

Agricultural Commodity Outlook

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I would like to thank TD Newcrest for, once again, inviting me to speak at this conference. I enjoyed my visit to Toronto last June and am pleased to be here again.

Because a number of you were not here in June, let me say once again what my responsibilities are as chairman of the World Agricultural Outlook Board (WAOB). In short, I am responsible for overseeing the coordination, review, and clearance of all commodity forecasts released by USDA. The *World Agricultural Supply and Demand Estimates (WASDE)* report is the primary source of information used by world commodity markets. It is WAOB's responsibility to ensure that USDA estimates and forecasts are unbiased, based on sound information, and released in a timely manner.

This morning, it is my task to present USDA's most recent situation and outlook assessment for grains, soybeans, and livestock, both in the United States and abroad. Last June, price volatility and meteoric rises in commodity prices to record levels captured the media's attention. Now, just 6 months later, the economic landscape has changed dramatically. While price volatility has remained a market feature; prices are on the downswing, and media interest now has turned to mortgage foreclosures, the credit crisis, and worldwide recession. Food price inflation remains a concern but is not on the front burner as it was then.

Having said the above, I do not want to leave the impression that agricultural markets have returned to "normal." They are not "normal" when compared to markets of 2 or 3 years ago. In the remarks which follow, you will see that USDA does not envision commodity prices, for the most part, falling to pre-2006/07 levels. There can be little doubt that global supply and demand prospects for the foreseeable future suggest market equilibrium will be achieved at generally higher prices than in the past. In this presentation, I will outline the factors driving these extraordinary developments and give the Department's most recent assessment of where commodities appear to be headed.

Last June, I focused on prospects for the 2008/09 marketing year. I can now speak with more certainty regarding 2008/09. At this date, our crop estimates for the northern hemisphere are nearly final. However, southern hemisphere crop prospects are still tentative. While harvesting of some crops such as wheat is underway, planting of crops such as soybeans is barely complete. So, we will not know the final results for several months.

Today, any discussion of the commodity situation and outlook has to begin with a reference to recent developments in world energy markets. However, whereas crude oil prices exceeded \$125 per barrel just 6 months ago, they have dropped in recent days, as Canada knows all too well, to less than \$60 per barrel. While oil prices have dropped dramatically, they are not expected to continue plummeting. Thus, the global demand for bio-energy is expected to continue rising, albeit, at a slower pace than projected last summer. Energy uses for crops will

continue to account for a growing segment of demand. The demand for ethanol and biodiesel will continue to support commodity prices, especially for corn and soybeans, as these commodities increasingly compete for acres and attempt to bid acres away from each other and other crops. The competition for crop land will continue to support prices across the board.

In the United States, the concern about energy prices and reliable sources of supply has resulted in significant policy initiatives including implementation of production incentives and mandated consumption goals for biofuels. As a result, ethanol and biodiesel production capacity has grown rapidly. In the longer term, commercial production of ethanol from cellulosic sources may reduce the upward pressure on corn and soybean prices. As yet, however, an economically feasible cellulosic alternative has not been identified, although extensive research is underway in both the public and private sectors.

Many observers attribute rising world food prices to the increased use of grain and oilseeds crops for renewable fuels. It should be noted, however, that there are other factors which may be even more significant. First, unprecedented increases in world energy prices drove the demand for renewable fuels and rippled through the entire food and agricultural sector in the form of higher production, processing, and marketing costs. Second, world wheat consumption exceeded world wheat production in 7 of the 8 years between 2000/01 and 2007/08. Several years of below normal yields in major exporting countries culminated in abnormally tight ending stocks levels and sharply higher prices. And third, a number of traditional exporting countries imposed restrictions in 2007/08 on exports of feed grains, wheat, and rice in an effort to pre-empt or stem the rise in domestic food prices. All of these factors plus rising labor costs and growth in demand contributed to a panic atmosphere in some markets earlier this year which, in turn, helped elevate prices to record levels.

2008 Crop Acreage

Record prices in 2008 and large year-to-year gains in expected net returns for corn, soybeans, and wheat attracted area from other crops and land uses. In addition, a net reduction of 2 million acres in the Conservation Reserve Program contributed to an overall acreage increase.

