imports for the first two months of the year grew by \$11 billion.





On the other hand – you knew we’d find another hand – the converse is that our declining exchange rate makes imported goods more expensive. For the first several years of the decade, the economy operated with minimal inflationary pressure, driven in part by falling prices from imported goods. Notice in the graph above, however, that from roughly the start of 2004 onward, there has been an increase in the price of imported goods, implying that they are contributing to the overall inflation level. Higher inflationary pressures of course leads us to greater pressure on the Federal Reserve to keep interest rates up and all the problems we’ve talked about previously.

So do you want a strong dollar or a weak dollar? In a typical economists’ response – it depends.

Crop Outlook

By Terry Francl, Senior Economist

Since the March Market Update there has been a lot of water under the bridge and, as of lately, standing in the fields of the Midwest. The March Planting Intentions report indicated that farmers intended to plant 90.4 million acres of corn in 2007, up 12 million acres or 15% from 2006. This was on the top side of the pre-report estimates. Most of the planned increase in corn acreage was drawn from soybeans, down 8.4 million acres from 2006 and cotton, down 3.1 million acres.

At the same time the corn quarterly stocks number came in higher than expected and, as a result, projected feed usage was reduced by 125 million bushels in the subsequent April WASDE with the 2006/07 corn ending stocks increasing by a like amount. Likewise, the estimated

soybean ending stock was increased 50 million bushels to a more than ample 615 million bushels and the cotton ending stocks number was raised another 400,000 thousand bales to 9.2 million bales. Wheat was the only major crop that saw estimated use increase due to a higher feed and residual number and exports, 25 million bushels each, and a 50 million bushel decline in ending stocks.

As a result of these reports corn prices crashed from \$4.00 per bushels (May CBOT futures contract), just before the Planting Intentions report, to \$3.45 per bushel shortly after the report. The May contract had traded as high as \$4.50 per bushel at the end of February. The May soybean contract, which had traded around \$7.80 per bushel just before the reports, declined to a low of \$7.09. The May NYBT cotton contract, which was trading around 54 cents per pound prior to the reports, is now at 48 cents. Ironically, the May KCBT wheat contract, which had traded as high as \$5.25 per bushel prior to the reports, followed the other crops downward spiral and traded at \$4.35 per bushel at the time the Planting Intentions report was released.

Nothing stays the same for long in agriculture. The next big weather event was the Easter weekend cold front that brought temperatures down into the teens across the Midwest, South and Southeast. (It was actually colder in many areas at Easter than it had been at Christmas.) Early planted corn in the South and Southeast and wheat across all areas was affected by the freezing temperatures. Some corn has been replanted while the assessment of the extent of the damage to the wheat crop is still in process. The net effect was that May KCBT wheat prices jumped back as high as \$5.15 per bushel.

Cool and generally damp, if not outright wet weather has settled in over a good portion of the Midwest and delayed the corn planting progress so far this spring. According to the USDA’s Corn Planting Progress report released April 30th, only 23% of the corn crop had been planted, just half the level of a year ago and the five year average. While a great deal of focus has been given to what has been planted so far this year the more telling issue is what remains to be

Crop Information (cont)

planted. That is reflected in the following table with a comparison of the past five years for the same week.

US Corn Crop That Remains to be Planted

Year	2002	2003	2004	2005	2006	2007
	Million acres					
Plantings (Intentions)	78	78.6	80.9	81.8	78.3	-90.4
	Percent complete					
Week of April 29	42	55	63	52	52	23
	Million acres					
Remaining to plant	45.8	35.4	29.9	39.3	37.5	69.6
	Bushels per acre					
Yield, US average	129.3	142.2	160.4	148	149.1	?

It should be noted that in 2002, the last time US farmers were anywhere close to being this far behind in their corn planting progress, was the only time in the past nine years that the US average corn yield dropped significantly below trend line.

There are a number of things occurring that are going to affect the number of acres of planted and the ultimate production of corn in 2007. First, as a result of the drop in corn prices since the end of February, the economic advantage of corn has declined somewhat relative to other crops. Second, given current weather forecasts, it seems likely that planting delays are likely to stretch into mid-May in several of the major corn producing states. With that, not only are some acres likely to be switched from corn back to soybeans, but the expectations for corn yields are lowered.

