

The Kentucky Agricultural Economic Outlook for 2011

edited by Laura Powers and Kenny Burdine



Kentucky's Agricultural Economy *Craig Infanger & Kenny Burdine*

2010 Review: U.S. agriculture rebounded quickly from the effects of the commodity market 'crash' in 2008 and the serious global recession in 2009. USDA is projecting U.S. net farm income to be up 24% this year. Most of the increase in farm income is coming from improved market conditions for beef cattle, dairy, poultry, and recent surges in corn and soybean prices. The balance sheet for ag is strong, despite the weak macroeconomy.

The most important factor behind the improved economics for agriculture is the revival of ag export markets. After plunging from a record-high \$115 billion in 2008 down to \$96 billion last year, ag exports have rebounded to a projected \$113 billion for 2010. Larger volumes of grain exports at higher prices, as well as improved horticulture and meat exports, are behind the reversal. After a short dip in 2009, food imports are forecast to be another record-high next year as economic recovery continues.

As a result of these market forces, Kentucky's farm economy had a better year in 2010. Total cash receipts are estimated to be \$4.4 to \$4.7

billion, up at least \$100-300 million over 2009 and well above the 10-year average of \$4 billion. Net farm income this year (excluding government payments) will be \$1.3 billion - just below the state's 10-year average. With ag exports booming and the economy in slow recovery, both cash receipts and net farm income for 2010 should be significantly higher, with a positive outlook for 2011.

Poultry is now solidly the #1 source of cash receipts in the state as growth in that sector continues. Equine receipts showed slight improvement from 2009, but will remain a distant second. Improving corn prices worked to offset disappointing yields to round out the top three cash generators for Kentucky agriculture. Had weather been more favorable in the state, grain receipts could have been significantly higher.

2011 Outlook: Kentucky agriculture is weather-dependent and trade-dependent. Therefore, the economic outlook for 2011 depends on reasonably good weather and continued strength in export markets. If the current drought conditions in western and central Kentucky continue into the 2011 growing season, the economic outlook will be dimmed considerably.

At this point in time, the outlook for exports

remains positive into 2011. With the world economy showing clear signs of growth and commodity markets surging, there is every reason to expect Kentucky farmers to benefit from continued expansion in U.S. ag exports. As long as the U.S. dollar's value remains fairly low relative to the value of the currencies of our major trading partners (e.g., China, Canada, Mexico, Japan, South Korea), ag exports should continue the strong recovery experienced in 2010.

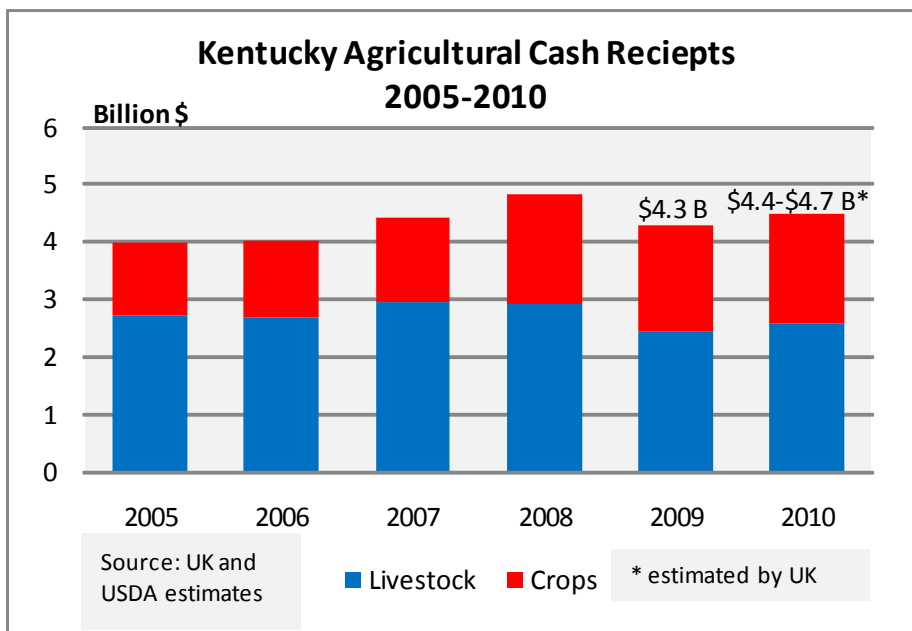
On the livestock side, meat supplies will remain relatively tight and support current price levels. Moderate growth in receipts is expected for most species, with poultry leading the way, followed by equine. Beef cattle receipts will likely be a distant third and will clearly be more affected by weather and feed prices. Continued improvement in the U.S. and world economies would greatly improve the demand outlook for next year. Livestock receipts will likely increase by \$100 to \$200 million in 2011.

