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Iowa Farm Outlook

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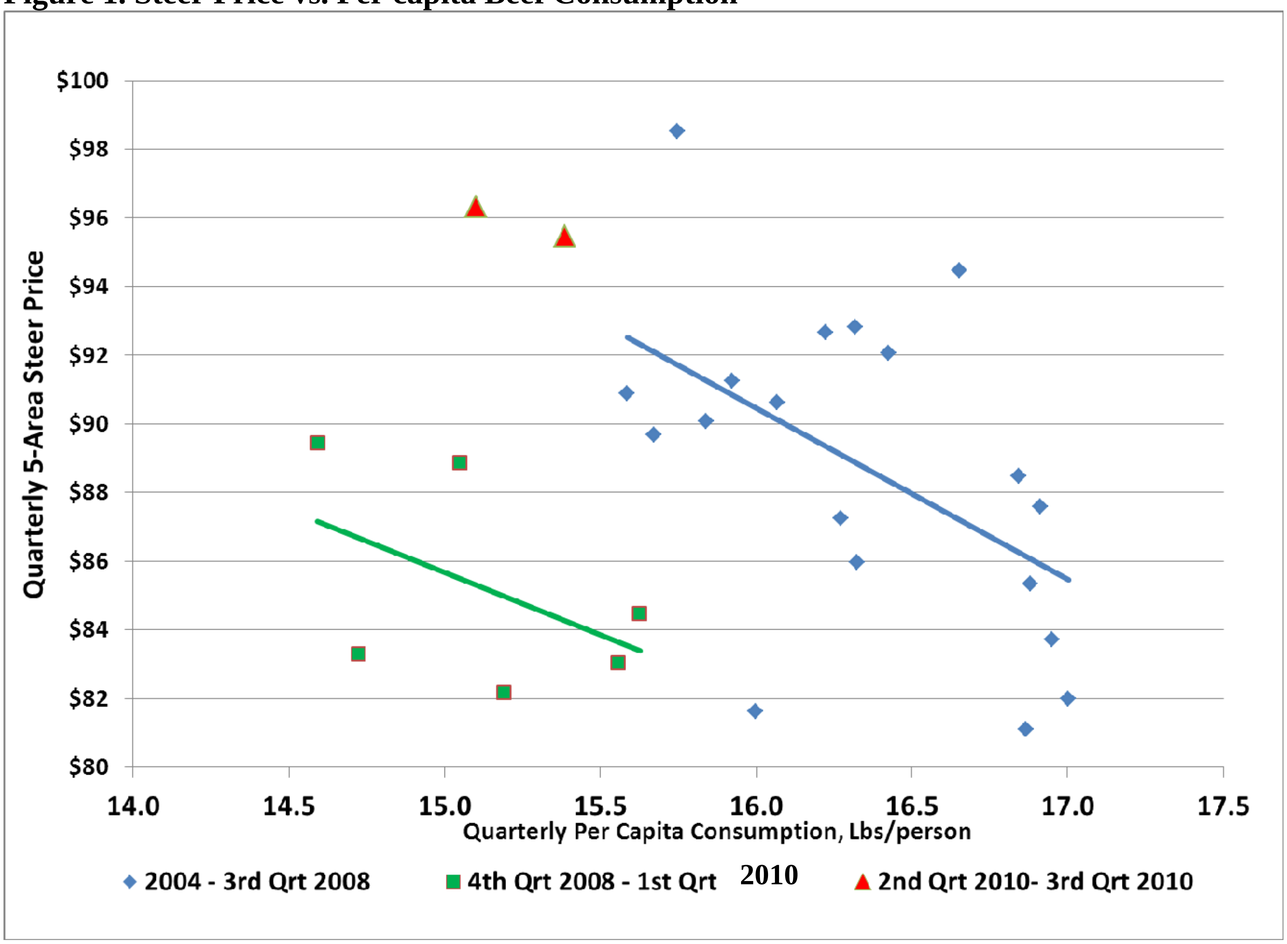
Beef Demand and Higher Prices Paint an Optimistic Outlook

