Hog Expansion Postponed

Iowa pork producers have enjoyed profitable conditions for the past 18 months and returns are expected to stay generally profitable well into 2006. Strong pork demand, that produced the highest annual hog prices since 1996 in spite of record US pork production, has weakened somewhat. Lower grain prices have reduced feed cost and have helped to maintain profitable conditions. As a result most analysts expected an expansion of the US breeding herd. **However, the USDA estimated that total hog inventories on September 1, 2005 were nearly identical to the same month a year earlier.** The total inventory and market hog inventory were in line with pre-report estimates, but the breeding herd inventory was smaller than expected by the trade and should be bullish of prices next summer.

Market hog inventories were estimated at 55.56 million head, unchanged from September 2004 and the number of breeding animals was also unchanged from the year before at 5.97 million head (Table 1). **Based on current information, hog prices are forecast to remain at or above breakeven this fall and move higher in early 2006. The next threat of red ink would appear to be late summer 2006 and beyond.**

Table 1. Summary of USDA September Hogs and Pigs Report, Million head and Percentage Change from Year Ago

<table>
<thead>
<tr>
<th></th>
<th>US Million</th>
<th>%Chg.</th>
<th>Iowa Million</th>
<th>%Chg.</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Hogs</td>
<td>61.536</td>
<td>0.0%</td>
<td>16.5</td>
<td>0.6%</td>
</tr>
<tr>
<td>Breeding Herd</td>
<td>5.972</td>
<td>0.2%</td>
<td>1.08</td>
<td>1.9%</td>
</tr>
<tr>
<td>Market Hogs</td>
<td>55.563</td>
<td>0.0%</td>
<td>15.42</td>
<td>0.5%</td>
</tr>
<tr>
<td>Under 60</td>
<td>20.634</td>
<td>-0.5%</td>
<td>4.76</td>
<td>0.4%</td>
</tr>
<tr>
<td>60-119</td>
<td>13.716</td>
<td>0.8%</td>
<td>4.32</td>
<td>2.9%</td>
</tr>
<tr>
<td>120-179</td>
<td>11.384</td>
<td>1.3%</td>
<td>3.45</td>
<td>3.0%</td>
</tr>
<tr>
<td>180+</td>
<td>9.830</td>
<td>-1.5%</td>
<td>2.89</td>
<td>-5.2%</td>
</tr>
<tr>
<td>Pig Crop</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mar-May</td>
<td>25.884</td>
<td>1.0%</td>
<td>3.982</td>
<td>5.8%</td>
</tr>
<tr>
<td>Jun-Aug</td>
<td>26.273</td>
<td>0.4%</td>
<td>4.050</td>
<td>3.4%</td>
</tr>
<tr>
<td>Farrowing Intentions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sep-Nov</td>
<td>2.888</td>
<td>0.0%</td>
<td>0.460</td>
<td>0.0%</td>
</tr>
<tr>
<td>Dec-Feb</td>
<td>2.875</td>
<td>1.4%</td>
<td>0.460</td>
<td>4.5%</td>
</tr>
</tbody>
</table>

Iowa gained some market share as its’ inventory posted a larger increase in most categories than did the US. In particular, the March-August pig crops had larger increases than did the US average.
**Current situation**
Weekly hog slaughter January through September was 0.1% larger than the same period of time in 2004. Sow slaughter was 5.9% lower this year than last and suggested that there would be an increase in the breeding herd inventory but it didn’t materialize. Barrow and gilt prices, that started 2005 stronger than 2004, have been generally weaker in the third quarter of this year.

While average carcass weights averaged 1.5 pounds heavier than the year before through September, they have been only 0.6 pounds heavier since July 1 and were actually lower than 2004 levels in September. The low cash corn price and current hog prices favor heavier weights and they will increase seasonally as the weather cools, but the fact that weights are below a year ago is encouraging.

Improved pork trade balance has also helped support prices. Through the first half of 2005 pork imports are down 9% from the year before while US pork exports are up 24%. This gain is on top of a 27% increase in 2004 pork exports over 2003. Japan remains the largest US pork export market with 41% of US pork exports in the first half of 2005 followed by Mexico (19%) and Canada (11%). While exports to Mexico were off less than 1% so far in 2005, pork to Japan and Canada has increased 15% and 33%, respectively.

