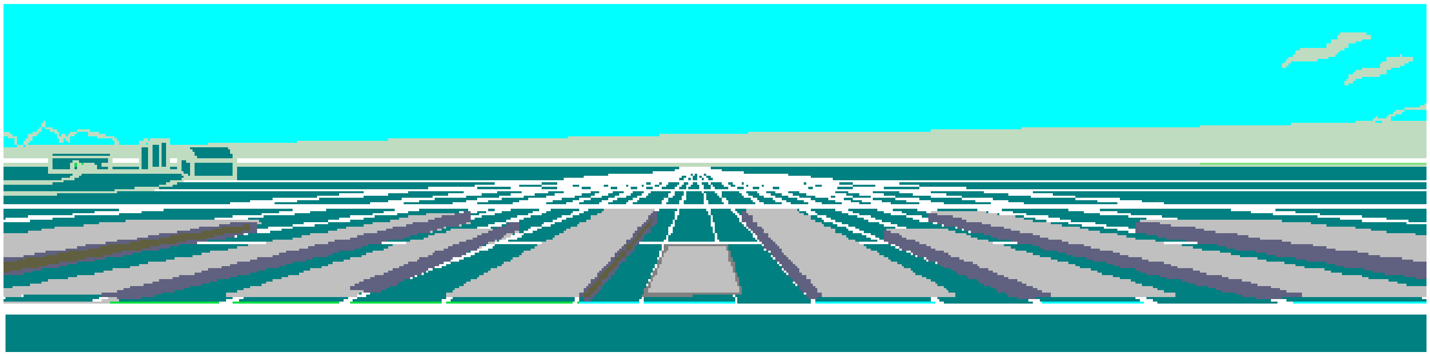
Iowa Farm Outlook



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Slow Pork Production Expansion Continues

The USDA released the *December Hogs and Pigs Report* December 28 with its estimate of December 1 inventories. As expected the report indicated that US producers are slowly expanding the herd with a 0.3% increase in the number of market hogs and a 0.7% increase in the breeding herd compared to December 2004 (Table 1). The estimated inventory was very close to the pre-report guesses by trade analysis that were already factored into the market.

The increased inventory will put downward pressure on farm level prices, but is not expected to significantly change the outlook for 2006. Based on this report and relatively stable demand, the first three quarters of 2006 are expected to be profitable for Iowa's rank and file pork producers. The forecast is for fourth quarter prices to be at or below breakeven.

Table 1. Summary of USDA December 2005 Hogs and Pigs Report

	US Mil. Hd	% Chg year ago	Iowa Mil. Hd	% Chg year ago
All Hogs	61.20	0.4	16.40	0.6
Breeding Herd	6.01	0.7	1.07	0.0
Market Hogs	55.19	0.3	15.33	0.7
Under 60	19.96	-0.1	4.53	-1.1
60 - 119	13.55	0.8	4.16	0.7
120 - 179	11.27	0.7	3.50	4.8
180 & over	10.41	0.1	3.14	-1.3
Pig Crop				
Jun - Aug	26.28	0.4	4.05	3.4
Sep - Nov	26.08	0.8	4.10	0.0
Sows farrowing				
Dec - Feb	2.88	1.5	0.44	0.0
Mar - May	2.89	0.3	0.44	0.0

Additional supply factors include a continued increase in carcass weights and pigs per litter. The 20 year trend is for a 1-2% increase in each annually. The additional finishing facilities built in the Midwest in 2005 will allow for additional pigs per litter and additional days on feed if needed to increase weights. Another supply factor to watch this year is the potential for increased Canadian pig imports. Imports of Canadian feeder pigs and weaned pigs were lower in 2005 compared to 2004. However, the Canadian government imposed a duty of $1.65 US / bushel on US corn imported into Canada which will increase the cost of finishing pigs in Canada. The higher Canadian feeding costs will make exporting the pigs to the US more attractive. This ruling may be overturned as it works its way through the International Trade Commission. In 2003 a duty was placed on hogs and pigs coming from Canada to the US, but it was overturned in 2004.

Pork Demand, the Big Unknown…

The big unknown in the price outlook is pork demand. Demand for pork was very strong in late 2003 and 2004 with some quarters posting an increase in supply AND an increase in price at the same time. For the year of 2004, per capita pork consumption decreased 1% and Iowa farm level prices increased 33%, an approximately ten times bigger impact than was expected.