On the crop side, the outlook for tobacco is not encouraging and overall sales will continue to decline. For corn, soybeans and wheat, the outlook is very bullish. Given reasonably normal weather, gross receipts could surge another \$300 - \$400 million dollars. Early forecasts indicate corn could be the #2 source of cash receipts in 2011. Certainly any improvement in the housing sector will be good news for the greenhouse-nursery sector, which has been severely impacted by the recession.

Given reasonable weather and a slowly improving macro-economy, Kentucky's farm cash receipts in 2011 should be in the range of \$4.8 - \$5.2 billion, a new all-time record high for gross income to the farm sector.

Tobacco *Will Snell*

2010 Burley Review: Burley contract volume was significantly reduced in 2010 due to softness in both the domestic and international markets. The domestic market continued to suffer from retail cigarette price/tax hikes, smoking restrictions, and the overall weak economy. Plus, the uncertainty of FDA regulations



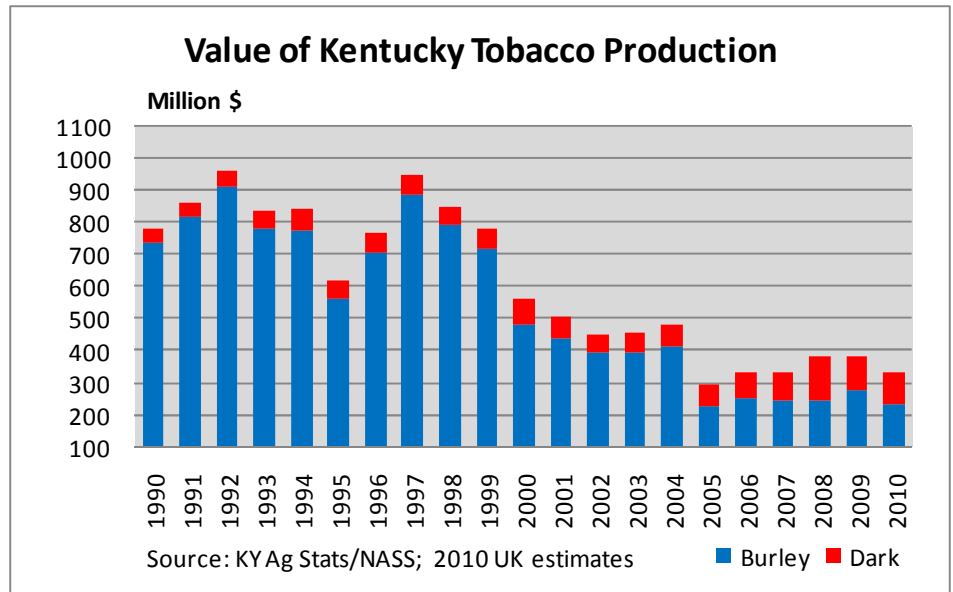
likely led domestic companies to be even more conservative in their purchasing plans for 2010.

Internationally, the value of the dollar kept U.S. burley price-competitive in the world market, but ample world burley supplies displaced U.S. burley in many foreign markets. In addition, following Canada's tobacco product flavoring ban in 2009, concerns over a potential worldwide international flavoring/ingredient ban may have also led to some conservative burley purchasing decisions for foreign buyers in 2010. Despite these and other adverse factors, U.S. burley acreage was down only 4% in 2010 due to a significant volume of non-contracted tobacco being planted in the burley belt. Extreme weather conditions (too wet early, coupled with heat and drought latter in the season) took its toll on both yields and quality. Furthermore, curing conditions in many parts of the burley belt were not conducive to a quality crop which led to many concerns over grading and prices for the 2010 crop.

According to USDA, the U.S. burley crop is expected to total 186 million pounds in 2010, 13% lower than last year's 215 million pound crop. A crop of that size is likely above the anticipated domestic and export use levels, which will result in increased buyer inventories and/or price adjustments to move this supply level into the trade. Decent quality contracted burley will continue to fare well in this environment (\$1.70s and \$1.80s/lb), but lower quality burley and non-contracted tobacco will likely suffer greatly unless the marketing volume is significantly below current expectations.