In the past two years, economic recession and financial stress have impacted consumer spending habits and in turn consumer demand for meat products. Recently cash fed cattle prices have taken another step up, and futures prices suggest that the market may keep this pace well into the next year. While the recent hike in cattle prices is mostly the result of early packer procurement for the holiday season, there are some market fundamentals at work that give the beef industry an optimistic outlook. Although it can be quantified in several ways, demand is still a measure of the impact price has on consumption. Figure 1 graphs the point by point quarterly relationship between live cattle prices and per capita consumption of beef. A trend line has been added to represent general demand for the period. (Pre-recession demand is represented in blue, demand during recession period is presented in green and demand in the past two quarters is plotted in red). Beef demand suffered during the recent recessionary period beginning in the fourth quarter of 2008. Declining consumption accompanied declining prices signaling weaker demand, represented graphically by the demand curve shifting lower. Weaker demand during the recession is old news everyone is familiar with. What is news worthy now is where demand has been in the past two quarters. As illustrated in the figure below, consumption in relationship to steer prices is back on a level consistent with pre-recession demand. If the economy continues to improve, the industry can count on demand remaining strong.

Figure 1. Steer Price vs. Per capita Beef Consumption



Cattle feeding appears to be profitability through the early summer of 2011, but producers should still be weighing their risk management options. Prices like those in the futures market would match or beat record high prices. Market risk is part of the business but what are the chances of those prices getting even better?

There has been discussion of how the improved cattle prices and return to profitability might provide some incentive to increase the national beef herd. Declining beef cow numbers has been a long term trend even through the usual cycle of changing cattle population. What has changed in the most recent cycle was the stagnant cow numbers during what should have been a period of expansion.   At the same time, the dramatic growth and retraction of cow numbers during previous cattle cycles has been dampened to little more than a whisper. Current fed cattle prices have improved the outlook for the entire industry, but are cow-calf producers ready to add expand their herds?

There are several factors that play into cowherd expansion. First is sustained profitability. Cow-calf production is not an in-and-out business and the resources needed require a medium to long term investment. While profitability is back for most cow-calf producers this year, there is no guarantee it will be in two years. In the past, cattle finishers were more willing to pay higher prices to procure feeder cattle because either cheap feed or good fed cattle prices would make up the difference. Market volatility for both feed and cattle has finishers sharpening their pencils, and any adverse market movement is being pushed back onto the feeder cattle producer. This translates into more volatility in feeder cattle prices and cow-calf profitability less certain. The second factor is the capital required to start or even expand a cow-calf operation. Buying additional cows or securing grazing land is not a small investment, and lenders are uneasy. Third, there must be incentive to keep additional heifers or reduce culling rates, and cull cow prices have been very attractive recently on short supplies in the trim beef market.   Finally, the fact that it does take a substantial interest in a cow-calf production to take on the extra work, investment and risk associated with it.

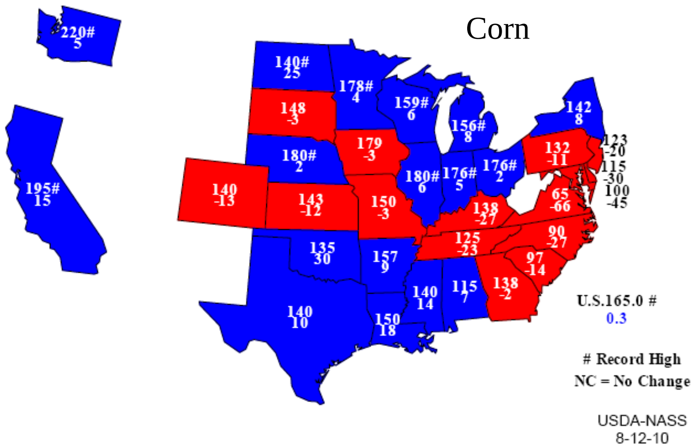
In summary, it may take a couple years of profitability to encourage producers to begin or expand a cow-calf enterprise. Heifer retention has been down in the past cattle reports, the soonest there will be an increase in cow numbers will be 2012 or 2013, which means the calf crop and feeder cattle supply will not increase until possibly 2014.