However, it appears that 2005 is returning to reality. Preliminary data indicates that per capita pork consumption decreased 2.9% and prices also fell 4%. The question is what will happen to demand in 2006. Unlike supplies that can be tracked from inventories and biology, demand is difficult to predict. Economists generally believe that demand is a function of the number of consumers, the price of substitutes, consumer income, and consumer preferences.

While total supplies are expected to increase, per capita domestic consumption may increase only slightly thanks to continued strength in pork exports. Supplies of competing meats are expected to be close to 2005 levels setting up a supply scenario similar to 2005 but with slightly more pork.

As mentioned, exports are expected to increase in 2006, but perhaps not at the 25% growth rate seen in 2004-05 due in part to expansion of beef exports. That leaves consumer income and their preferences.

Consumer income has been impacted by rising energy prices. Gasoline is down from its $3/gallon peak early in the fall, but appears to have settled in the $2/gallon range compared to $1.79/gallon national average a year ago. Home heating cost estimates are expected to be 25-40% higher than last winter. This increased pressure on consumer spending will likely impact their purchasing decisions including for food. Higher priced and away-from-home food will likely be impacted more than the lower priced and at-home meals. Thus, bacon cheeseburgers may be replaced with ham sandwiches or a pork loin roast may be replaced with pepperoni pizza.

Most analysts credit the low-carb trend with supporting demand in 2003 and 2004. Indicators suggest that while protein consumption is higher than before the low-carb craze, the rate of growth of new high protein dieters has slowed and perhaps even declined.

Thus, pork demand, while still above its pre-2003 levels, will likely be below its 2003-04 level in the year ahead. Because it is difficult to predict, the market may have trouble anticipating weaker demand. Add in larger and expanding pork supplies and 2006 looks like a year to be more aggressive on locking in prices.

Price Forecast….
Table 2 indicates the forecast change in supplies and resulting Iowa Southern Minnesota live hog prices. The supply forecast is based on the USDA inventory estimates and assuming a slight increase in US hog slaughter due to increased Canadian pig imports and an increase in carcass weights. The price forecast assumes that demand remains similar to 4th quarter 2005 levels.

Table 2. Forecast of Change in Pork Supply and Iowa S. MN Live Hog Price

	Supply Change	ISM Live Price
JAN-MAR	0.5%	$47-50
APR-JUN	1.5%	$47-50
JUL-SEP	2.5%	$44-47
OCT-DEC	1.5%	$37-40
2006	1.5%	$44-47

Table 3 lists the futures prices near the close on Dec 28 before the release of the report. The historic basis and basis adjusted live hog price is projected for each month and averaged into quarters. Before the report the futures were anticipating Iowa Southern Minnesota Live Hogs to average $45-46/cwt with a summer high near $51 and a fall low below $40.

Table 3. Lean Hog Futures and Basis and Expected Hedge Price on a Live Weight Basis, Dec 28, 2005

	LEAN HOGS	Carcass Basis	Live Price	Quarterly Average
Jan		-4.00	45.09	
Feb	64.93	-2.40	46.27	46.34
Mar		-2.50	47.66	
Apr	66.90	-2.40	47.73	
May	69.02	-2.00	50.82	49.73
Jun	70.68	-2.25	50.64	
Jul	67.50	-2.40	48.17	
Aug	64.70	-1.50	46.77	46.24
Sep		1.50	43.77	
Oct	57.65	-1.60	41.48	
Nov		-1.75	38.85	40.07
Dec	55.15	-1.25	39.89	
AVG			45.59	

Basis is 3 year average for ISM:
http://www.econ.iastate.edu/faculty/lawrence/Acrobat/CurrentHogBasis.pdf

Table 4 provides the quotes of the two insurance products, Livestock Revenue Protection and Livestock Gross Margin from the day before the report. These quotes are subject to change, but the website to check up-to-date quotes is http://www.rma.usda.gov/tools/livestock.html

Table 4. Hog Price and Gross Margin Insurance Quotes

Livestock Review Protection, Lean Hogs, Dec 27, 2005

Endorsement Length Weeks	**End Date**	**Expected End Value**	**Coverage Price**	**Cost Per CWT**
13	3/28/2006	$66.88	$59.98	1.219
17	4/25/2006	$68.57	$53.55	0.619
21	5/23/2006	$70.35	$59.67	1.018
26	6/27/2006	$67.93	$60.43	1.563