2010 Dark Review: Dark tobacco producers continued to benefit from growing domestic snuff sales as consumers respond to smoking restrictions and perceptions of lower health risks for smokeless products relative to cigarettes. Following two straight years of supply adjustment, it appeared that the industry moved more toward an acceptable supply/demand balance as dark tobacco contracts for 2010 remained relatively constant.

According to USDA, U.S. dark tobacco acres were off around 3% in 2010. However, unfavorable growing conditions also reduced yields resulting in a total U.S. dark crop of 63.5 million pounds (48 million pounds for dark fire-cured and 15.5 million pounds for dark air-cured), compared to a 70 million pound dark crop in 2009. These combined production levels are still above dark tobacco disappearance levels that have averaged a little over 50 million pounds in recent years. Ideally the extra supply will be absorbed in the market to meet the growing sales of smokeless tobacco products. Look for dark tobacco prices to remain near recent levels (\$2.25-\$2.30 per pound for dark air-cured and \$2.50 - \$2.55 per pound for dark fire-cured).



2011 Outlook: Kentucky's tobacco outlook for 2011 hinges critically on what evolves on the regulatory front. FDA regulations are being formulated and will likely lead to increased record-keeping and required changes in farm-level production practices, which likely will affect costs of production and eventually the number of farmers willing/able to adhere to these changes. While FDA is a concern for burley growers, the domestic market now comprises less than 25% of the market.

The major issue confronting the U.S. burley industry evolves from potential international regulations on flavorings/other added ingredients, which are critical to blend with burley tobacco to make the taste of cigarettes acceptable to tobacco consumers. Given regulatory uncertainty, buyers of U.S. burley will likely continue to be very conservative in their contract offerings for 2011, especially amidst an era of ample world burley supplies (although they are declining).

Dark tobacco growers are expected to fare much better as prices and contract volume should stay relatively constant in response to anticipated strong domestic sales of smokeless tobacco products. The number of farms growing tobacco in Kentucky will likely continue to decline to below 5,000 farms, compared to around 8,000 farms reported in the 2007 census and more than 30,000 farms just prior to the buyout.

While tobacco will continue to remain an important crop for the remaining farms, its overall relative importance in Kentucky's ag economy will continue to be much lower than the pre-buyout era. Tobacco now comprises less than 10% of Kentucky ag sales vs nearly one-fourth of cash receipts back in the 1990s. Following a record crop of more than \$900 million in the late 1990s, the value of the crop fell to around

\$300 million immediately after the buyout. After some adjustment period, tobacco sales did rebound in response to additional burley export and dark tobacco demand opportunities enabling the crop to surpass \$380 million in 2008 and 2009. But declining domestic cigarette sales, slumping exports, labor and infrastructure challenges along with poor growing conditions likely caused the crop to fall back to around \$325 million in 2010 with domestic/international regulatory concerns creating much additional uncertainty about whether the crop can exceed \$300 million in sales for 2011.

Grains *Cory Walters*

2010 Review: Kentucky producers faced a dramatically different year in 2010 compared to last year in corn, soybean, and wheat production. Overall, Kentucky corn and soybean production was down while wheat production was up. The good news was that prices for all three commodities significantly increased from the end of summer to now.

The November 2010 USDA Crop Report put the corn crop at 12.54 billion bushels, down 4% from last year's record production. U.S. yields are expected to average 154.3 bushels per acre, down more than 6% from last year.

On the corn use side, feed and ethanol are expected to increase while exports are expected to decrease, for a total use of 13.43 billion bushels. Ending stocks are expected to come in at 827 million bushels, down an astounding 48% from the previous year. U.S. use in 2010 is expected to exceed production.

For soybeans, crop size decreased to 3.37 billion bushels (a record) from the October USDA crop and less than 1% more than 2009. Estimated

yield decreased by 0.5 bushels per acre over the October USDA crop report to an average of 43.9 bushels per acre.

Total soybean use slightly increased to 3.35 billion bushels over the October report stemming from increases in exports and residual. Smaller production coupled with a larger use number resulted in ending stocks decreasing by 30% to 185 million bushels from the October USDA crop report. However, use is still less (although slightly) than production.

At 2.21 billion bushels, the U.S. wheat crop was slightly lower than the October USDA estimate and 2009 production levels. Exports, feed, seed, and food are all expected to be higher than last year. Overall, ending stocks are expected to decrease by 13%. For 2009, production was less than use.

