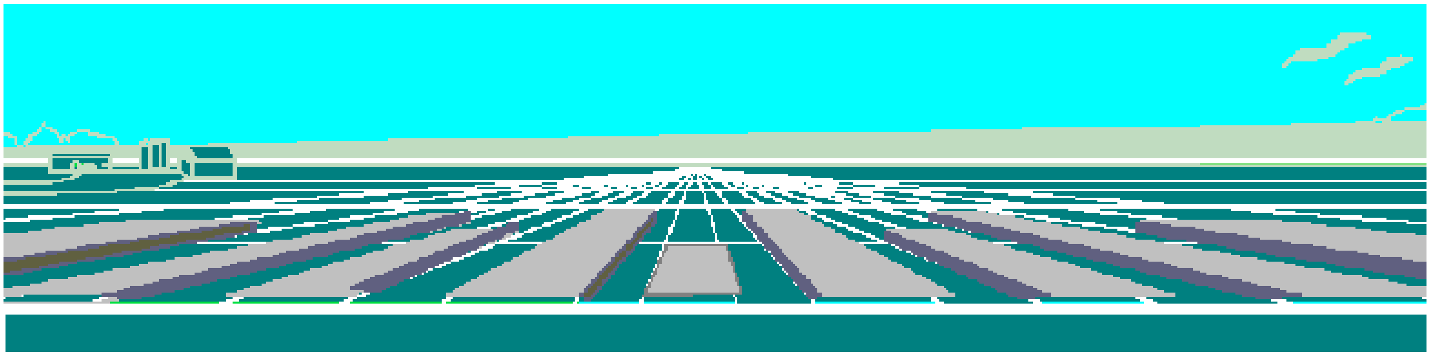
Iowa Farm Outlook



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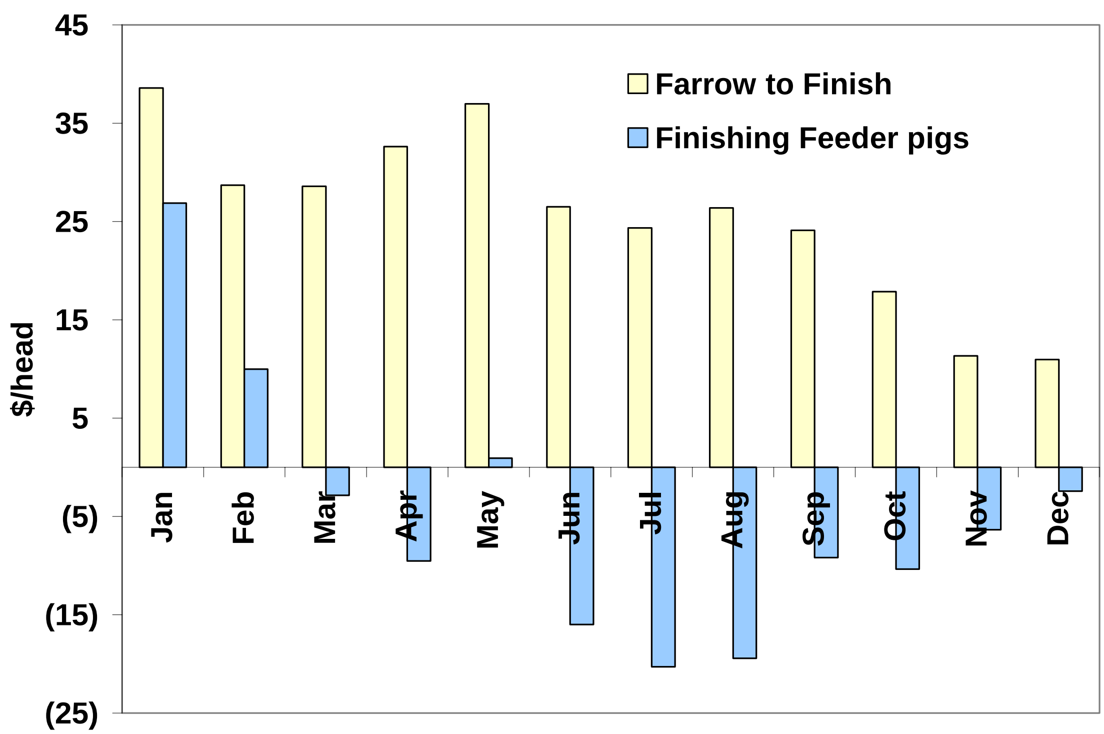
2005 Iowa Estimated Livestock Returns

