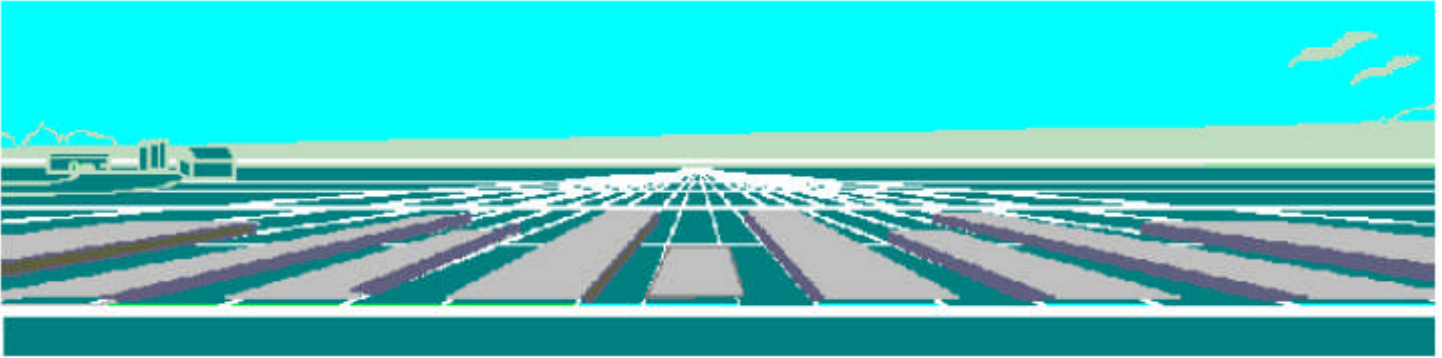


# Iowa Farm Outlook



December 1, 2006

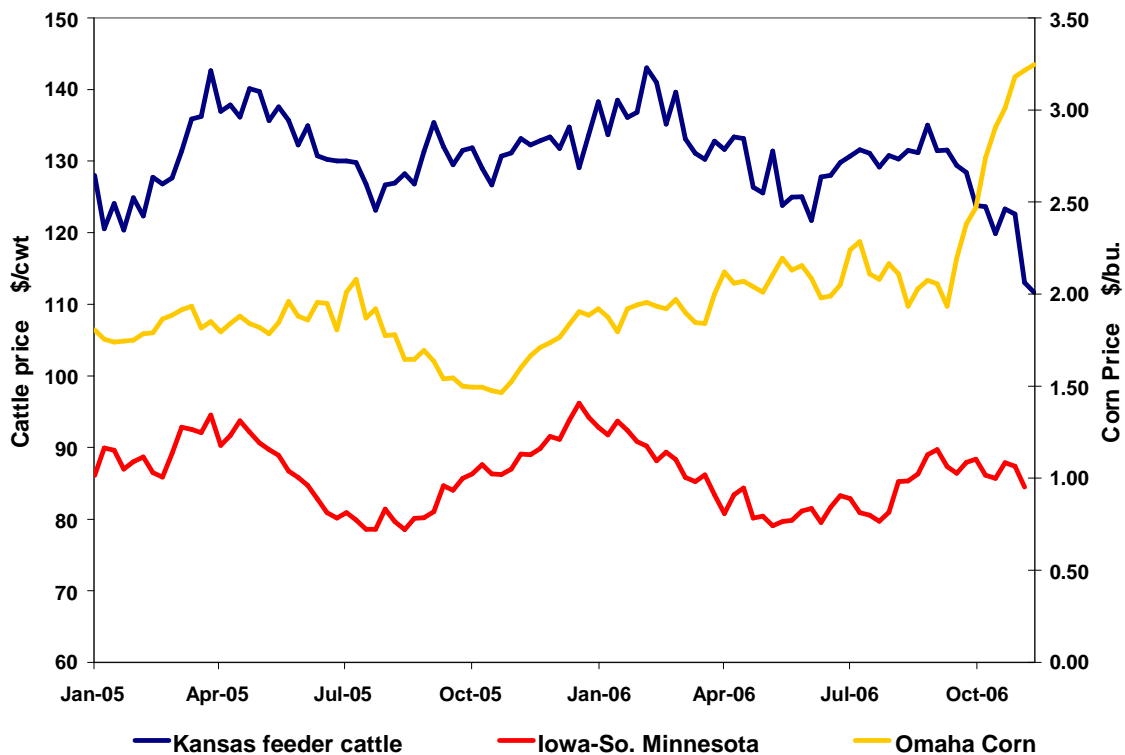
Ames, Iowa

Econ. Info. 1947

## Current Beef Industry Situation

The beef industry is facing a situation that many have been predicting. Additional demand for corn, created by both more livestock production and a growing ethanol fuel industry, has led to a recent jump in the price of corn. The additional cost of purchasing corn for feed has affected not only the profitability of cattle finishers but also dampened the market for feeder cattle. Figure 1 is a graph of the price of 500-600 pound Kansas feeder cattle, Iowa-So. Minnesota fed cattle and Omaha corn. Light feeder cattle prices were following a price trend similar to that of fed cattle until September of this year. Although the market value of fed cattle has dropped by 6 percent between early September and mid-November, Kansas feeder cattle prices have slipped by 15 percent in the same period. The cash corn price has steadily increased during the same period, up 58 percent from early September. The effects of corn price on the feeder cattle market are painfully obvious.