Commodity index funds continue to hold large long (i.e., they bought futures) futures positions. Throughout the spring and summer, index funds have either added to or held their long positions. Currently, in the corn market, index funds hold 24% of open interest of which 83% are long. For soybeans, index funds hold 28% of open interest of which 94% are long. For wheat, index funds hold 45% of open interest of which 84% are long.

2011 Outlook: Currently, new crop corn, soybean, and wheat futures prices are at or near record highs. Factors influencing current futures prices include the value of U.S. dollar (low relative to historical standards and currently declining), crude oil (currently strengthening), index fund investment (currently strengthening or holding), speculator interest (currently very bullish), demand prospects (strong), cotton price (record highs), and South American crop size (which is expected to be large). With all of the uncertainty surrounding the market, producers should expect high levels of price volatil-

ity. Price direction will be influenced as information enters and uncertainty exits the market.

Livestock and Meats

Kenny Burdine and Lee Meyer

Equine 2010 Review: For the second straight year, the equine sector will not lead Kentucky in cash receipts. Sales have been largely steady from a weak year in 2009, and stud fees likely came under pressure this year as the equine industry continued to deal with a weak economy. Recreational demand for pleasure and show horses has also negatively affected the markets. Receipts for 2010 are expected to be very close to 2009 levels.

Equine 2011 Outlook: Farm level equine receipts are primarily derived from sales and stud fees. The strength of the equine sector will likely follow the overall U.S. economic recovery. Given the recent sales trends, it is not likely that stud fees will increase overall in 2011. Therefore, sales prices will need to be much stronger next year to see serious improvement over 2010.

Beef Cattle 2010 Review: For the third year out of the last four, Kentucky cattle producers were forced to deal with drought conditions across much of the state. Consequently, hay feeding began early in many locations, which will increase production costs by year's end. Calf prices rallied from late 2009 levels and spent much of the spring and summer in the \$115 to \$120 range. Prices fell sharply in the fall, but have remained above 2009 levels. Strong export demand supported fed cattle prices and offset much of the negative effect from rising corn prices during the fall. Fall 2010 calf prices, coupled with spring feeder cattle futures, are creating some attractive opportunities for winter backgrounders.

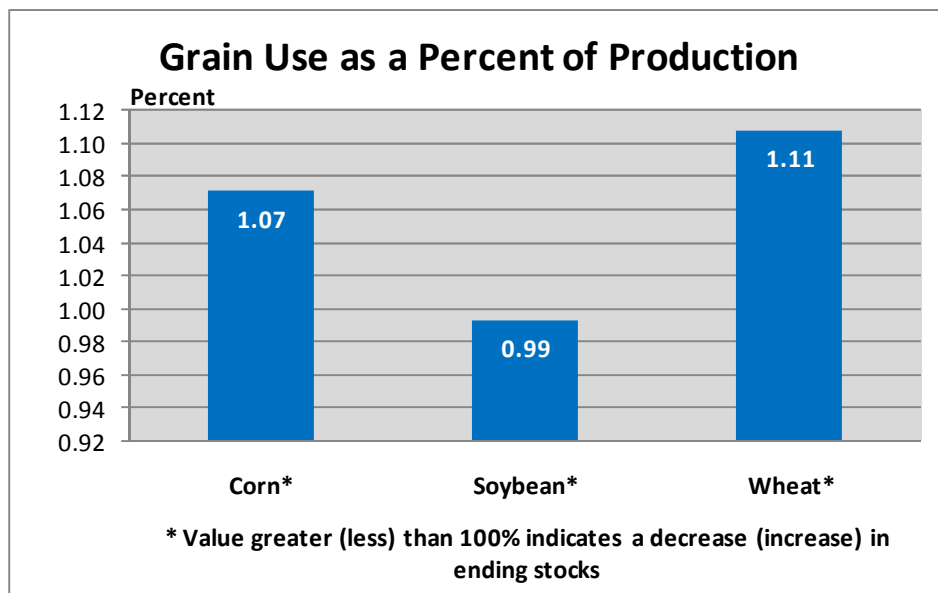
Beef Cattle 2011 Outlook: Based on heifer retention estimates and cow slaughter, it is likely that beef cow numbers will show another decrease by January 2011. Overall beef supply will also remain very tight and support slaughter cattle prices. Feed costs will ultimately determine how much of these strong prices will be enjoyed at the stocker and feeder cattle level. Calf prices will mostly likely improve into the spring and have the potential to exceed 2010 levels. If feed prices stay at high levels, it is also very likely that price slides will narrow, providing more incentive for backgrounders to add pounds in Kentucky.