Iowa State University has been producing monthly estimates of the returns to hog producers and cattle finishers for over three decades. These estimates are based on production practices and costs, feed prices, and market prices. Looking at market prices alone most would conclude that it was profitable year for cattle and hog producers, and it certainly was. However some months were more profitable than others as sale and input costs fluctuated through the year. Starting with hogs, Figure 1 contains a graph of the monthly estimated returns to Iowa hog producers for each hog finished and sold. Farrow to finish operations enjoyed a continually profitable year, as corn was cheap to "dirt cheap" through the year. The price, paid for finished hogs, has tapered down some from a year ago so profit estimates were scaled back some. For the year, average profits were $25.57 per head sold.

Figure 1. Estimated Returns to Hog Producers in Iowa, 2005

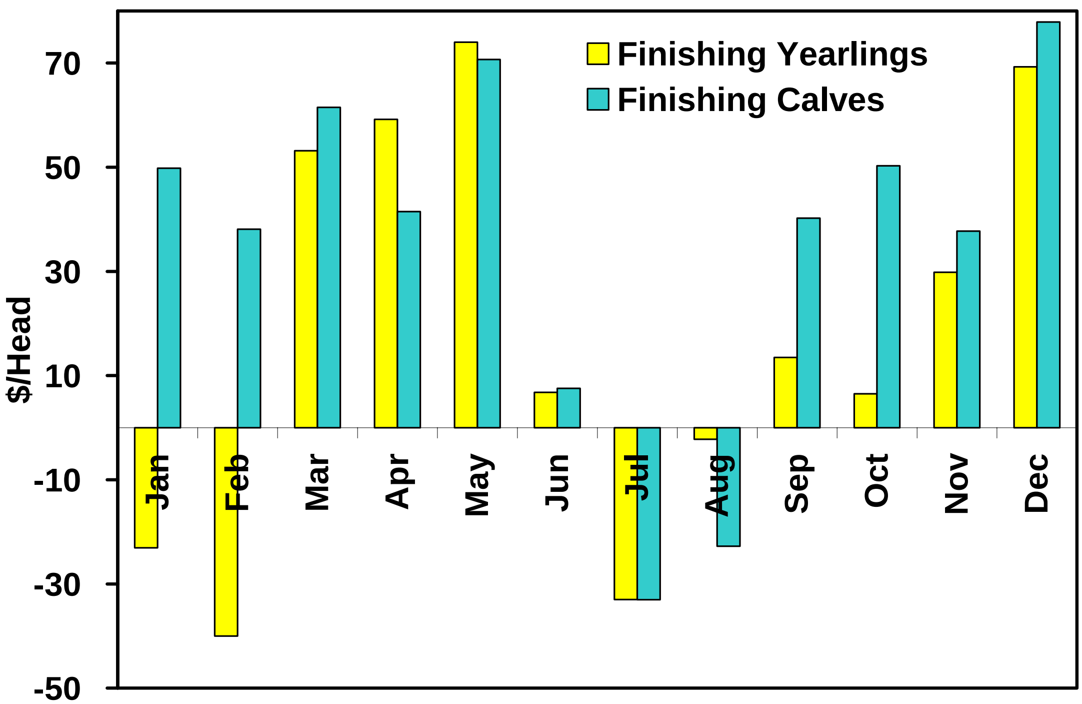


Hog finishers, who bought feeder pigs (50 lbs), did not have the same profit potential as farrowing operations. When hog prices high jumped in the final quarter of 2004 so did the price of feeder pigs.

Hogs that were finished and sold in the early months of 2005 had been purchased as feeder pigs at relatively cheaper prices than those purchased when the hog market went north. As the feeder pig market rallied with the hog market, finishers had to forfeit a considerable chunk of their profit potential, just to acquire pigs. When the hog market softened in the spring and then diminished further in the summer months, profit margins disappeared, but later recovered some in the fall when another plentiful corn crop dropped the price of corn. For the year the average loss for finishing swine operations was $4.89

Cattle finishers had a rewarding year with remarkable cattle prices and plenty of corn feed. Figure 2 illustrates the estimated returns to operations finishing yearling or calf steers. The lighter starting weight cattle proved to be more profitable through the year in general. Yearling finishers started off last year selling January and February cattle that they had paid a premium for during the previous summer months and so were estimated to have some loss ($20-$40). When cattle prices surged in the spring months profits were significant. The usual summer price slump, starting in June, lasted a month or two longer than it usually does. Finished cattle prices in the fall recovered considerably and the recent price jump in December made it a great time to own market-ready cattle. On the average, feedlots finishing calves had an average estimated profit of $34.96 for the year and yearling finisher had an estimated profit of $17.83 per head sold.