Livestock Gross Margin Insurance, Margin/Head Dec 27, 2005

	Farrow - Finish	Finish	Finish SEW
Dec	N/A	N/A	N/A
Jan	$83.80	$92.33	$89.63
Feb	88.94	97.24	94.56
Mar	91.42	98.66	95.95
Apr	92.71	100.15	97.41
May	94.12	101.57	98.79

John Lawrence

Key Market Indicators for Corn and Soybeans

In late December, corn and soybean futures prices moved above key chart resistance areas but stalled out a few cents below the next level of resistance. The price strength came despite seriously negative fundamentals for both crops, and was partly in response to short-covering by commodity fund traders. Limited farmer marketings also were a factor behind the price strength, along with reports of some dry areas developing in the northern part of Argentina's soybean belt. Unless there are significant surprises in up-coming USDA reports or a strong recovery from this season's depressed U.S. export sales, chart resistance points that capped the December rally appear likely to strongly temper up-side futures price potential in the next several weeks.

Key Market Indicators to Watch

Other key indicators of price trends this winter will include (1) USDA's season-final estimates of 2005 U.S. corn and soybean production—to be released January 12, (2) the January 12 grain stocks report, (3) weekly export sales reports, (4) South American weather and crop conditions, (5) rainfall and wheat crop conditions in the Southern plains, and (6) prospects for fertilizer prices during the spring planting season. Wheat prices in late December were being strengthened by concern over severe dryness in parts of Nebraska, Colorado, Kansas, Oklahoma, and Texas. While there is reason for concern about wheat crop prospects, corn and soybean farmers should keep in mind that wheat is a very hardy crop and in the past has often endured dry weather at this time but yielded well with spring rains. Also, while Iraq is becoming a sizeable market for U.S. wheat, sales to China are down sharply from last season's large sales. Continued strength in wheat prices would be somewhat supportive to corn and soybean prices.

The track record of crop estimates over the last 40 years suggests that the U.S. corn crop estimate could be increased modestly again this month. In years similar to 2005 when corn crop forecasts were increased every month from August to November, crop estimates increased from November to the season-final report about 77% of the time. For soybeans in similar years, the season-final estimates were increased from November about 55% of the time. If crop estimates are increased this month, there is a good chance most of the increase will go into higher 2006 projected carryover stocks.

Along with season-final crop estimates, the USDA National Agricultural Statistics Service (NASS) will release its December 1 grain stocks estimates. The corn stocks numbers allow analysts to estimate the amount of corn fed to livestock and poultry in the previous quarter. Current livestock numbers, marketing weights, and profitability suggest total grain feeding was slightly larger than a year earlier. However, part of the increase in feed demand has been met by replacing corn with distillers grain from ethanol plants.

The Census Bureau provides reliable data on domestic soybean crushings (processing) and exports, so the stocks report will not provide new information on domestic soybean demand. However, stocks data do provide a check on accuracy of the soybean crop estimate. Smaller than expected soybean stocks would hint that last year's soybean crop was over-estimated.

Bean Export Sales Lagging Severely

With the 2005-06 marketing year already one-third completed, U.S. soybean export sales are lagging severely, with cumulative sales through late December 25% smaller sales than a year earlier. Sales to China, our largest soybean export customer, are down 27% from a year earlier. Last season, China accounted for 40% of all U.S. soybean exports and 20% of the total demand for U.S. soybeans. Sales to EU, normally the second-largest foreign market for U.S. soybeans, are down 66% from a year earlier. As shown below, sales to most other U.S. foreign customers also are down sharply. USDA projects that U.S. soybean exports for the marketing year will be down only 7%***. Since U.S. soybean export sales were quite large last winter, extremely large sales will be needed in the next two months if U.S. export sales are to move ahead of a year earlier and approach USDA projections. Weekly export sales consistently***

in the 0.9 to 1.1 million ton range would offer some hope of moving the season total close to a year earlier. Soybean meal and oil export sales to date are down nine and 30 percent respectively from a year earlier.

