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Iowa Farm Outlook

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Living with Higher Feed Costs

Livestock producers are well aware that feed costs are higher than they were two years ago. The higher prices are expected to encourage increased world production of grains and oilseeds, but growing demand for food, feed, and fuel will remain strong. While we can debate what the new price levels will be, there is nearly universal agreement that higher grain prices are not a passing fad. Eventually, we expect for livestock and poultry prices to increase in response to the higher feed costs and reach a level that yields enough margin to sustain the industry. However, the transition may not be smooth or timely. The challenge for producers is to survive the short-term transition and prepare for long-run success.

Cattle and hog producers have had significant losses on animals sold since the fall of 2007. In addition to higher feed prices, there will also be greater grain price volatility. The loss of equity, higher input costs and price volatility lead to greater risk for producers. Short term survival and long term management in the future will require a review and possible revision both production and business practices.

The first step is to recognize that the world has changed. Strategies that worked well when corn was under $2/bu and was readily available may not work when its price is over $5/bu and may be difficult to buy when you need it. Second, implementation of changes in management and practices is important. Recognizing that things have changed isn't worth much unless you adjust to the change. Put another way, how do you change your habits that were developed with feed costs were low. Many times the change needed is not a one time correction, but rather an ongoing practice that must be continued.

There are several other articles in this publication that address production practices for dealing with higher feed costs. I want to focus more on business management to address surviving in higher feed costs.

What will feed prices be?

Given enough time, more land will come into grain production world wide, yields will increase, livestock demand for grain will decline, and cellulosic ethanol production will be commercially viable filling part of ethanol demand. These expected changes in supply and demand will help moderate corn prices. However, in the coming year or two corn prices are expected remain near $5/bu for the 2008/09 crop year. This spring's delayed plantings may push that number higher as will adverse weather during the growing season. A recent study by the Center for Agricultural and Rural Development (CARD) indicates that even a bummer crop would only lower crop year average prices to near $4/bu, but a sever drought could put average prices to near $8/bu.

This study reinforces two important management considerations. First do not wait for $2 corn, but rather anything near $4 will probably be a good purchase. Second, price may go very high if weather problems occur. Do you have a strategic reserve of corn to get through a period of very high prices or will you have to buy grain during these volatile times? Do you have borrowing capacity and storage to purchase some or all of your feed needs if the opportunity presents it self?

When will livestock prices adjust?

There are two ways that commodity prices can increase; higher demand or lower supply. Domestic demand depends largely on the price of competing meats, consumer income, and consumer preference. Rising feed costs has impacted all animal proteins so prices of competing meats are expected to be impacted somewhat similarly. Consumer spending is being negatively impacted by a weaker economy and rising gas prices and there is little indication that they prefer pork or beef more than they did before, all else equal. Demand also depends on exports and pork exports have been strong in recent months. Beef exports continue to grow slowly and there is hope that South Korea will be supportive for exports. After a slow start in 2007, pork exports have increased rapidly in since fall. At least a portion of the increased sales are likely related to the lower pork prices that occurred in October – March and may decline somewhat during the higher prices of summer.

Given the demand outlook, livestock production will likely have to decline to return to profitability to livestock and poultry producers at the higher feed costs. Liquidation of both the hog and beef cattle breeding herds has begun. Beef cow and heifer slaughter are higher than the year before. This adds to the current supply of beef, but will reduce supplies in the future. Higher pasture and forage costs and downward pressure on calf prices are squeezing cowherd margins will continue to encourage a reduction in cowherds. Lower placements of cattle into feedlots will reduce slaughter later 2008 and prices are forecast to be higher than we saw in the spring. However, sustained higher price levels will require further reductions cattle inventories.

By mid-May hog prices neared breakeven, but feed and total costs are expected to trend higher and prices are expected to decline again in the fall and red ink will likely return. The sow herd liquidation underway is expected to lead to hog higher prices in 2009. There is concern that the reprieve this summer may slow or stop the liquidation that is needed to return to profitable levels with the higher feed costs. Pork production from October 1, 2007 to mid-May 2008 was 10.1% higher than the same period the year before. Getting prices back to late 2006 – early 2007 levels will not be profitable in 2009. Export growth will help. The US exported approximately 15% of its production in 2007. Through the first three months of 2008 exports are 40% higher than the same period in 2007. If this pace is maintained, total demand will increase 6%. In addition, Canada has reduced its breeding herd. But, the bottom line is that the US will need to significantly reduce its breeding herd to achieve long term profitability. Some estimates predict a reduction of 10% or more is needed in the higher corn price era.