Figure 2. Estimated Returns to Cattle Finishers in Iowa, 2005



From current futures projections, the first five months of 2006 could see as good or better prices than the same period last year for cattle producers. Consumer demand will continue to have significant influence on boxed beef prices, and in turn affect what packers will be offering for cattle. Demand for beef was slightly lower in the final quarter of 2004 due primarily to the impact that higher energy costs have on consumers' disposable income. Cattle supplies are starting to increase as the US herd starts into the building side of the cattle cycle, but with sustained or increased demand prices should remain profitable for at least the year.

Shane Ellis

U.S. and World Grain Supplies Increase Again

With USDA's, January 12 domestic and world production and use reports, supply-demand indicators ***look a bit more negative than last month, especially on soybeans.*** Both corn and soybean domestic crop estimates were increased from the November figures. For corn, much of the increases in production and reduced export prospects were offset by an increase in the domestic feed use projection, with projected 2006 carryover stocks rising only seven million bushels from last month***. However, the USDA's world total grain carryover projection rose from last month by an unexpected 10.41 million metric tons (410 million bushels corn equivalent), with the increase in world grain carryover stocks totaling 871 million bushels in the last two months. In the January report alone, world feed grain stocks rose by 10.1 million metric tons (398 million bushels) with most of the increase being in corn.***

Soybean Fundamentals Become More Negative

For soybeans, increased U.S. production and a sharp decline in U.S. export projections produced a 100 million bushel increase from last month in the projected August 31, 2006 soybean carryover stocks***. In the last two months, the projected 2006 U.S. soybean carryover stocks have increased by 255 million bushels. That's a 73% increase from stocks indicated in November and will be a 97% increase from last year's stocks if the current projection materializes. Stocks at the projected level would be four and one-half times as large as two years earlier.*** The sharply rising stocks reflect higher U.S. production estimates than indicated late last fall and severely lagging U.S. export sales. ***Cumulative U.S. soybean export sales from last September 1 through January 5 were down 27% from a year earlier. Despite recent purchases, U.S. sales to China were down 29% from last season's huge purchases.*** China is our largest export customer for soybeans, accounting for 40% of U.S. exports last season and 20% of total demand for U.S. soybeans.

With these dramatic changes in the soybean supply-demand balance since early December, sustained strength in soybean cash and futures prices this winter and early spring likely would require (1) serious deterioration in South America's crop prospects and/or (2) a rapid recovery in U.S. soybean export sales. The South American soybean crop appears to be in generally good condition at this writing, with important areas in Brazil and Argentina receiving significant rains this week. Some dry areas are still being reported in southern Brazil, and lack of rain there or development of other dry areas in either country may still generate short-term rallies in soybean prices this winter. The markets will be especially sensitive to South American weather into the third week of February. That will be the most critical period in its production cycle, although weather afterward can still have some impact on yields. If the South American crop comes close to current projections, soybean prices could experience downward pressure again in late spring or early summer. High fertilizer prices and last year's record soybean yields are expected to cause a slight shift of corn acres to soybeans in the U.S. this spring. Combined soybean production in Brazil and Argentina is projected to be up 258 million bushels from last year, for a total crop of 3.64 billion bushels vs. last year's U.S. crop of 3.09 billion bushels. Brazilian farmers experienced severe drought in the 2003-04 and 2004-05 growing seasons.

Fund Traders and the Bean Market

Commodity fund traders played an important role in the strength of soybean prices in late winter and spring last year. There are two basic types of fund traders. One type concentrates on short-term price movements, looking for opportunities to profitably buy or sell commodities, with their positions varying with market conditions. This type of trader can generate large volumes of trading in short periods of time, thus contributing to price volatility. They tend to be motivated by conditions that receive wide publicity such as South American droughts of the last two years and the U.S. drought last summer. These fund traders appear to operate with a herd instinct, with many of them following the same technical indicators and making similar decisions about timing of purchases and sales. The result can be abrupt changes in price trends such as the 60 cent decline in March soybean futures from the market close on January 4 to the close on January 12, 2006. This type of fund trader will continue to play an important role in the soybean market in the next several months, causing short-term rallies that provide opportunities for farmers to increase sales.