Live hog imports from Canada have also slowed this year. The number of feeder pigs crossing from Canada through the first 38 weeks of the year totaled 3.7 million head, down 10.5% from the same period in 2004. Meanwhile, the number of barrows and gilts imported from Canada for slaughter is also lower at 1.6 million head, down 6.4%.

Pork in cold storage at the end of August was 418 million pounds, 9% larger than August 2004. Total red meat and poultry stocks were approximately 1% higher than one year earlier.

**Production and Prices**
Based on the estimated pig crops and farrowing intentions from the USDA report and steady to lower year-over-year carcass weights and Canadian imports pork production in the coming four quarters is expected to be only modestly higher. Table 2 summarizes that forecast changes in production and Iowa barrow and gilt live prices by quarter through September 2006. Even though supplies are expected to be near the same level as the year before, prices are forecast to be slightly weaker because of weaker demand in the year ahead. However, the forecast prices are expected to be profitable for most Iowa producers.

<table>
<thead>
<tr>
<th>% Chg '04</th>
<th>Live cwt</th>
</tr>
</thead>
<tbody>
<tr>
<td>OCT-DEC</td>
<td>0.0</td>
</tr>
<tr>
<td>JAN-MAR</td>
<td>0.0</td>
</tr>
<tr>
<td>APR-JUN</td>
<td>1.0</td>
</tr>
<tr>
<td>JUL-SEP</td>
<td>1.5</td>
</tr>
</tbody>
</table>

This forecast also expects beef and poultry supplies to increase somewhat over the year earlier levels for the same quarter. It also assumes continued strength in the economy and continued exports of pork.

**Factors to watch**
Demand will be a key for prices in 2006. This year will be near the record production set in 2004 and 2006 will be larger. Exports are expected to set another record in 2005 and continue to grow in 2006. Energy cost for export transportation will be a wild card, but it takes even more energy to export grain to
produce pork in countries that import US pork making pork a better long term value. However, higher energy costs are expected to cut into disposable income of US and export customers hurting demand for red meats. As a result the modest increase in supply forecast is expected to push prices lower over the next 18 months or longer compared to the same time period the previous year.

There is expected to be strong demand for hogs due to the new processing capacity added by the opening of the new plant in St Joe, MO. Once ramped up, it should process approximately 8,000 head a day on a single shift. It is expected to begin procession later this fall. This new capacity will improve hog basis.

Factors to watch to gauge pork demand include cold storage and the amount of retail featuring relative to beef and poultry. A fair amount of poultry production was in the path of Katrina and was at least temporarily disrupted. This may result in unfilled broiler orders and higher broiler meat prices in the near term, but longer term most, if not all, of the production will be back on line.

There are two opposing demand forces as a result of Katrina and her recovery efforts. While the human suffering and loss of property was devastating, the population will still consume food. There will be a switch from restaurant meals in the hardest hit areas to more conservative meals, but the meals will still be served. The largest impact of Katrina is expected to be its impact on energy prices. Higher gas prices will cut into household income. Also watch natural gas prices for home heating this winter, a substantial portion of US natural gas comes from the Gulf region. It would seem that food away from home and particularly up-scale restaurants will feel more of the impact than grocery sales as people will look for places to economize. The good-news, bad-news story for pork is that it will be less impacted by slower restaurant trade than beef because it typically has fewer menu items.

The other opposing force is that the billions of dollars that will be spent on rebuilding the region will stimulate the economy and create new jobs and payroll that will increase spending. The net impact on pork demand will depend on the relative size of the recovery compared to the lost commerce.

Longer-term, if gas prices have moved to a new higher price plateau we could experience an inflationary adjustment in the US economy. The rebuilding in the Gulf Coast region will also drive up prices for building materials. If, and how, that adjustment may occur will play out over the coming months and beyond.

**Managing cost**

While hog prices are expected to be at profitable levels for the next four quarters, producers can still do things to control costs. Clearly an energy assessment on buildings is order. Cleaning and maintaining fans, air intakes, heaters, and thermostats is important. Understand the trade off between ventilation rates, heating costs, and indoor air quality for optimal animal performance.

The impact on trucking costs is not expected to be a big factor on a per head basis, but should be evaluated. At four miles/gallon, a $1/gallon increase in fuel causes the cost per loaded mile to increase $.25. At 180 head per load the cost of trucking 100 miles increases $.14/head. Iowa producers are better positioned than producers that have further to haul.