It is impossible to precisely predict how corn yields will be affected at this early stage in the growing season, but Emerson Nafziger, University of Illinois, has done some research on this issue. In one article dated March 31, 2004, he published the accompanying chart on estimated yields by planting dates. In another article just published April 20, 2007, he said: "Even with the ability to plant fast, wet fields and some wet weather ahead will probably delay corn planting past the ideal time." He further defined the impact as follows: "This is about 1/2 bushel per day of delay for the first 10 days of May, 1 bushel per day during the second third of May, and 1 1/2 bushels per day for the last third." While this research was done in

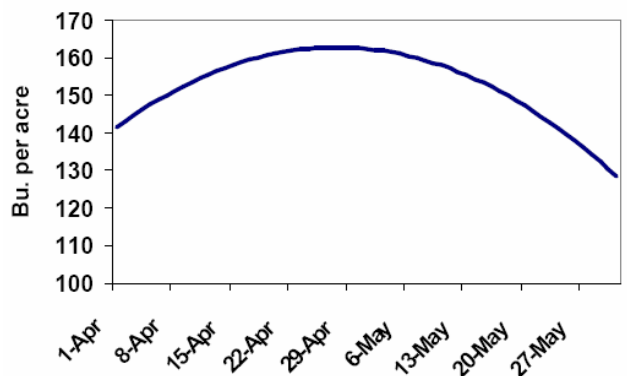
Illinois, it should be a rough approximation of what could be expected in the major Corn Belt states.

Although Nafziger does not go into the reasons for the reduction in yields, they are fairly well known. First, the later planting date reduces the length of the potential growing season and/or growing degree days available for the plant to develop. Second, the later planting pushes the corn's pollination period back from late mid- to late June into early to mid-July when high temperatures can interfere with the pollination process. This period is so critical that even when soil moisture is adequate yields can be reduced 5-10%.

Speaking of summer weather, prospects for a La Nina condition in the equatorial Pacific Ocean are growing, though somewhat more slowly than some experts had expected. During April the average temperature deviation fell to minus 0.6 degrees Celsius from minus 0.3 degrees in March and minus 0.1 degrees in February. This suggests that a La Nina may be in full swing by June or July. Frequently, the transition to a La Nina is accompanied by volatile weather in the U.S. and elsewhere

The net result of all this is that corn planted acreage will likely be reduced from two to three million acres from the March 1 planting intention of 90.4 million acres. Nearly all of that acreage difference is likely to return to soybeans. The potential for corn yields in 2007 has been reduced by some amount to be determined by future spring and summer weather.

Figure 1. Estimated Yields by Planting Date



Crop Information (cont)

Previous yield projections, by some analysts, of 155 bushel per acre or more are only a slightly probability. A 150 bushel per acre national average yield number seems appropriate at this juncture, with any significant deviation more likely to be on the down side than up. With this acreage and yield outlook it means total corn production will probably be close to 12 billion bushels. The increasing demand for corn to produce ethanol will most likely result in an ongoing tight supply and demand situation in the 2007/08 crop year. Likewise, this will add up to 100 million bushels or more to the already abundant soybean supply.

The only thing that can be said about crop prices is that they are going to remain volatile. Clearly corn will continue to be the leader in price direction. Cotton remains relatively unaffected at this juncture with the May contract trading near its seasonal low of 48 cents. Corn could test the previous high of \$4.30 per bushel, CBOT December futures contract, depending on the length and intensity of rainfall in the Corn Belt the next couple of weeks. If not then, corn prices may make another run at the highs in July, should hot weather threaten during pollination. Soybean prices will follow corn in the short run, but could come under substantial downward pressure, especially if it is confirmed that two or more million acres of ground intended to be planted to corn is switched back to soybeans.

Crop producers should utilize these market up ticks to finish old crop sales and to add to new crop price commitments. On any pullback in corn prices feed users need to start extending purchasing commitments into the summer and early fall. Harvest time lows could ultimate slip back to around \$3 for corn, \$6 for soybeans and \$4 for wheat. However, that probability decreases with each passing day of adverse weather.

Livestock Information

By Jim Sartwelle, III, Livestock Economist

April was a month spent digesting USDA's March 30 planting intentions report. That report was initially thought of as friendly to the livestock complex and market activity bore that optimism out. CBOT July Corn futures took a 40-cent break from the \$4.15 area mid-March to the \$3.65-\$3.85 area by the end of April. This was welcome news to cattle, dairy, hog, and poultry producers who had run up against a completely new world of corn demand and feed prices.