Managing risk

Grain prices will be volatile and sensitive to weather this growing season. Likewise, hog and cattle prices will be volatile as we move from high supplies to lower supplies. Exports, the economy, producer reactions to volatile corn prices will all impact these selling prices. Producers are encouraged to recognize these risks and focus on the margin between revenue and costs rather than simply prices. While opportunities will exist in volatile markets, it may be wiser to be more cautious in the months ahead.

Futures, options, forward contracts and livestock insurance products are tools that can help protect producers from significant shocks to their operating margins. Locking in an acceptable margin on at least a portion of your production may be a better strategy than hoping things work out for the best. If you are not familiar with these tools look for a opportunity to learn more about them a workshops and online seminars that are offered by Iowa State University, the Chicago Mercantile Exchange, Iowa Farm Bureau and others.

John Lawrence

ISU is still in the process of seating a new grain marketing specialist to provide grain marketing outlook article for the IFO Newsletter. For this month we again refer this section to Darrell Good at University of Illinois. This article was previous released in the Weekly Outlook produced by Univ. of Illi. Extension.

Assessing Corn and Soybean Market Fundamentals

Corn and soybean prices continue to be supported by a broad range of fundamental factors. These include strong domestic and export demand and a fair amount of concern about the potential size of the 2008 crops in the U.S.

The Census Bureau reported the domestic soybean crush in April 2008 at 149.2 million bushels, nearly 3 percent larger than the crush of April 2007. Importantly, the estimate of the March crush was revised higher so that the cumulative crush during the first eight months of the 2007-08 marketing year exceeds that of a year ago by 2.7 percent. Crush during the last four months of the year needs to exceed year ago levels by only 0.3 percent to reach the USDA projection of 1.84 billion bushels for the year. It appears likely that crush will exceed that projection.

Prospects for domestic feed demand of soybean meal and corn are bolstered by the sharp recovery in hog prices outlined in last week's newsletter. Higher cash and futures prices may slow the rate of liquidation of the herd. In addition, as of May 1, the number of cattle on feedlots with capacity of at least 1,000 head was down only 1 percent from that of a year earlier. Placement of broiler eggs and chicks continues at a rapid pace, with broiler production over the next 10 months expected to be only 0.5 percent less than during the same time period last year. Feed demand for corn during the summer months, however, may be tempered by increased wheat feeding. The average bid for harvest delivered wheat in southern Illinois, for example, is currently only about $.20 per bushel above the current spot cash price of corn.

Domestic demand for corn to produce ethanol also remains strong as current cash crush margins are solidly in the black. Higher ethanol prices and strengthening prices of distiller grains have offset the higher prices of corn and natural gas. A continuation of relatively high crude oil and gasoline prices would be supportive of continued strong demand even with a lower blender tax credit and reduced mandates. The current wholesale price of unleaded gasoline along with a $.45 per gallon blender's tax credit, for example, would support ethanol prices $.20 above current plant level prices. Higher fuel prices might also give a boost to soybean oil demand for biodiesel production. That use has declined sharply since the peak in August 2007, but the use of other fats and oils for biodiesel production has increased sharply.

Soybean export demand remains brisk. Cumulative shipments through May 22, 2008 (38 weeks into the marketing year) were only one percent less than the total of a year ago, while the USDA is projecting a 2.5 percent decline for the year. Unshipped sales as of May 15 totaled 136 million bushels, compared to only 81 million on the same date last year. It is also significant that Census Bureau export estimates through March exceeded the USDA estimates by 30 million bushels. Last year, Census Bureau estimates through March were 30 million less than USDA estimates. Through March, then, the Census Bureau showed soybean exports exceeding those of a year ago by 39 million bushels. Continued strong demand from China, export interruptions in Argentina, and prospects of only a modest increase in soybean acreage in South America keep export prospects strong.