The wide corn basis this fall provides an opportunity for reducing feed costs. Producers will likely have to own and store the corn to capture the opportunity. The basis ahead of harvest was 20-30 cents/bushel wider than normal due to large stocks of the 2004 crop in the country. With more ethanol plants coming on line in 2006 the basis is expected to return to historic levels or narrower in the spring and summer.

*John Lawrence*
September 1 Stocks: Positive for Bean Prices, Slightly Positive for Corn

The soybean complex this week received up-dated supply-demand information that points to slightly higher harvest-time and season average prices than previously anticipated. USDA’s September 30 grain stocks report verified earlier indications that the 2004 U.S. soybean crop was slightly over-estimated. The U.S. average soybean yield for 2004 was lowered 0.3 bushels per acre, and total production was reduced from the previous estimate by 17 million bushels. August soybean crushings were 3.6 million bushels above previous expectations. However, the July crush figure was revised down 0.7 million bushels from last month’s preliminary figure. With this new information, the “residual use” of soybeans for the 2004-05 marketing year is still a little higher than anticipated. “Residual” use reflects handling losses as soybeans are moved through the marketing system, and possible statistical errors. The current residual number hints that another small reduction in the 2004 crop estimate is possible at a later time.

Bean Stocks
The September 1 U.S. soybean stocks were placed at 256 million bushels. That’s 30 to 35 million bushels below many private analysts’ expectations and down from USDA economists’ projections of 295 million bushels earlier this month. Last year’s September 1 U.S. stocks were an unusually low 112 million bushels. U.S. soybean yields for the 2005 soybean crop are expected to increase in the October 12 crop report. Smaller than expected carryover stocks will offset about ½ bushel per acre of any yield increase.

Increase in Iowa Old-crop Grain Supplies vs. a Year Ago
The stocks report confirms earlier indications that grain storage space is likely to be tight this year. Total Iowa corn and soybean old-crop stocks on September 1 were estimated to be 299 million bushels larger than a year earlier. The September crop forecast placed this year’s potential state-wide production at 151 million bushels less than last year. That reflects a forecast decline in the state’s corn crop of 106 million bushels, along with a 45 million bushel decline in soybean production. Yield reports so far hint that the final crop numbers could be larger than currently indicated. The current production forecast shows total Iowa grain supplies this fall to be about 148 million bushels larger than last fall, when many elevators were forced to store corn in outside piles. Large supplies almost certainly will keep the corn and soybean basis depressed for the next several weeks. The soybean basis may recover some in the first month or two after harvest, but the corn basis may remain depressed into at least December in the western half of the state.

Soybean Price impacts
Our price forecasting model indicates these changes, not including any changes in October and November crop estimates, should add about 15 cents per bushel to the season average soybean price. Without further changes in crop estimates, we would expect the August 31, 2005 U.S. soybean carryover stocks to drop to about 160 to 170 million bushels, slightly less than a three weeks supply. Declining carryover stocks will make winter, spring and summer 2006 soybean prices more sensitive to weather and Asian rust concerns than previously anticipated. However, the prospects for slightly higher prices than previously anticipated plus this year’s surprisingly good Midwest soybean yields may bring increased soybean plantings in 2006. Extremely high natural gas prices (about double last winter’s level) and sharp upward pressure on nitrogen fertilizer prices likely will encourage farmers to shift some corn acres to soybeans next spring. The outlook for nitrogen fertilizer costs is much more uncertain than usual. Natural gas is the key raw material for producing nitrogen fertilizer.

Corn Stocks
U.S. September 1 corn carryover stocks were placed at 2.112 billion bushels, more than double the 958 million bushels a year earlier. Corn stocks were closer to expectations than soybeans. USDA September 12 projections placed the 9/1/05 carryover at 2.125 billion bushels. The corn stocks reflect a very high
feed and residual use from March through August, with the marketing year indicated corn feed, seed, and residual use up 6.7% from last season. Feed use is not measured directly by USDA, but is combined with residual use, which like soybeans, includes a possible statistical error term. **A sizeable part of the increase in feed and residual use likely was corn that deteriorated in outside piles in the western Corn Belt during the last eight months.** With better quality maintenance in grain stored from this year’s crop, the residual use may decline next year.

