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PROSPECTS FOR THE U.S. FARM ECONOMY IN 2008

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Good morning. I, too, would like to welcome everyone here this morning to USDA's annual Agricultural Outlook Forum. My task is to briefly focus on the economic outlook for U.S. agriculture.

Current Outlook Remains Strong

The outlook for agriculture has rarely, if ever, been more favorable. First, world economic growth is projected to increase at a 3.5-percent average annual rate between 2008 and 2017, after averaging 2.9 percent annually in 2001-07. Strong economic growth in developing countries, particularly important for growth in global food demand, is projected at 5.8 percent annually for 2008-17.

Second, the U.S. dollar continues to depreciate. This provides a boost to exports by partially offsetting currently high commodity prices. We expect growth in export demand from this and from rapidly rising developing country incomes. Sustained exports will contribute to increased agricultural commodity prices and gains in farm cash receipts. However, assuming normal weather, we will face increased competition from South American oilseeds, increased wheat production by traditional exporters and newcomers to the market such as Ukraine, and to livestock producers around the globe. Despite challenges from abroad, the United States will remain a major player in world agricultural markets.

Third, world oil demand is expected to rise due to strong global economic growth, particularly in highly energy-dependent economies in Asia. As a result, returns for ethanol production remain high, leading to a continued expansion in the production capacity of the ethanol industry over the next several years. Corn starch will remain the primary feedstock in the United States for the foreseeable future. Increases in corn-based ethanol production also will lead to shifts in land use to more energy-intensive crops.

The production of biofuels is experiencing rapid growth in a number of countries. Significant increases in foreign biofuel production over the next decade are expected in the EU-27, Brazil, Argentina, and Canada.

Producers to Increase Plantings in 2008

Cropland area is expected to expand in 2008 with higher expected net returns for the major field crops. Combined planted area for the 8 major field crops (corn, sorghum, barley, oats, wheat, rice, upland cotton, and soybeans) is expected to reach 252.3 million acres, up 6.8 million acres from 2007 (figure 1). Higher area is supported by strong incentives to expand overall planting including double crop soybeans with an additional 1.6 million acres of soft red winter wheat sowed last fall. Also available for planting is 2 million acres of Conservation Reserve Program (CRP) land from contracts not renewed last October.

Leading the expected expansion in area is higher wheat seedings and a substantial rebound in soybean area (figure 2). Wheat farm prices are projected at record levels again in 2008/09 even as high prices last fall encourage expansion in fall seedings and record prices for durum and spring wheat are expected to boost area for these crops in the Northern Plains. Farm prices for soybeans are projected at a record again for the coming year boosting net returns sharply higher compared to last year at this time. Corn acreage is expected to decline in 2008 reflecting stronger competition from soybeans this year; however, corn plantings will remain well above those in recent years as expected returns are up substantially from last year at this time even with higher fertilizer costs. Upland cotton and rice also are expected to lose area in 2008 as year-to-year gains in net returns fall short compared to the other crops.

Wheat Prices Hit Record Levels But World Production to Rebound

The domestic and world wheat markets are the focus of attention with record prices for all the major classes of wheat set in recent weeks (figure 3). Wheat prices have risen to record levels on strong demand and tight supplies in the current marketing year. U.S. ending stocks are expected at the lowest level in 60 years while world ending stocks are expected to fall to a 30-year low. With growing world income levels, demand for wheat has grown faster than supplies with consumption outpacing production in 7 of the last 8 years. During the past 2 years, production has fallen short of expectations with back-to-back droughts in Australia, crop problems in the EU-27, declining production in Canada, and below trend yields in the United States (figure 4).