**Figure 1. Fed and Light Feeder Cattle Price vs. Corn Price, January 2005-Present**



The degree of impact increased corn price will have on producers' short-run profitability will depend upon the quantity of feed stored or under contract and the availability of alternative feedstuffs such as co-products. Cattle feeders are not strangers to tight margins. Feed costs are likely to continue increasing before we see prices taper off. Cattle feeders who are currently purchasing feeder calves for \$110/cwt and can lock in corn at \$3.25 per bushel are estimated to need \$88-90/cwt to break even next summer. If dried distillers grains are used, the breakeven price may be \$1-3/cwt dollars lower, depending upon cost and quantity in ration. The feeder cattle market will continue to soften as corn becomes more expensive.

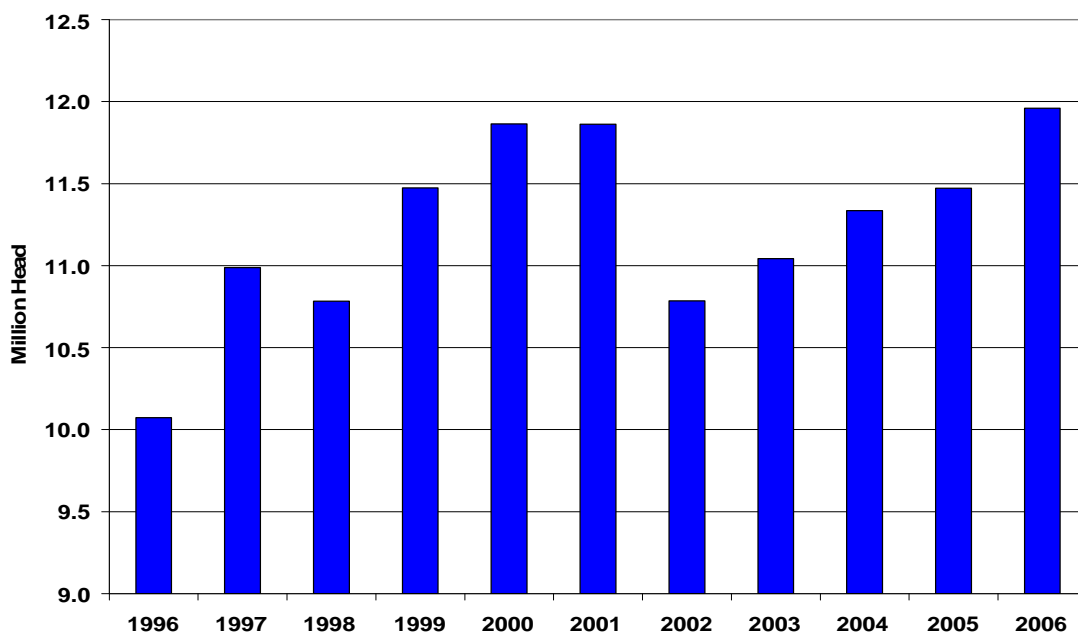
Fed cattle prices have also softened in recent months. The Iowa-Southern Minnesota fed steer price has fallen \$5/cwt since early September. Historically, fed cattle prices usually improve going into December. There is not a clear reason for why prices have slipped. Some possible explanations are that competing poultry meat has been considerably cheaper or that year-to-date US beef production is up 5.7 percent from this time last year. However, domestic demand has been fairly supportive, with average per capita consumption at about 16 pounds.