Index funds are the other type of fund trader. These traders have taken notice of the Commodity Research Bureau (CRB) index of all commodity futures prices and its trend over the last few years. The CRB index includes prices of grain, livestock, industrial metals, precious metals, lumber, cotton, tropical products, and various energy futures. It has moved almost steadily upward since late 2001, with approximately an 80% increase since that time. Some managers of large blocks of investments such as pension funds have concluded that a portfolio of commodities matching the CRB index might be a good hedge against inflation and a better investment than the stock market. We understand that the Commodity Futures Trading Commission (CFTC) classifies these traders as hedge funds and includes their transactions in trading reports with other hedgers such as large grain firms. Thus, their trading activities are difficult to separate out. Many analysts and market observers have been anticipating these traders to resume aggressive purchases of commodities. However, their actions are not easy to forecast. History tells us that after an 80% rise in commodity prices, the big gains could be behind us. History also is a reminder that commodity markets can be quite volatile. Whether these considerations will temper willingness of index fund traders to buy commodity futures is unknown. Also, keep in mind that commodity futures are different from stock investments. Commodity futures have expiration dates. If the contracts were purchased, a time comes when they need to be sold, thus causing potential price volatility in both directions.

Specifics on Crop Estimates

USDA's season-final estimates for 2005 crops boosted U.S. corn production from the November estimate by 80 million bushels, along with a 43 million bushel increase in the soybean production estimate. Both were larger than expected by the grain trade. The U.S. corn crop is now estimated at 11,112 million bushels, down from 11,807 million bushels in 2004, but still the second largest crop on record. The nation's soybean crop is estimated at 3,086 million bushels, down from 3,124 million bushels the year before, and also the second largest on record. Our latest balance sheet projections of U.S. supplies, utilization, and carryover stocks are shown on our web site, http://www.econ.iastate.edu/faculty/wisner/ including early projections for 2006-07. Our 2005-06 soybean projections are the same as USDA, although our corn use projections differ slightly. Cash corn prices may increase gradually into the second or third week of February, then pause briefly before resuming a gradual uptrend into the planting season. We expect much of the increase in cash prices to come from a strengthening basis as ethanol plants bid against other users for supplies. Basis patterns have the potential to vary from one area to another more than in the past. Ethanol plants are shifting some areas from a long history of surplus corn supplies to deficit supplies. In a deficit supply situation, corn prices have to be enough higher than other areas to attract corn into the plant from a considerable distance.

Chinese Corn Crop Estimate Up Sharply in Last Two Months

Along with the U.S. increases, USDA increased its estimate of China's 2005 corn crop by 4 million tons (158 million bushels). That followed last month's increase of 4 million tons (158 million bushels). In other words, the Chinese corn crop estimate has increased by 316 million bushels in the last two months. Last month, USDA increased its Chinese corn export projection by 3 million tons. This month, it left China's export projection unchanged and put all of the increase in production into carryover stocks. China is now projected to export 6 million tons of corn, down from 7.59 million tons last year.

Southern Hemisphere Corn

In its World Supply-Demand Report, USDA lowered Argentina's projected spring 2006 corn harvest and exports by 0.5 million tons (20 million bushels) because of dry weather in some areas. ***At the same time, it increased Brazil's projected 2005-06 corn exports by a nearly offsetting 0.4 million tons (16 million bushels) so that expected Southern Hemisphere corn export competition is expected to be about the same as indicated last month.*** However, combined corn exports from the Southern Hemisphere are projected to be down 2.8 million metric tons (110 million bushels) from last season due to a 1.3 million ton anticipated decline in South Africa's exports. This news, while not much different from last month, offers some hope for partial recovery in lagging U.S. corn export sales. The speed of the recovery will depend on market reactions to bird flu worries, the actual level of Chinese corn exports, and competition from feed wheat and barley.

Cumulative U.S. Soybean Export Sales
1/05/06 vs. yr. ago

• China	-29%	231 mil. Bu.
• Africa	+3%	20
• EU	-64%	47
• Japan	-7%	60
• Taiwan	+20%	33
• Other Asia	-22%	56
• W. Hemisphere	+14%	83
• Unknown	-49%	29
Total	-27%	568
SBM	-11%; SBO -34%	

The table shows U.S. cumulative soybean export sales from September 1, 2005 through January 5, 2006. That's slightly more than one-third of the way through the current marketing year. The best opportunity for a catch-up in sales is from now through early March, before new-crop South American soybeans start moving in world markets. Weekly sales in the 0.9 to 1.0 million ton range for the next several weeks would offer some hope of moving up near the current USDA projection.

Robert Wisner