Wheat prices are not expected to remain at their current lofty levels in 2008/09. Record prices have encouraged increased planting of winter wheat in the Northern Hemisphere. With Australian production expected to bounce back from the drought-reduced levels of the past 2 years, world wheat production should be sharply higher 2008/09. World wheat production for 2007/08 is estimated at 603 million tons (figure 5). With a return to more normal weather around the world, 2008/09 production could rebound by 40-50 million tons. U.S. farm prices for 2008/09 are projected at a record $7 per bushel, up 35 cents per bushel from the mid-point of the 2007/08 projected price. Export competition from larger world supplies are expected to weaken domestic wheat prices by fall as newly harvested grain becomes available outside the United States.

Ethanol Production Continues to Drive Corn Market

The U.S. corn market will continue to be dominated by ethanol production in the coming year. Ethanol corn use for 2008/09 is projected to increase 28 percent and account for 31 percent of total corn use as ethanol production capacity continues the unprecedented expansion begun in 2006.

Based on monthly production data from the Energy Information Administration, ethanol production capacity exceeds 7.3 billion gallons annually (figure 6). With plants under construction and expansion coming on line over the next 18-24 months total capacity will reach 13.4 billion gallons.

The Energy Independence and Security Act of 2007 raises mandated levels of renewable fuel use to 9 billion gallons for 2008 and 10.5 billion gallons for 2009. This is sharply higher than the previous mandated level of 7.5 billion gallons in 2012. The current pace of plant construction and expansion indicates that annual ethanol production capacity will surpass 9 billion gallons before this summer and exceed 12 billion gallons early in the 2008/09 marketing year (figure 7). Corn prices, as currently forecast, support profitability for the sector, but plant utilization rates will be increasingly sensitive to prices for ethanol and co-products and heavily influenced by prices in the energy sector.

The relative tightness of the corn balance sheet in 2008/09, combined with increased risk premiums and growing investment in commodities, is expected to push farm prices higher again in 2008/09. The average price received by farmers is projected at a record $4.60 per bushel, up $0.60 from the mid-point of the 2007/08 forecast.

Rice, Soybean, and Cotton Prices to Strengthen Further

Rice farm prices in 2008/09 are expected to strengthen on continued tight domestic supplies, strong prices for wheat, corn, and soybeans, and firm global prices. Area in production is expected to decline about 2 percent from 2007 to about 2.7 million acres. Higher net returns for competing crops will constrict rice area. If realized, planted area will have declined 3 consecutive years after reaching 3.4 million acres in 2005. Total use is expected to decline in 2008/09 due to the smaller crop—exports are expected to fall. Ending stocks are expected to be about the same as 2007/08. The average price received by farmers is projected at $11.80 per cwt., up 35 cents from the mid-point of the 2007/08 forecast.

U.S. soybean production is expected to rebound in 2008 as producers shift plantings back to soybeans. With soybean futures prices up 65 percent from a year ago, and soybean meal and oil prices up 50 and 85 percent, respectively, soybean area is projected to recover to 71 million acres, up from last year's 63.6 million. Increased area is expected to come from reduced corn and cotton plantings, as well as from increased double cropping in some winter wheat areas. Despite the sharp reduction in beginning stocks, increased production leaves supplies down just 1 to 2 percent from 2007/08.

U.S. soybean crush is projected to increase modestly reflecting mainly increased protein demand by livestock. Export demand for soybean meal is expected to remain near the levels reached in 2007/08. Despite strong meal prices and expected slow growth in animal numbers, the soybean meal to corn price ratio is expected to favor soybean meal feeding, allowing for modest gains in domestic disappearance of soybean meal. Continued relatively high soybean oil prices will also contribute to the value of crush despite sharply slower growth in soybean oil use in production of biodiesel resulting from the impact of record soybean oil prices on profitability, especially in the U.S. market. With higher crush and reduced supplies, trade prospects are limited for 2008/09. Exports are projected lower, keeping ending stocks near the level projected for 2007/08. The U.S. soybean farm price is projected at a record $11.50 per bushel, up $1.10 per bushel from the mid-point of the current market year forecast.