Foreign demand is actually increasing as US exports have increased to all major foreign markets. Total exports are up over 80 percent from this time last year, with most of the additional export volume going to Canada and Mexico. Mexico remains our largest market, while Canadian exports have nearly tripled from last year. Canadian cattle slaughter volume is down 10 percent from last year, as more live feeder and fed cattle are shipped to the US for finishing and/or processing. Beef markets in Asian nations continue to be slow to develop amid consumer distrust and wrangling over trade regulations and violations.

### Cattle on feed update

As of November 1, the inventory of cattle on feed was up 4.2 percent from a year ago. With over 11.9 million head of cattle on feed, this is the largest November cattle on feed inventory on record. Figure 2 is a graph of cattle on feed inventories over the past decade since the series began in 1996. Cattle on feed inventories have been on a steady increase since 2003.

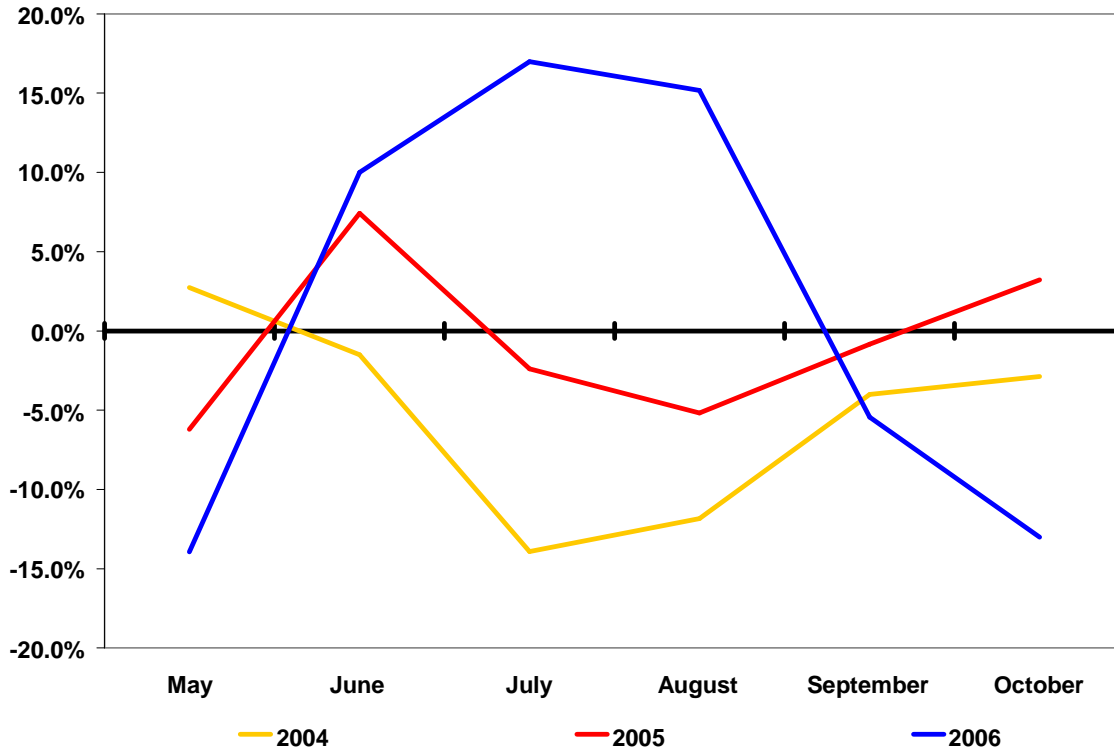
**Figure 2. November 1, Cattle on Feed, 1996-2006.**



However, this increased inventory is not an indicator of aggressive feeder cattle purchasing. October cattle placements were down from 2004 and 2005 by 13 and 10 percent, respectively. Placements of heavier weight feeder cattle were down significantly from last year. Placements of cattle weighing between 700 and 799

pounds decreased 18 percent and placements of cattle 800 pounds or heavier were down 13 percent. Figure 3 is a graph of the percentage change in cattle placements year over year for the months May through October.