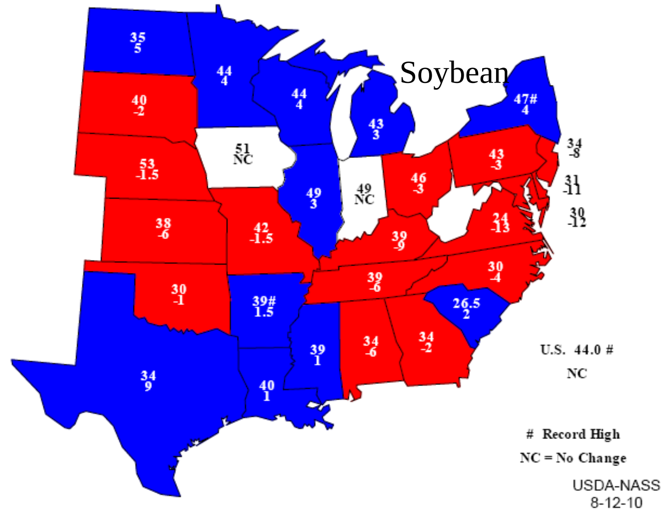
Shane Ellis

Record Yields and Increasing Demands

USDA’s first field survey of the corn and soybean crops this year led to record production estimates for both crops. For soybeans, USDA raised its national yield estimate to 44 bushels per acre. That was up 1.1 bushels from their trend and on par with last year’s actual yield. Combined with the record acreage planted to soybeans, USDA projected another record crop for soybeans, with 3.433 billion bushels of soybeans being produced across the nation. Estimated yields were up in Arkansas, Illinois, Minnesota, and North Dakota. Yields in Indiana and Iowa were steady at last year’s levels. On the corn side, USDA projected the national corn yield at 165 bushels per acre, up 1.5 bushels from last month’s estimate and 0.3 bushels above last year’s actual yield. As with soybeans, a record crop was projected with 13.365 billion bushels of corn being produced. Projected yields were higher in Illinois, Indiana, Minnesota, Nebraska, Ohio, and Wisconsin. Projected yields were lower in Iowa, Kansas, Missouri, and South Dakota. Figure 1 shows the state-level yield estimates for corn and soybeans. States in blue have yield estimates above last year’s yield. States in red have yield estimates below last year’s yield. And states with a “#” in them are projected to set a record yield. As the maps show with the August yield estimates, 10 states were projected with record corn yields, but only 2 states were projected to set soybean yield records.

Figure 1. Corn and Soybean Yield Estimates





Source: USDA-NASS, Crop Production report, August 12, 2010

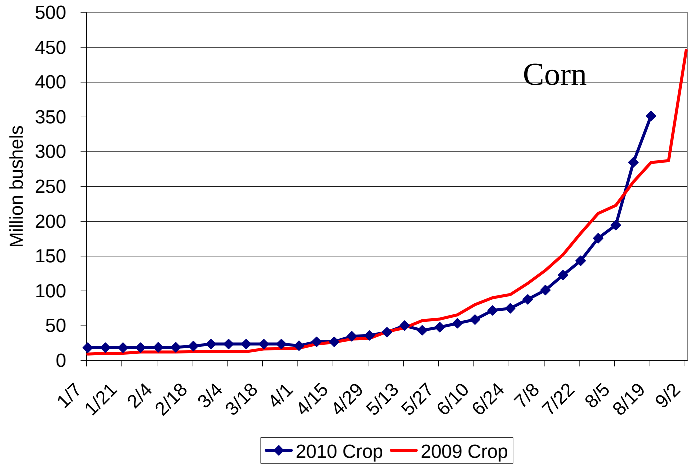
The field surveys for the August report were taken during the last week of July and the first couple of days in August. So the USDA yield estimates reflect conditions out in the fields at that time. Since then we have seen a substantial outbreak of sudden death syndrome in soybeans, especially here in Iowa, and drier conditions in the eastern Corn Belt that could impact pod-filling and reduce yield potential. Traders will also be watching the next USDA reports in September to see if the rapid maturity pace of the corn crop will pull down yield estimates. There are some early reports of ears not filling out all the way and lighter kernel weights. As the second round of field surveys is going on right now, the USDA projections that will be released in mid-September will capture some of these potential issues. The weekly USDA Crop Progress reports have begun to show some weakness in Iowa crops as the percentage of the crops rated “Good to Excellent” has fallen 3 percent for corn and 5 percent for soybeans over the last couple of weeks. Nationwide the crop conditions have held a little better with corn relatively steady and soybeans only dropping 2 percentage points. So we’re likely to see a larger revision in the Iowa yield estimates than the national estimates.