South American soybean production is expected to expand more sharply than in recent years as producers react to continued strong soybean prices, especially in Brazil where additional land is readily available. With limited growth prospects for U.S. soybean exports despite increased production, South America will capture a greater trade share in 2008/09. Global demand for soybeans is likely to expand, mostly due to growth in China where higher incomes are increasing the demand for meat and vegetable oil (figure 8). Global oilseed stocks are unlikely to rebound in 2008/09 as oilseed supply gains are unlikely to significantly outpace demand growth.

Turning to cotton, USDA projects that producers will plant 9.5 million acres in 2008, a 12-percent reduction from the preceding year and a 38-percent reduction from 2006/07. If realized, this projection would be the smallest cotton area in 25 years. Area is declining despite recent cotton price increases because prices of alternative crops—especially wheat and soybeans—have risen relatively more. Assuming normal abandonment and yields, we can expect around 15.0 million bales to be produced, the smallest crop since 1998/99. Sharply-reduced U.S. production will result in tighter stocks in both the U.S. and the world, since increased foreign production is not likely to offset both higher world consumption and lower U.S. supplies.

Livestock Sector Facing Higher Feed Costs

The livestock sector is facing the challenge of higher feed costs. Net returns weakened in 2007 and producers are likely to be further stressed as grain prices escalate in 2008. Meat production is forecast to increase just over 2 percent in 2008. Pork production is forecast to increase about 5 percent and broiler production will grow almost 3 percent. Beef production is forecast to decline less than 1 percent. Due to biological lags, much of the changes in red meat production forecast for 2008 are the result of producer decisions made in 2007. Increases in dressed weights, which have been common over the past several years, are expected to slow or stop as producers market animals at lighter weights to offset higher feed costs.

In the December *Quarterly Hogs and Pigs* report, farrowing intentions indicated that producers remain in an expansionary mode. However, given declining returns, the rate of growth in farrowings likely will slow by midyear (figure 9). While farrowing intentions may slow, output growth will be supported by a dramatic increase in pigs saved per litter as producers have been able to overcome disease problems in 2006 and early 2007. In addition to large domestic supplies of hogs in 2008, imports from Canada are expected to increase. The Canadian industry is liquidating as producers there respond to poor returns, leading to increased shipments of both feeder pigs and slaughter hogs to the United States.

The broiler sector began to expand by the second quarter of 2007 after contracting in late 2006 and early 2007. In response to improved returns following the production decline, producers began to expand chick placements at 3 to 5 percent in the fourth quarter of 2007 and early 2008. Although production is expected to increase throughout the year, weakening returns are expected to slow the rate of expansion to less than 1 percent by the end of the year.

The recent *Cattle* report indicated that there was a 1 percent decline in cattle inventories during 2007 and that producers were holding fewer beef cows and replacement heifers on January 1, 2008. Supplies of cattle outside feedlots are fractionally below last year and will limit the supplies of fed beef during the latter part of 2008. In the face of lower net returns, cattle producers normally attempt to reduce costs by bidding lower for feeder calves. This year, however, tighter supplies will give some support to feeder calf prices. In addition, assuming improved forage conditions in 2008, feedlot operators may face increased competition for young cattle from stocker operators. And finally, cow-calf operators may also retain more heifers for addition to the breeding herd if pasture conditions improve and feeder calf prices remain favorable, further limiting supplies of cattle for placement in feedlots. These retained heifers will not calve until 2009 and their offspring will not be available for slaughter before 2010.

Livestock and poultry prices are expected to decline in 2008 as supplies of meat will be large (figure 10). Fed cattle will be about $1 per cwt lower than their 2007 record but still the second highest on record. Hog and broiler prices will also decline in 2008 as production increases. Pork prices are forecast to decline about $5 per cwt. Broiler prices likely will decline about 1 cent per pound from their 2007 record but will also be the second highest.