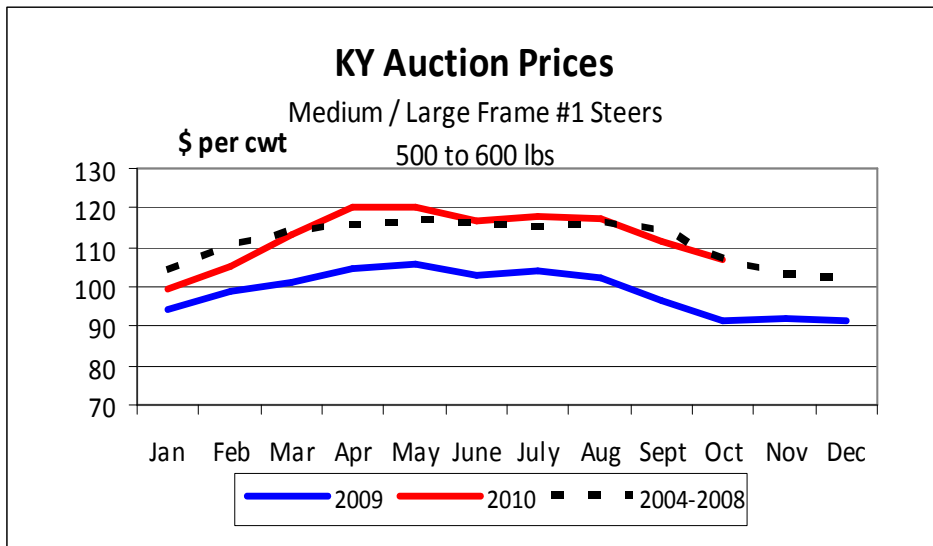
Dairy 2010 Review: Coming off a brutal 2009, the 2010 dairy markets showed considerable improvement. A combination of CWT herd retirements and overall profitability challenges during 2009 resulted in a smaller dairy herd to start the year. Kentucky mailbox prices began the year in the \$17-\$18 range, fell by about \$2 by spring, but slowly rallied back above \$18 by summer. By year's end, the U.S. All Milk Price and Kentucky mailbox prices will likely average around \$3 per cwt higher than was seen in 2009. According to USDA, Kentucky began the year with 80,000 dairy cows, a 7% decrease from 2009.

Dairy 2010 Outlook: Milk production is projected to increase slightly in 2011. While many component prices should remain strong, it is unclear if exports will play as significant a role in 2011 as they did in 2010. Farm level milk prices in 2011 are likely to be very similar to 2010. A U.S. All Milk Price in the \$15 to \$18 per cwt range is likely with prices slightly stronger in Kentucky. Production costs are also likely to be higher in 2010 given what has happened in the grain markets this fall.

Poultry 2010 Review: U.S. broiler production continued to increase in 2010, rising 3% to over 36 billion pounds. Exports remain a key part of the broiler business, but dropped 4%. Greater production with lower exports leaves higher domestic supplies. U.S. consumers ate an average of 82 pounds of chicken, the highest of all meats. The overall demand for broiler meat remained strong through 2010. Moderate growth in the general economy and very high retail pork and beef prices pushed consumers toward chicken.

Poultry 2011 Outlook: For 2011, production is expected to increase another 3%. While exports declined in 2010, they are likely to rebound by 3%. (About 20% of the U.S. broiler production is exported.) As a result, 2011 prices are expected to be moderately higher. While prices will be higher, profits will not. Corn price is up more than \$1.10 per bushel from year-earlier levels, reducing the profitability of broiler production. Corn prices are forecast to stay high, so 2011 industry profits will be lower than 2010.





cated an expected acreage increase for produce crops of 4% overall to a total of around 13,000 acres. Fruit crop acreage was projected to be up slightly at an estimated 3,000 acres and vegetable crop acres estimated at 10,000. Kentucky had around 10,500 acres in all produce in 2002. While Kentucky remains a relatively minor produce supplier compared to surrounding states, the sales growth in Kentucky has outpaced that of surrounding states, especially for fruit.

Green Industry: The green industry nationwide is driven by new home construction and healthy consumer spending, which have been in a deep and extended slow down for the past 2 years. Greenhouses, sod operations, landscapers and mid-size nursery businesses grew rapidly between 2002 and 2006, but have each been in difficult times since. A continued weak overall economy and relatively high input costs, especially labor, resulted in another weak marketing season for Kentucky's green industry. Demand has remained subdued for most green products, particularly trees, shrubs and sod.