The pace of corn export shipments has slowed since mid-April. Cumulative inspections through May 22 exceeded year ago levels by 17 percent, in line with the 17.6 percent increase for the year projected by USDA. Unshipped sales as of May 15 totaled 503 million bushels, compared to only 381 million bushels a year earlier. In addition, Census Bureau export estimates through March exceeded inspections by 49 million bushels, compared to a margin of 25 million a year ago. While sales remain brisk, the pace of exports needs to increase to reach the USDA projection for the year of 2.5 billion bushels.

On the supply side, the focus will continue to be on the rate of planting and development of the U.S. crops. More than half the corn crop in Iowa, Minnesota, and Missouri will be planted after May 10 and more than half the soybean crop in most corn belt states will be planted after May 20. Late planting, slow emergence, and slow growth all raise concerns about yield potential. In addition, the late maturity of the soft red winter wheat crop in Illinois, Indiana, Missouri, and Ohio raises questions about the timeliness of soybean planting following the wheat harvest. A late wheat harvest might reduce acreage and/or yield of double-cropped soybeans in those areas.

Some suggest that corn and soybean prices have not been following fundamentals, but have traded outside markets like crude oil. However, energy prices are more fundamental to crop markets than ever before. Others have argued that crop prices have been inflated by increased speculation in the futures market. There is no hard evidence to support that argument. It is sufficient that corn and soybean markets have plenty of supportive fundamentals on their own.

Darrel Good,
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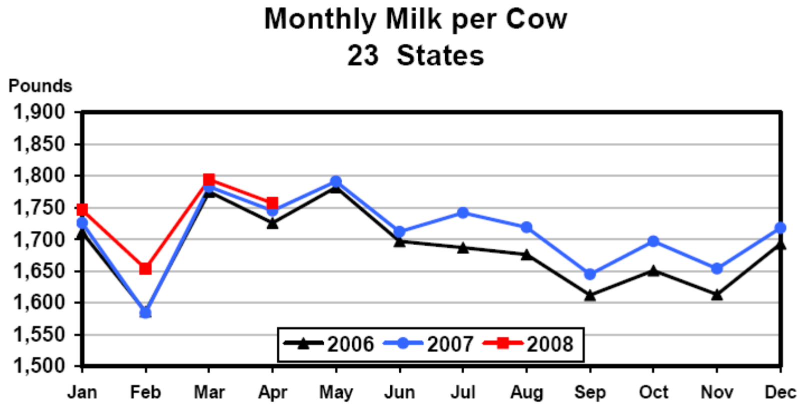
Milk Production up 2.5%, Cheese Hits Record Prices

April 2008 23 major dairy states milk production rose 2.5%. Production per cow was only 12 pounds higher for April. Milk cow numbers were 152,000 more than April 07 and 8000 more than March 08. March milk production was revised down by 10 million pounds or 0.1%.

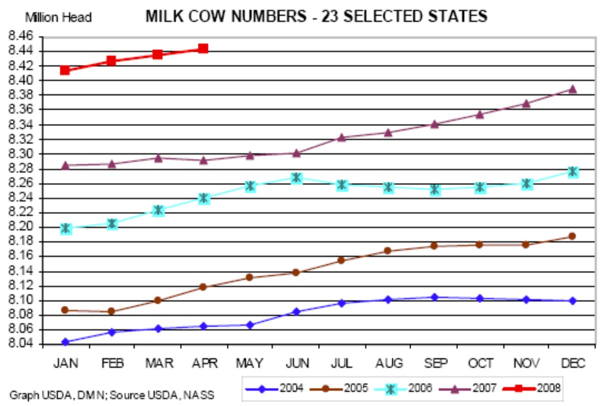
Iowa April 08 milk production was the same as one year ago. Again cow numbers were higher than one year ago, 5000, but milk production per cow was 40 pounds lower. March 08 cheese production was 18.3% higher than one year ago and 7.4% more than Feb 08.