Cumulative Soybean Export Sales
12/22/05 vs. yr. ago

• China	-27%	217 mil. Bu.
• Africa	-17%	4
• EU	-66%	38
• Japan	-6%	56
• Taiwan	+37%	33
• Other Asia	-20%	54
• W. Hemisphere	+17%	80
Unknown	-47%	32
Total	-25%	535
SBM	-9%; SBO -30%	

Lagging bean export sales likely reflect foreign buyer nervousness about Asian bird flu. So far, there has been minor destruction for birds in several countries to control the flu. However, only a very small percentage of world poultry numbers have been destroyed, and impact on actual physical demand for soybean meal appears to have been small. Lagging sales may also reflect foreign buyer over-booking of needs during the concern over last summer's U.S. drought. Perhaps more significant is the possibility that South America's spring 2005 soybean crop was larger than currently estimated. If current estimates are correct, South American soybean exports should have been quite small during the last two months, leaving much of the world soybean market for U.S. supplies.

Corn Export Sales

U.S. corn export sales have performed somewhat better than soybeans, but still lag significantly behind a year earlier. Season to date total sales are down 6% from the same date a year ago, with lower sales to a number of foreign destinations. USDA's recently lowered corn export projections for the marketing year are still 5% above a year earlier. Current USDA Foreign Agriculture Service projections indicate Brazilian farmers are shifting some soybean land to corn and may export a little more corn than last season. At the same time, Argentina's spring 2006 corn harvest and corn export availability are projected to be slightly below the previous season. South Africa and China together are projected to export about 230 million bushels less corn than last season. However, Chinese corn exports are very difficult to forecast. Much of the time over the last nine years, early USDA forecasts of Chinese corn exports have been too low. These four countries are the major non-U.S. sources of corn for export.

U.S. corn also faces competition from feed wheat and barley. Supplies of these grains are large and competition is significant. Canada's mid-December decision to place import taxes of $1.65 per bushel on U.S. corn will almost certainly cut off exports to our northern neighbor for the next several months. In the 2004-05 marketing year, Canada imported 50 million bushels of U.S. corn. The Canadian government is continuing an analysis of charges that the U.S. has been dumping unfairly subsidized corn into the Canadian market and expects to report further findings in March or April.

Corn export sales have the potential to catch up with last year in the next few months since year earlier sales were relatively slow during the winter. Weekly U.S. corn export sales consistently in the 1.0 to 1.2 million ton range for the next two months would move the season total close to or possibly a little above a year earlier.

Fertilizer Prices and the Grain Markets

Sharply increased fertilizer prices are a major concern for grain producers. Potash prices reportedly in some cases have doubled since last spring. Phosphorus prices are up sharply. Nitrogen prices also have been pushed substantially above last spring because of higher natural gas prices. Natural gas is the major ingredient for production of nitrogen fertilizer. With tight environmental restrictions on drilling of new wells, U.S. natural gas supplies have been relatively constant in recent years, although imports from Canada have increased some. At the same time, the electric power generating industry has sharply increased its use of natural gas in an effort to economically meet air quality regulations. Its increased use has led other gas users to cut utilization in response to limited and more expensive supplies. Hurricane damage to infrastructure last fall also complicated the natural gas supply-demand balance.

At this writing, natural gas prices have dropped about 28% from their mid-December peak. Price trends the rest of the winter will be sensitive to weather conditions. The relationship of February natural gas futures prices and spring anhydrous ammonia prices from the last few years suggests that spring anhydrous prices could be in the $500 to $550 per ton range. The upper end of this range is in line with recent prices being quoted for spring 2006 delivery. Actual prices during the spring planting season will depend on domestic natural gas price trends this winter, and on how much nitrogen fertilizer the U.S. can import. U.S. nitrogen fertilizer imports have increased sharply in the last few years. The Fertilizer Institute indicates that imports two years ago accounted for about 45% of U.S. nitrogen fertilizer supplies. Imports come mostly from countries that historically have been politically unstable: former Soviet republics, the Middle East, and parts of Latin America.

As with industrial metals and petroleum, the U.S. has to compete for fertilizer in world markets. A number of countries including China, Brazil, Argentina and former Soviet republics are making efforts to increase crop yields and need more fertilizer to do so.

Impact of High Fertilizer Costs on 2006 Crop Rotations and Yields?