Supply-Demand Projections

Our latest corn and soybean supply-demand projections are shown on our web site, http://www.econ.iastate.edu/faculty/wisner/, in the upper right-hand column. Column B represents the USDA September 12 crop forecasts and our projections of potential use, carryover stocks, and prices for the year ahead. We have also added a very early and tentative set of projections for the 2006-07 marketing year, assuming normal weather. **One very uncertain element in next year’s supply projections is the impact of high natural gas prices on nitrogen fertilizer costs and corn acreage.** We have projected a modest decline in corn acreage for 2006. Depending on winter temperatures and the trend in natural gas prices in the next several months, corn acreage could decline a bit more than we are currently projecting. Also note our corn utilization projections for 2006-07, with the rapid expansion in corn processing for ethanol.

Marketing Year Average Prices & CCPs

USDA released the marketing year weighted average prices received for corn and soybeans this week. The U.S. corn marketing year average price was $2.06 per bushel, one cent below our earlier projection. As a result, total Counter Cyclical Payments (CCPs) for 2004 corn are placed at $0.30 per bushel. Some farmers may have taken first and second advance payments that bring them above that level. If so, FSA will ask for repayment of the excess or more likely will deduct it from advance payments for the 2005 crop. The U.S. soybean marketing year average price was $5.74 per bushel. That is well above the $5.36 per bushel trigger level for CCPs, so that soybean farmers will not be receiving a CCP on last year’s crop. If the marketing year average price is below the trigger, CCPs will be paid. Early indications are that 2005-crop corn will receive a CCP, but final crop estimates, export demand, and next year’s acreage and weather will be key influences on the size of the CCP.

Soy Oil Prices & Diesel Fuel

Soybean oil prices have been supported in the last few weeks by the announcement of several new soy diesel plants that are being built. High diesel prices will encourage increased use of soy diesel, as will new EPA rules next year that call for reduced sulfur content in diesel fuel. Economists consider soybean oil demand to be highly inelastic. Traditional users are not very price sensitive. When supplies are short, it takes a high price to persuade some users to reduce consumption. When supplies are large, it takes a large price decrease to encourage consumers to use more. For this reason, modest use of soy diesel may bring significantly higher soy oil prices at times, especially when the markets are worried about U.S. and/or South American production prospects.

Gulf Update

The Louisiana gulf ports and the Houston-Galveston grain ports are operating. Their capacity is restricted some by daytime-hours-only for navigation. Shipments by port elevator for the week ended 9/22/05 and comparisons with a year earlier were as follows:
Shipments were restricted the week of 9/22/05 by early shut-downs of port elevators both in the New Orleans area and the Houston-Galveston port. Shipments should gradually increase in the next few weeks, barring problems from another Hurricane.

There has been much talk of a weak Gulf corn basis placing the Corn LDP at risk. In Iowa, county LDPs are determined by the higher of the Louisiana Gulf or Kansas City prices. The Louisiana Gulf basis for corn was around 42 cents over nearby futures last week, before the shut-down for hurricane Rita. This week, it has been in the mid-30s. A year earlier, the Louisiana Gulf basis for corn was about 28 over, and soybeans were 44 over nearby futures. Last week, the soybean basis was 33 over. These and other historical data indicate the Louisiana corn basis has not been severely depressed in the last two weeks, compared with past basis levels. However, basis levels further up on the Mississippi, Illinois, and Ohio rivers have been depressed by congestion on the river. The river market basis in eastern Iowa may strengthen a little as barge congestion diminishes and traffic on the lower Mississippi moves back to round-the-clock shipping. However, large supplies and a lack of grain storage space in the western 2/3 of the state appear likely to keep the eastern Iowa basis from making a sharp recovery during harvest. In central, northern, and western Iowa, the large supplies appear likely to keep pressure on the corn basis into early winter, although some strength in the soybean basis probably will occur after harvesting is finished.

Robert Wisner
Milk Production Extends Large Increases

August 2005 milk production recorded the 4th straight month of 4% plus milk production gains. The 23 dairy states reported a 4.6% milk increase with milk per cow up 4% and dairy cow numbers up 0.6%. Cow productivity increased 64 pounds above year ago and cow numbers were 52,000 larger. Monthly milk per cow and total milk production started to show strong gains over year ago levels in March 2005, about 3 months after full allocations of Posilac reached dairy farmers.

Iowa milk production did not show the same response. Total milk production was down 1% due to a 6,000 cow drop in the Iowa dairy herd. Milk production per cow did increase by 40 pounds. Iowa’s cheese production did rise 1.9% from one year ago but was 5.4% less than the previous month. SD now consistently produces more cheese than Iowa even though their dairy herd is less than half the size of Iowa.