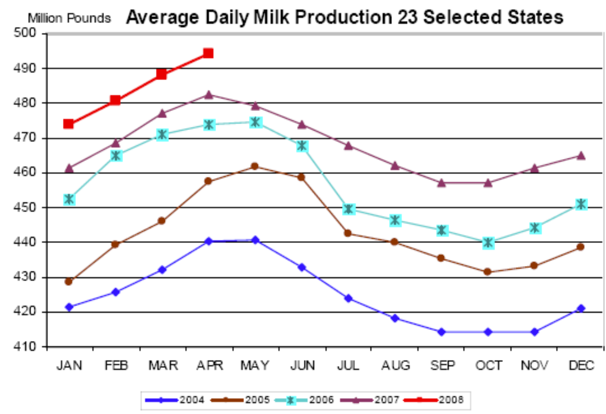
Milk Production: Selected Dairy States, April 2008

State	thousands 2007 cow numbers	thousands 2008 cow numbers	% change cow numbers	pounds 2007 milk per cow	pounds 2008 milk per cow	% change milk/cow	million pounds 2007 total milk production	million pounds 2008 total milk production	% change total milk
Iowa	211	216	2.37%	1710	1670	-2.34%	361	361	0.00%
MN	455	463	1.76%	1610	1570	-2.48%	733	727	-0.82%
WI	1246	1251	0.40%	1615	1630	0.93%	2012	2039	1.34%
IL	103	102	-0.97%	1645	1615	-1.82%	169	165	-2.37%
CA	1801	1848	2.61%	1915	1900	-0.78%	3449	3511	1.80%
CO	115	127	10.43%	1900	1910	0.53%	219	243	10.96%
ID	503	540	7.36%	1860	1840	-1.08%	936	994	6.20%
NM	345	342	-0.87%	1740	1990	14.37%	600	681	13.50%
PA	550	549	-0.18%	1690	1670	-1.18%	930	917	-1.40%
NY	627	626	-0.16%	1605	1670	4.05%	1006	1045	3.88%
TX	347	370	6.63%	1860	1965	5.65%	645	727	12.71%
23-State	8292	8444	1.83%	1745	1757	0.69%	14470	14833	2.51%



Source: Milk Production, NASS





Source: Dairy Market News

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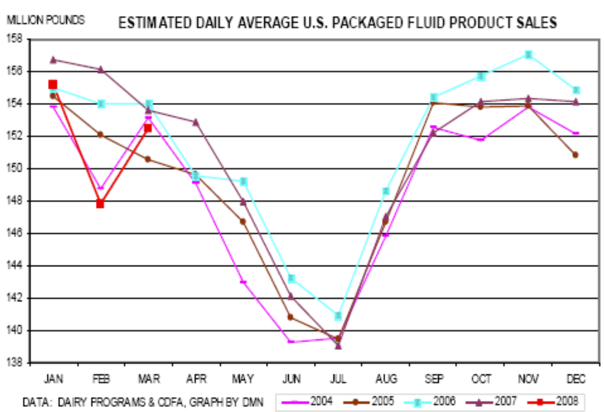
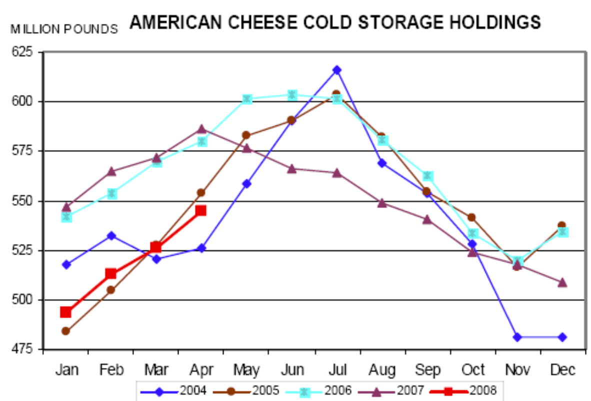
Demand or Disappearance

Cheese inventories continue below year ago levels for the 12th straight month. The day before the "Cold Storage" report was released, CME block cheese prices rose 12 cents and barrels rose 10 cents per pound. May 2 was the last date cheese prices had a decline.

Year to date fluid milk consumption is down 1.2% from the same period one year ago. Organic milk consumption is up 28.6% and 32.8% for whole and fat-reduced milk respectively. Buttermilk consumption is also up 17.1% year to date.

All dairy products disappearance is up 4.2% for the Dec 07-Feb08 period. During the same period butter demand was +9.8%, American style cheese +4.2%, other cheese +3.75% and NDM +12.7%.