**Figure 3. Year-to-Year Percentage Change in Feeder Cattle Placements, May-Oct.**



Higher corn prices were the main factor for this decline in placements. The current record number of cattle on feed is primarily a result of a large number of placements during the summer months when corn prices were considerably lower. Some of those cattle will be at a finished weight in the coming months and we may see our cattle on feed numbers come down from record levels. The cost per additional pound of gain is significantly higher now than it was a year ago, so feeders are less likely to feed cattle to the record weights they have been in the past two years. Lighter slaughter weights can be expected as corn prices increase.

*Shane Ellis*

### **Year-end Fund Trading Activity and Charts Hint at Technical Correction in Grain Prices**

After nearly a 90% rise in Iowa cash corn prices since mid-summer and about a 20% increase in soybean prices, *technical indicators in the grain markets hint that at least a short-term downtrend in prices for both crops may occur. At this writing, soybean and soybean meal price charts have turned negative, and corn price charts are at a critical point. A close moderately below the December 4 settlement price on March 2007 corn would indicate prices have temporarily broken out of the two and one-half month uptrend.* Profit-taking by fund traders appears to be the main factor behind the current price signals. However, three important fundamental developments may also be playing a part in current price actions. Several developments suggest recent corn prices may be setting the stage for a large increase in 2007 corn plantings. *These indicators include (1) reports from the seed industry that supplies of the best corn varieties are already sold out and that overall*

*corn seed sales may be up by around 10 to 12 percent, (2) reports of temporary local shortages of nitrogen fertilizer, due to unusually heavy fall applications for next year's corn, and (3) reports from a few forecasting firms that show a potential sharp increase in corn plantings next spring.* Early crop prospects also look favorable in South America, although late December through February weather will hold the key to corn and soybean yields in Brazil, Argentina, and South Africa. At recent price levels, there is some risk that sharply higher corn plantings and good yields could push 2007 harvest prices moderately below levels indicated by recent December 2007 futures prices.

The driving force behind this fall's counter-cyclical increase in corn prices has been the aggressive expansion in corn-based ethanol plants. There are a few reports of plants delaying construction, but so far these represent only a small percentage of the planned plants. Factors behind delayed construction or halting of plans include the rising cost of building ethanol plants, and concern about future availability and cost of corn – as well as prices for ethanol. However, these reports don't appear to be widespread enough to have much impact on corn prices.

**Demand Indicators Still Strong**

Indicators of demand for the 2006 U.S. corn crop still look quite strong. Cumulative U.S. corn export sales through late November, as shown below, were up 35% from a year ago and were sharply above the levels of two and three years earlier. The number of cattle in feedlots over 1,000 head capacity on November 1 was up 4% from a year earlier and up 6% from two years ago. It was the highest number on feed since this data series began in 1996. Hog farrowing intentions show a slight increase anticipated for the next few quarters, although marketing weights may run slightly below a year earlier.

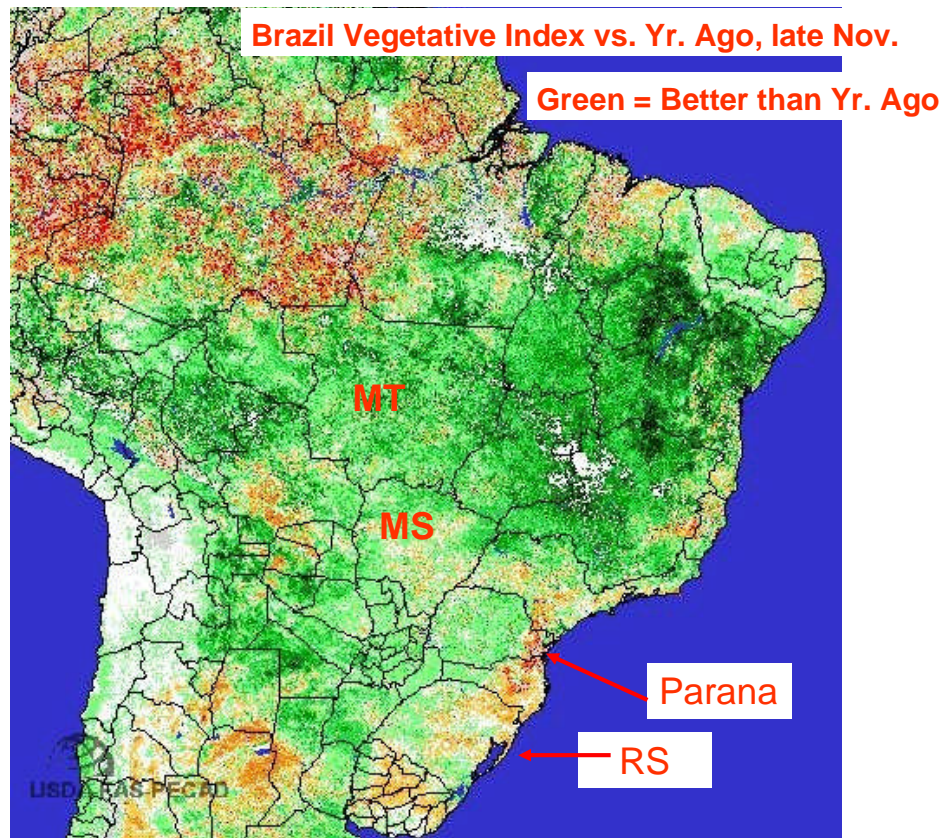
**Cumulative Export Sales to  
11/23/06 Vs.**