2011 Outlook: Direct market, auction and independent grower-shipper wholesale sales will likely increase again next year. Two new produce auctions started in 2010 and another is planning to open in 2011. A number of important issues however, will shape commercial fruit and vegetable production in Kentucky. A recent survey of the southeast horticulture Extension specialists pointed to labor management and food safety standards and compliance as the top issues influencing production. These will remain the key industry drivers during the next few years. Gross sales will continue to be driven by higher-value direct marketing at farmers' markets, directly off the farm, and direct to foodservice. Wholesale opportunities will continue to expand as demand for local products remains strong in local markets. Overall produce acreage will continue to move higher and higher-value market channels should see sales increasing over the next few years.

Producer expectations for the next three years were surveyed in the 2010 planting intentions and marketing survey. Many growers expect to stay about the same, but the number increasing substantially outpaced the number expecting to decrease, even more so than when growers were surveyed in 2008. This was pretty much the case in every market channel.

The green industry should see a modest rebound in 2011 as the economy moves toward recovery. Floriculture and service-oriented enterprises should see an earlier response to the recovery followed by nursery and sod. Gross sales for 2011 for all of Kentucky horticulture could approach the record high observed in 2008 of \$118 million.

Hogs 2010 Review: In 2009, hog prices were dismal, well below cost of production at times. In 2010, prices dramatically recovered, moving up by 70% to the mid \$70s on the basis of 3% less pork, stronger demand and an increase in exports. Tight supplies led to higher grocery prices – a record high \$3.23 per pound. Per capita consumption of pork has been about 50 pounds for the past 5 years, but dipped by 6% during 2010.

Hogs 2011 Outlook: The hog price situation in 2011 will depend largely on demand because supply is probably not going to change much. Sow numbers are down by about 2%, thus farrowing intentions for the next six months show little change. Slaughter hogs are currently selling for about \$60/cwt. (equal to about \$50 on a live weight basis). Profitability is being hurt by increasing grain prices. Corn price is going to be more than \$1.00 per bushel higher adding \$10 per head to the cost of production. With other feed costs higher - and expected to rise more in 2011 - the hog enterprise will be more profitable than in 2009, but not quite as healthy as the higher hog prices would indicate.

Sheep and Goats 2010 Review: Nationally, there were about 2% fewer sheep in 2010. Kentucky sheep numbers were down about 7% to 37,000. While there are not nearly as many goats in the U.S. as sheep (3.04 million goats, compared to 5.6 million sheep), that doesn't hold true for Kentucky. As of January 1, 2010 there were about 85,000 goats in Kentucky (79,000 meat goats and 6,500 dairy goats). Lamb prices averaged almost 20% higher. Goat prices were up 25%.

Sheep and Goats 2011 Outlook: Domestically produced lamb and goat meat supplies are unlikely to change much unless there is significant drought in the major producing areas. An important factor has been the strength of the

Australian and New Zealand dollars against the U.S. dollar. While lamb imports have not changed much, the cost is considerably higher. This will keep lamb and goat prices at the profitable levels of 2010.

Horticulture Tim Woods

2010 Review: Just ten years ago, when Kentucky was starting to make a concerted push toward diversification and development of the horticulture industry, the value of all horticulture cash receipts was \$78.6 million, with floriculture, nursery, greenhouse, and sod contributing \$59.7 million and produce contributing \$18.9 million. Kentucky's produce (vegetables/fruit) industry has seen steady growth over this period, even through a difficult economy. The green (nursery/greenhouse) industry has been negatively impacted during the slow recovery. Current industry sales trends point toward 2010 gross sales winding up somewhere around \$115-\$120 million, about the same as in 2009.

Produce Industry: Gross produce receipts appear to be about equal to where they were in 2009 as more producers benefited from additional direct market channels, especially farmers' markets and auction sales. Weather was the main limiting factor from realizing record produce sales. Producer numbers and acreage has continued to expand. The dry late summer slowed yields and size for some items after a very strong spring. Direct markets remain an important channel for most of our producers. Over 2,300 vendors sold in farmers' markets in 2010 and the number increases each year. Auction and other wholesale channels have experienced significant growth in producer numbers, with the sustained interest in local produce in Kentucky markets.

Preliminary planting intentions for 2010 indi-