A key question for grain market analysts is whether the high cost of fertilizer, especially nitrogen, will cause Midwest farmers to switch some corn land to soybeans. U.S. corn plantings have increased by about 5.5 million acres since 2001 in response to farm program changes, an increasing corn yield advantage over beans and increased demand for corn for ethanol processing. In about 18 Extension meetings this fall and early winter, most Iowa farmers indicated to us that they intend to maintain current rotations rather than shift land to soybeans. Even so, it would not be surprising to see a slight shift to beans when crop final crop financing decisions are made in late winter and early spring. High costs of fertilizer may also cause some decrease in average application rates. Accordingly, our balance sheets show early projections for a small decrease in corn plantings and a slight increase in soybean acreage in 2006. USDA's prospective plantings report is scheduled for release on March 31 and will be an important market indicator for new and old-crop corn and soybeans during the spring. Our latest balance sheet projections can be seen at http://www.econ.iastate.edu/faculty/wisner/

Robert Wisner

More Milk Yet Again

November 2005 milk production made another 4% plus rise, up 4.6%, for the 7 straight monthly increase above that mark. October milk production was revised down by 17 million pounds to end up with a 4% milk increase. Milk per cow was up 59 pounds (3.7%). Dairy cow numbers were 60,000 higher than Nov 04 but only 2,000 more than Oct 05.

Iowa milk production dropped 1% from one year ago. Dairy cow numbers remained constant from the previous month but were 3,000 less than one year ago. Milk production per cow only gained 10 pounds. Iowa cheese production was 5.4% lower for Oct 04 compared to one year ago but was 0.3% higher than Sept 05.

The largest production increase came in Idaho, again, at 12.3%. Idaho added 37,000 cows and 60 pounds of milk per cow. Two states had a 12.2% production increase, TX and NM. NM added 15,000 cows and 115 pounds of milk per cow. TX only added 1000 cows but had milk per cow rise by 175 pounds. The fourth largest increase occurred in IN. That increase, 9.3%, came about with 3000 more cows and 110 pounds of milk per cow. Two states had greater than 6% production increases, CO 6.6% and MI 6.5%. CO added 3000 cows and 60 pounds of milk per cow while MI added 6000 cows and 75 pounds of milk per cow.

Both MN and WI had milk production gains. MN had 1000 fewer cows but the remaining cows made 55 pounds more milk. WI added 1000 cows and 70 pounds of milk per cow.

KY was the biggest milk production loser last month, -5.4%. KY had 7000 fewer cows (-6.4%) but did gain in milk per cow by 10 pounds. FL had 3.5% les milk but only 1000 fewer cows. Production per cow dropped by 40 pounds in FL. MO had a milk production drop of 4.1%. MO cows gained 15 pounds of milk but MO had 6,000 fewer milk cows.

Demand

October dairy product stocks were in pretty good shape, near their 5 year average. Total cheese production for Oct 2005 was up 0.9% from one year ago and 1.7% above Sept 05. Butter production was up 7.4% compared to September 05 and 3% above one year earlier Oct 04. The largest percentage increase in cheese production was Hispanic cheese, 11.1% from one year ago. American style cheese is the largest production category, about 41%. For October 05, it was up 0.3% from one year ago and 2.8% higher than the previous month. Yogurt production was 6.2% higher than one year ago but off 9.6% compared to Sept 05.

Butter stocks dropped 37% during Nov 05 from the previous month and were 7% higher than last year. Total cheese stocks dropped 5% during Nov 05 but were 2% above one year ago. American style cheese stocks were 6% higher than last year.

Analysis

Dairy market reports indicate weakness in butter, cheese and fluid milk sales. The majority of holiday season sales have been made. Some cheese buying will occur prior to the Super Bowl game and some butter buying ahead of Easter. Fluid milk sales will not get a boost until schools are back on their normal schedules Bad weather has negatively impacted bottling schedules as well.

It appears that the US will finish with about 176.7 billion pounds of milk for 2005. That is a daily adjusted average production increase of 3.7%. As of the end of October, commercial disappearance is

2.4% more than one year ago. Imports are up by 12.4% for the year as well. Other than American style cheese consumption has increased by 3.9% this year while butter and American cheese consumption has grown by 1%. Fluid consumption is up by 0.4% this year in large measure due to increases since August.

Block and barrel cheese prices have dropped on the CME 9-10 cents since Dec 20. The dairy market appears to be preparing for larger cheese stocks due to normal weakened seasonal demand and the large milk production increases. For instance, cream supplies are currently reported as burdensome leading to discounts in price and transportation rates.

Mailbox milk prices will finish 2005 off about $1 from the 2004 record. Some dairy processors expect a larger drop in milk prices for 2006. Class III Futures have closed Dec 29 showing relatively good price contracting possibilities. Mailbox milk prices could be $13.25 or higher during Spring 06 if farmers start a price protection strategy now.

Robert Tigner