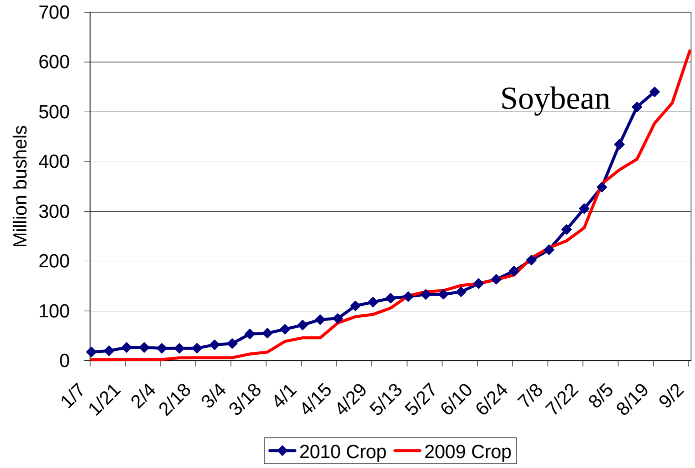
But even if there is a pullback in the corn and soybean production estimates, we are still looking at two very large crops coming to market this fall. Normally, the outlook for record crop production would put the markets on a downward trajectory, but the outlook for crop demands has been strong enough to boost the markets higher. In the USDA August estimates, soybean crush demand was raised 5 million bushels for both the 2009/10 and 2010/11 crops. Soybean export demand was raised 10 million bushels for last year’s crop and 65 million bushels for this year’s crop. Chinese soybean demand continues to pull soybeans from the U.S. market at a very strong pace. The changes brought 2009/10 ending stocks down to 160 million bushels, 15 million bushels less than last month’s estimate. So soybean stocks are still very tight. The 2009/10 national season-average price estimate was raised to $9.60 per bushel, up 5 cents. The projection for 2010/11 ending stocks were held steady at 360 million bushels, but the projected season-average price was increased to $9.25 per bushel with the increased domestic and international demand.

For corn, exports, sweetener, and starch demand have exceeded expectations, causing USDA to lower 2009/10 ending stocks to 1.426 billion bushels. The tighter stocks, in combination with higher projected exports, sweetener, and starch demand for this year’s crop, point to lower ending stock and higher prices for the 2010 crop. The drought and fire problems in the former Soviet Union have lowered wheat expectations from those countries and corn exports from the U.S. are projected to partially fill in for those lost crops. With the expected boost in demand, USDA increased its estimate of the 2010/11 national season-average price to $3.80 per bushel, up 5 cents from last month and up 25 cents from the 2009 estimate.

Advance export sales have been strong for both corn and soybeans. As Figure 2 shows, this year’s pace has leapt ahead of last year for both crops. August sales have been especially strong. Stronger export demand for corn and continued export demand for soybeans are keys to steady to higher prices as we look out over the coming marketing year. The advance sales thus far have supported the price rise both crops have experienced this summer.

Figure 2. Advance Export Sales





Source: USDA-FAS, U.S. Export Sales reports

It has been an unusual August as futures prices have rallied throughout the month. Corn futures have added nearly thirty cents over the month, while soybeans have added nearly 40 cents. Both futures markets are more bullish than USDA on the 2010/11 season-average prices. While USDA is at $3.80 for corn and $9.25 for soybeans over the Sept. 2010 to Aug. 2011 time period, futures indicate season-average prices of $4.20 for corn and $9.89 for soybeans (as of August 27, 2010). This bullishness extends to the 2011 crop year as well, with futures showing prices in the $4.25 range for corn and $9.75 range for soybeans. But the bullish futures prices are being offset by weaker basis as we enter the harvest season. Grain buyers see the coming record (or near record) crops and the early harvest run and those factors reduce the pressure to bid up cash prices.

In setting up for the 2011 crop season, corn and soybean prices are currently projected above production costs. But we'll likely see some strong competition for acreage. And winter wheat will get the first shot at increasing acreage. Futures prices for wheat are up roughly 25% since July 1st. For comparison, corn prices are up about 7% and soybean prices are up 10%. So wheat futures are set to pull some land back to wheat production. But wheat is also suffering from weaker basis, which may give farmers some pause in shifting back to wheat. One of the key areas to watch will be winter wheat areas in Missouri, Illinois, and Indiana. These areas can double-crop wheat and soybeans and price movements have supported both crops.

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