	<u>Yr. ago</u>	<u>2 yrs. Ago</u>	<u>3 yrs. Ago</u>	<u>'95-96</u>
<b>Corn</b>	<b>+35%</b>	<b>+26%</b>	<b>+21%</b>	<b>-21%</b>
<b>Beans</b>	<b>+42%</b>	<b>+6.7%</b>	<b>-13%</b>	<b>+48%</b>

As the table above indicates, cumulative U.S. soybean export sales also have been sharply above the depressed level of a year earlier, when bird flu problems restrained export sales. However, the increase in soybean export sales so far this season has been less impressive than for corn when compared to the last few years.

**South American Crop Conditions**

Because much of Brazil's Soybean Belt does not have killing frosts, it has a very long planting season that extends from late September to early January. The peak planting season typically has been from the last half of October through December. Argentina's planting season is a little shorter, with November and December being key months. Recent reports show nearly ideal planting conditions for soybeans in both countries. In Brazil, soybean growers have faced very serious financial stress for the last two years. An unfavorable exchange rate has reduced local prices. Multiple sprayings for Asian soybean rust also have added to production costs. These problems have been most severe in Mato Grosso, the area that was at the forefront of rapid expansion until about three years ago. The sharp rise in soybean prices this fall has helped to offset some of the negative economic effect of these two factors. Our Brazilian contacts now expect only a very small drop in the nation's total soybean plantings this year, although a decline still appears likely in some states. The map below shows the change in the mid-November vegetative index of crops in Brazil vs. a year ago. It is from a

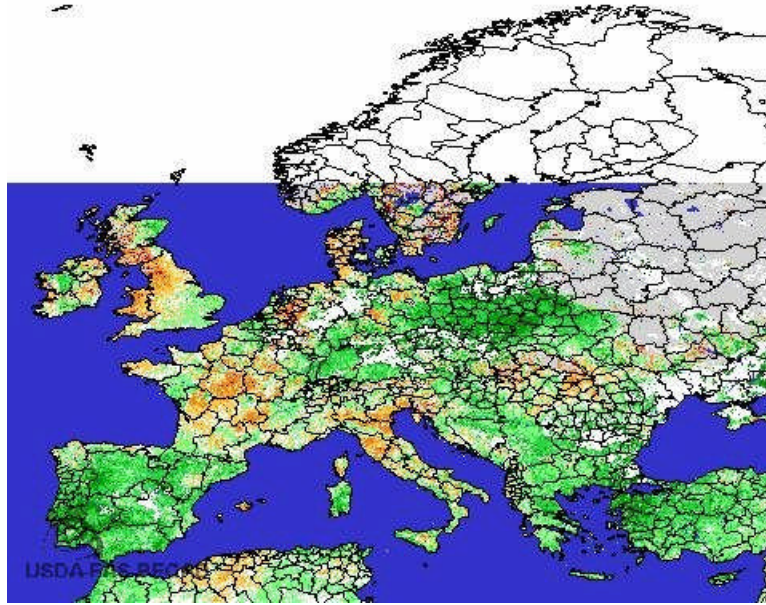


joint project of USDA and the National Weather Service. Keep in mind that this reflects conditions very early in the growing season and that conditions may change later. Green areas in the map are areas with a higher vegetative index than at the same time last year. At this point in the growing season, we should be careful not to read too much into these readings. They show generally favorable conditions for much of the Soybean Belt. However, tan areas in extreme eastern Parana, the eastern and central parts of Rio Grande do Sol and a few other areas may reflect dry conditions. The leading soybean producing states in Brazil are Mato Grosso (MS), Parana, and Rio Grande do Sol. Mato Grosso do Sul (MS) is an important producing state along with Santa Caterina (between Parana and Rio Grande do Sol).