USDA released its monthly Cattle on Feed report on April 20th. The supply of cattle resident in the nation's 1,000-head plus capacity feedyards grew by 45,000 head during April. Relative to year-ago levels, April 1 cattle on feed was 1% lower in 2007. March 2007 marketings were 6% lower and placements were 7% higher. This report seemed pretty bearish on its face. However, the markets took that information, blended in new feedgrain planting intentions, and plowed on. At month's end, cash markets for all classes of calves and feeder cattle remained strong, backed up by CME Feeder Cattle futures contracts from the nearby through the end of 2008 trading at or above \$109.

The fed cattle and beef trades traveled rocky roads during April. Live Cattle futures followed beef values the first three weeks of the month. Carcass cutout values dropped more than \$10/cwt and the cash and futures markets for fed cattle followed. After hitting the \$100 mark in early April, the cash trade lost \$5. Still, there is little or no reason to think beef markets will drop much more. Memorial Day draws near, marking the traditional start of the summer outdoor grilling season. Every CME Live Cattle futures contract from June 2007 through June 2008 closed the month trading above \$92.50.

The pork and dairy complexes also had a good April. Lean Hog futures contracts from the nearby through the end of this summer ended the month trading above \$75. The Chinese melamine situation concerned many by month's

Livestock Information (cont)

end, but those jitters were not obvious in either the cash or futures trades. Dairy markets remained strong. Class III and Class IV milk, block and barrel cheese, and butter all added value. Non-fat dry milk and whey markets remain amazingly strong. The weak U.S. dollar and reduced dry products in other major producing areas combine to drive these hot markets. Expected cutbacks in production per cow and cow numbers are yet to materialize, but we remain concerned with scarce hay supplies and other high production costs and will continue to monitor milk production as temperatures rise during the next few months.

Many livestock producers are likely watching the current farm bill debate. Most major crop commodity associations have promulgated proposals for farm bill reauthorization, and in late April, the American Farm Bureau Federation provided details on its own proposal. There are several items in the AFBF proposal that pertain directly to livestock producers.

Farm Bureau supports allowing haying, but not grazing, on Conservation Reserve Program (CRP) acreage with a reduction in the rental rate to partially offset the economic gains. Farm Bureau supports increasing the EQIP baseline funding by \$125 million annually for hog and broiler operations. AFBF believes Congress should prioritize research on modifications of Dried Distillers Grains (DDGs) and other byproducts to expand their use, especially in non-ruminant animals.

AFBF's Standing Catastrophic Assistance proposal would apply the same assistance criteria across years to all forage crops, as well as field crops and specialty crops. This would address the concern of many livestock producers that they are sometime omitted from federal disaster funds that are triggered by crop losses.

Competition issues have come front and center in the pre-farm bill debate. AFBF supports

enhancing USDA's oversight of factors that have the potential to limit the competitiveness of livestock markets. AFBF calls upon USDA, in conjunction with the Justice Department, to closely investigate all mergers, ownership changes or other trends in the meat packing industry for actions that limit competition. To that end, AFBF supports establishing an Office of Special Counsel for Competition at USDA.

AFBF supports amending the Packers and Stockyards Act to provide jurisdiction and enforcement over the marketing of poultry meat and eggs as already exists for livestock. This includes treating breeder hen and pullet operations the same as broiler operations. AFBF supports efforts to provide contract protections to ensure that a production contract clearly spells out what is required of a producer. In addition, we support prohibiting confidentiality clauses in contracts so that producers are free to receive assistance with the contract from family members, an outside advisor, a lawyer, or a lender.

Farm Bureau supports a proposal to change the structure of the dairy price support program from the current program that supports the price of milk to one that supports the price of butter, nonfat powder and cheese. Farm Bureau supports this change only if total federal government funding does not increase by moving to the new program. AFBF supports continuation of the Milk Income Loss Contract (MILC) program or another form of counter-cyclical payments and opposes reductions in the program payments. Farm Bureau supports implementation of the dairy promotion assessment on imports.

Livestock producers must discuss external issues like the impending farm bill debate and the relentless advance of animal welfare advocates who seek to effect serious change on our modern animal production practices. While we spend great time and resources following markets and production trends, these outside forces most directly shape the long-term economic viability of animal agriculture, if not its very existence. We will ignore these forces at our own significant peril.