The largest milk production increase occurred in Idaho, 13.4%, with 35,000 more cows and 90 pounds more milk per cow. TX was second with a 10.9% milk increase. TX did not add cows, but did have a milk per cow increase of 160 pounds. CO had the third largest increase, 9.5% with 2,000 more dairy cows along with 135 pounds more milk per cow from the herd. NM seems to have reversed direction on cow numbers. During July they were flat but added 4000 cows in August and ended up with a 6.2% production increase. Other states with strong milk production increases were IN 7.5%, MI 6.8%, NY 5.5%, PA 7.1% and WA 6.9%.

Six of the 23 dairy states had production declines. Iowa was one of these as earlier noted. Others were FL -1.2%, IL -0.6%, KY -5.2%, MO -7.5% and OR -1%. KY, MO and OR had declines in milk per cow.

A couple of other states near Iowa had milk production gains, MN 2.2% and WI 4.6%. Both of the increases were due to gains in milk per cow. MN had 10,000 fewer dairy cows while WI only had 4,000 fewer than one year ago.

Demand
The additional milk is making its way to the churn and cheese vat. Butter production was up 2.3% for July 05 and but cold storage stocks were 7% lower than one year ago on August 31, 2005. Butter stocks were also 15% lower than the previous month. Butter prices on the CME have fluctuated around $1.70 per pound for the last few weeks. Price does not appear to be drawing as much cream to the churns as the draw down in stocks would warrant.

July 05 cheese production is up as well, 4% above July 04 but 3.3% lower than June 05. The largest percentage increase came in Hispanic cheeses, 12.8% than one year ago. Mozzarella gained 6.9%, American 4.2%, cheddar 4.1% and Swiss 7.9%. Total cheese in cold storage on August 31, 2005 was 2% lower than one year ago and 4% lower than the previous month.

Many of the low-fat frozen dessert categories had production declines, except for sherbet, 14.6%, increase and a 13.6% gain for the hard and soft mixes. Non fat dry milk for human food dropped 11.1%.

Fluid milk sales were flat during July 05 compared to one year ago, after calendar year composition adjustment. First half 2005 sales are up 0.2%, again after adjustment. High fat fluid milk, whole and buttermilk, are the fluid products off in consumption.

Commercial disappearance is up 1.6% for the first half of 2005 compared to the same period last year. Butter use was down 0.5%, American cheese up 0.8% and other cheese up 0.8%. Total commercial use is projected to increase by 7.6 billion pounds during 2005, up to 181.1 billion pounds on a skim solids basis.

Analysis
So far milk prices have held up better than might be anticipated based on the large milk production gains. Disruption by hurricane Katrina, and now maybe Rita, puts market prediction in even more uncertain territory than usual. Production in Florida was rebounding from its hurricane disruptions but jobs and business in the Gulf Coast puts consumption gains in question.

The uncertainties may also take some time to become obvious as well. For instance, USDA has issued an invitation for 24 million pounds of UHT packaged milk for hurricane relief efforts. This may or may not offset anticipated declines in fresh fluid milk consumption if the effort is continued by USDA. July fluid milk consumption was 2.2% lower than one year ago. Until July, fluid consumption year-to-date had been near previous years, except January and March.

Fuel and natural gas prices have risen which will certainly affect both dairy producers and processors. How long these costs will remain is unknown. Much of the price gain may be lost if the economy weakens due to hurricane damage or lack of damage from hurricane Rita.

At current milk price levels and feed prices, the latest Milk-Feed ratio was 3.08, dairy producers have strong incentives to continue herd expansion and pushing up milk per cow. The five top dairy states, CA, WI, NY, ID and PA weren’t affected by hurricane damage. These states produce half of the US milk supply. Most of the Texas dairy industry is relatively safe as well from hurricane Rita.

Class III futures prices closed Sept. 21 at a 12 month average price of $13.17. The first 8 months of 2006 Class III prices had all closed above the historic average, one month was over $1 above.

A price risk management strategy should be in place for dairy farms. That strategy should take advantage of the weak corn basis now in place due to harvest and storage pressures. Milk price strategies should be used to protect the margins that are now available. If the economy begins to show weakness due to the hurricane damage, high energy costs and increased interest rates, milk prices will decline below current price opportunities.

Robert Tigner