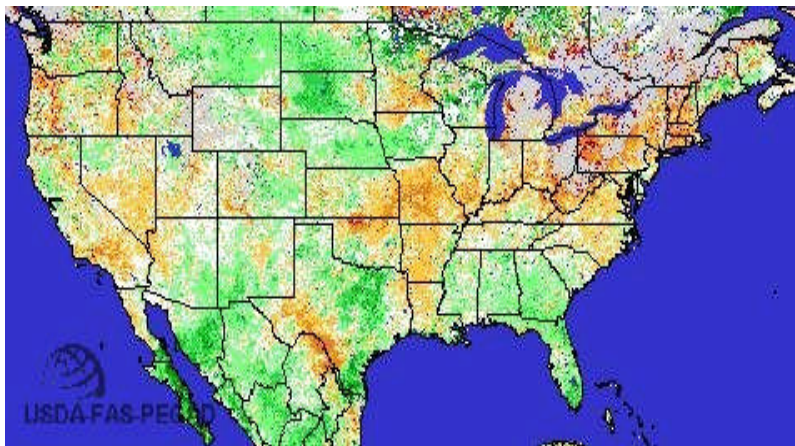
Conditions looked similar in Argentina in November. These maps will become more important in January and February, when crops are further along in development.

Another vegetative map below shows crop conditions in Europe in mid-November. Winter wheat and barley are important crops in that region and are potentially important competitors with U.S. corn in international markets. The map indicates sizeable areas of France and northern Italy have less favorable conditions than a year ago.

These will be important areas to monitor in the next several months. A continuation of less favorable conditions than a year earlier could lead to increased volatility in wheat prices this winter. That in turn could at times strengthen feed wheat prices and might boost U.S. corn export sales.



The map below shows the crop vegetative index for the U.S. in mid-November. The most significant areas to monitor this winter are Kansas and Oklahoma for indications of wheat pasture and wheat for grain conditions. Large areas of tan color for these two states indicate crop conditions are not as favorable as a year earlier. Also note that similar conditions exist in Missouri, and parts of Illinois, Indiana, Michigan, and Ohio. *These five states normally raise about 4 million acres of wheat. Wet weather this fall delayed plantings and in some cases prevented plantings of part of the intended acres. Arkansas typically adds another 0.6 to 0.7 million acres to this total.* The unplanted wheat acres in this region will likely be planted to corn and soybeans next spring. Also, any wheat that has serious winter kill likely will be planted to corn or soybeans. At current prices, corn likely would be the logical choice, although spring weather, fertilizer supplies and costs, and labor availability on individual farms also will be factors in the cropping decisions.



### Corn and Soybean Prospects for this Winter

After an almost steady increase in prices since mid-September, at least a brief downward correction in prices should be expected. The most important job of corn futures prices this winter and early spring will be to keep prices high enough to cause a 9 to 12 percent increase in corn plantings in 2007. Recent prices clearly have generated the potential for a moderate increase in next year's corn plantings. However, no one knows how high prices need to be to bring the 9 to 12 percent increase that is widely believed to be needed. The necessary

prices will depend on South American soybean and corn crop conditions as well as fertilizer prices and spring weather. History suggests the odds are high that at least a brief period of concern about South American weather and crops may develop. If so, that would bring temporary strength in bean prices this winter. Strength in soybeans would tend to push corn prices higher, as would serious concern about U.S. and/or European winter wheat crop prospects. If South American weather and crop conditions should remain ideal throughout the winter, current corn prices may be high enough to bring at least a 9 to 12 percent increase in next spring's corn plantings.

The chart of March soybean futures below shows that prices have broken out of the longer-term upward trend. That is an indication that more weakness could be ahead in bean prices in the next week or two, barring deterioration in South American crop prospects. Price charts for soybean oil indicate that market is still in an uptrend at this writing. However, soybean meal price charts have turned negative and have contributed to stalling the advance in soybean prices. Production cost data for biodiesel from virgin soybean oil suggest current prices may be pushing some biodiesel operations into the red. Returns for individual plants will be influenced by how much of the oil supply was locked in earlier at lower prices.



*Robert Wisner*