Source: Dairy Market News

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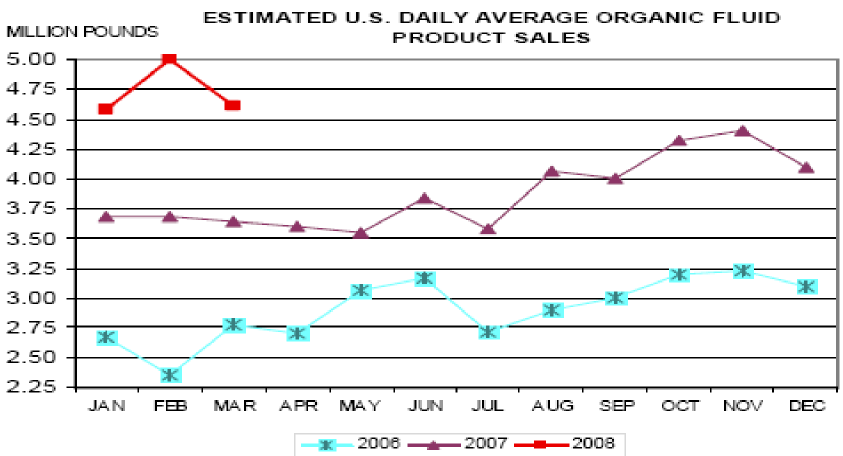
Exports for dairy products have been strong during first quarter 08. Cheese exports +5.4%, butter +798.6% and NDM exports were +73.5%. Dry whey exports dropped 5.5%.

Even though milk production has increased, cheese production has been weak. Cheddar cheese for March was -1.7% from one year ago. CA, the second largest cheese producer, cheese manufacturing was -20.7% for cheddar and -10.7% for all cheese.

As of April 30, butter stocks are 3% higher than one year ago, but cheese is down. Total cheese stocks are -5% from April 07. American cheese stocks are 7% lower and Swiss is 25% lower than one year ago. Other natural cheeses are 3% higher.



Source: Dairy Market News

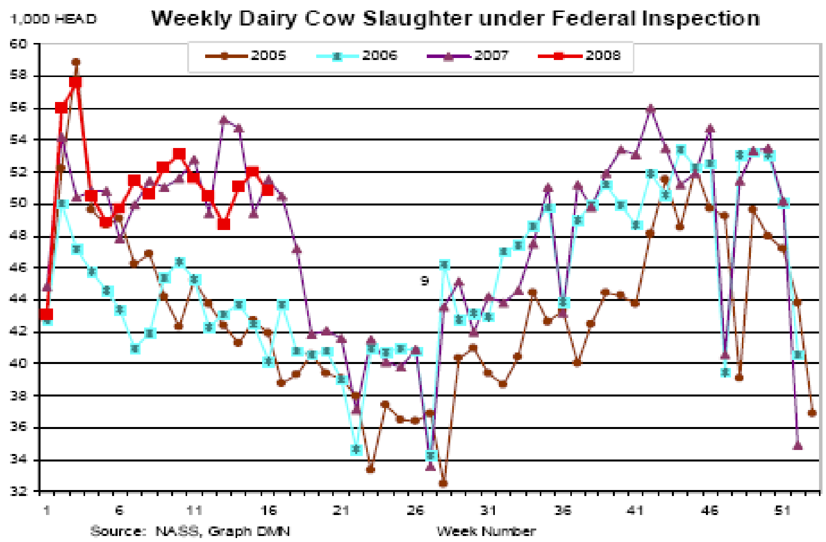
Analysis

Cheese production and stocks must be viewed a little carefully. Cheese makers knew that milk used for cheese would be purchased at higher prices than they were able to get out of the cheese when sold. So they were reluctant to make cheese except for existing contracts or orders.

USDA reported April dairy cow slaughter was 5700 higher than one year ago. Some of these were part of the last CWT herd reduction. For the last 9 years, April slaughter has averaged 10,600 less than went during April 08. The 23 major dairy states are still increasing dairy cow numbers. The question is why. Recall that the dairy heifer inventory was very large on January 1. In fact since 2000 the replacement inventory is 12.8% higher now.

New Zealand and Australia continue to have milk production difficulties due to drought. The weak dollar and this drought have helped to dramatically increase US dairy exports.

Milk and cheese prices continue to surprise observers. Typically milk and cheese prices would be declining about this time of year. However we have new record cheese prices on the CME. These prices are positive for dairy producers with increasing feed costs.



Source: Dairy Market News

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