Higher feed prices are expected to impact the dairy sector, but the industry is currently in an expansionary mode (figure 11). Milk producers are expanding herds in response to generally favorable milk-feed ratios during much of 2007, but growth will be tempered later in the year as poor returns reduce incentives for expansion. Production in 2007 increased about 2 percent as the herd averaged fractionally higher. Milk per cow increased but lagged its historical growth patterns. Driven by strong domestic and international demand for dairy products, the all milk price averaged a record $19.13 per cwt, over $6.00 above 2006 and $4.00 above 2005's record.

Cow numbers are expected to increase in 2008, but high grain prices may slow the growth in milk per cow. Milk production in 2008 is expected to increase just under 3 percent, supported in part by an extra day due to leap year. Demand for dairy products, both domestically and for export, may lag production growth, resulting in higher stocks and weaker prices in 2008. The all milk price for 2008 is forecast to decline to $16.85 to $17.55 per cwt, still the second highest ever. Dairy product prices are forecast to remain above support and no Commodity Credit Corporation net removals are forecast.

For specialty crops, including sugar, fruits and vegetables, and greenhouse/nursery crops, prices and farm revenues have not increased as sharply as for food and feed grains and oilseeds. Farm sales for specialty crops are expected to rise modestly to $57 billion in 2008, accounting for about one-third of all crop cash receipts. In addition, the booming markets for field crops are putting upward pressure on land, fertilizer, and other input prices. With sharply higher production costs and reduced profit margins, resources likely will be drawn away from specialty crops.

Food Price Outlook

Consumer prices for food are expected to increase 3 to 4 percent in 2008 compared to the 4 percent increase in 2007 (figure 12). Processing, transportation, and marketing costs which are subject to volatile energy costs and other factors in "core" inflation will contribute about 2 percent to retail food prices. Commodity prices at the farm level are expected to increase less than last year, with declines for livestock and dairy products partially offsetting higher crop values.

While the ethanol boom can be expected to bring higher incomes to farmers and reduce government outlays for farm programs, it also will contribute to higher crop and livestock prices. As a result, overall retail food prices for 2008-10 are expected to rise faster than the general inflation rate.

Despite Increased Production Costs, Farm Income at Record Levels

The outlook for the farm economy as a whole is for another very good year in 2008, driven by strong demand for feed crops, oilseeds, and food grains. Net farm income is forecast at $92.3 billion, up 4.1 percent from $88.7 billion in 2007, and 51 percent above the 10-year average (figure 13). Favorable returns to the farm sector translate into another year of rising asset values, particularly land. Declining ratios of debts to assets and equity point to a financially strong farm economy.

For 2008, the value of crop production, at $174.6 billion, is forecast to exceed its previous record (attained in 2007) by $30.6 billion, a 21-percent increase. Prices of major crops (corn, soybeans, and wheat) were trending upward in late 2007 and are expected to maintain those gains in early 2008. Livestock cash receipts are projected to decline about 2 percent to $138.7 billion. Small declines are projected in the value of production for all major livestock sectors (cattle, hogs, poultry, and dairy).

Production expenses for 2008 are forecast to increase to almost $280 billion, up 9 percent from 2007, following an 11 percent increase last year. Feed prices forecast at $45 billion are up 18 percent, after rising 25 percent in 2007. Manufactured inputs (fertilizer, fuels, electricity, and pesticides) are forecast to total $47 billion, up 14 percent in 2008 on top of a 12 percent rise in 2007. As we move into the spring planting season, prices for selected inputs are increasing sharply. Notably, the January 2008 index of prices paid for fertilizer is up 32 percent on the year. Fertilizer price increases largely reflect crop area expansion here and abroad, a growing dependence on imports, and the weak U.S. dollar.

There can be little debate that 2007 was one of the most remarkable years agriculture has ever seen. As we look forward to 2008, the stage seems set for another year of prosperity and growth. In the end, how the new year unfolds will be determined by the vagaries of weather and the impact of public policies which will affect global trade and investment in agriculture.

Thank you.