Combined planted area for the three major U.S. field crops (corn, soybeans, and wheat) increased by 6 million acres year-to-year and reached a 24-year high in 2008. Corn plantings, while down from the previous year, remained at a historically high level as substantial year-to-year price gains continued to support favorable corn returns despite rising fertilizer and other input costs. Soybean plantings rebounded sharply as returns improved year-to-year with rising prices. Total wheat plantings increased as high wheat prices last fall boosted winter wheat seedings, and record prices for spring wheat encouraged hard red spring wheat and durum plantings in the Northern Plains.

Wheat

The global wheat situation has been transformed over the past few months as world wheat growers responded to high prices in the fall of 2007 and record prices in 2008. The wheat situation was extremely tight last spring, but with increases in planted area and favorable weather in most of the major producing countries, global production has rebounded sharply in 2008. USDA's current forecast for 2008/09 global wheat production is a record 682 million tons, up 72 million from last year.

Global ending stocks in 2007/08 fell to a 26-year low as consumption exceeded production for a third straight year. Global stocks declined 43 percent from 1999/2000 through 2007/08. Prices rose rapidly during the 2007/08 marketing year as available supplies shrank with a second year of below-trend yields and production in major exporting countries such as Australia, Canada, European Union, the United States, and Ukraine. For many importing countries, the United States became the only available source of wheat, further reducing domestic U.S. supplies. As a result, U.S. ending stocks for 2007/08 declined to the lowest level in 60 years.

U.S. wheat planted area increased 4 percent in 2008/09 to the highest level in 10 years as producers responded to high prices and favorable returns. Record yields combined with higher area to increase production 21 percent for the year. At 2.5 billion bushels, the U.S. wheat crop was also the largest in 10 years. Domestic use is projected 22 percent higher in 2008/09 as larger supplies, particularly of soft red winter wheat, support a large year-to-year increase in feed and residual use and modest growth in domestic food use. Total use, however, is expected to be down 1 percent from 2007/08, as large world supplies and stiff competition from less expensive European and Black Sea wheat limit U.S. exports. Also pressuring U.S. exports, particularly for higher quality milling wheat, are larger supplies in Australia and Canada, as production has rebounded sharply in both countries. U.S. exports for 2008/09 are projected 21 percent lower than last year's 15-year high. Ending stocks are expected to build in 2008/09 as production increases more than offset the historically low carryin. Ending stocks are projected to nearly double in 2008/09 at 603 million bushels, compared with 306 million in 2007/08. The season-average farm price for 2008/09 is projected at \$6.55 to \$7.15 per bushel compared with last year's record of \$6.48 per bushel. The higher year-to-year price reflects strong prices during the summer months when a majority of the U.S. crop is marketed. Price prospects for the remainder of the year will be under pressure from rising world supplies, strong export competition, and continued declines in futures prices as a result of broader financial and economic problems.

Record global wheat production has significant consequences, not only for U.S. wheat exports, but also for U.S. corn exports, as much of the year-to-year increase in world wheat output is from higher production of feed quality wheat. Record wheat production by the EU-27 and Russia, and an 18-year high by Ukraine, account for 56 million tons of the 72-million-ton world production increase. These traditional producers of feed quality wheat remain extremely competitive in feed markets in North Africa and the Middle East, and to major feeding countries, such as South Korea, that can shift to wheat feeding when prices become attractive relative to corn. Global wheat feeding is projected to increase 29 million tons or 31 percent in 2008/09.

Corn

The United States remains the world largest feed grain exporter and is expected to account for 48 percent of total world coarse grain trade in 2008/09. This is down, however, from 54 percent in 2007/08 as reduced domestic supplies of corn, strong demand for corn to produce ethanol, and strong competition from larger foreign supplies of coarse grains and wheat cut into the U.S. market share.

U.S. corn production for 2008/09 is down 8 percent from last year's record. At 12.0 billion bushels, 2008/09 production is still the second highest ever. Planted area in 2008/09 was down 8 percent from the 63-year high in 2007/08; however, at 86 million acres, this year's plantings were 9 percent above the 1997/98-2006/07 average. With larger beginning stocks in 2008/09, supplies are expected to be down just 5 percent from last year's record level. Although exports are projected down 22 percent in 2008/09, rising domestic use, driven by rising demand for corn

to produce ethanol, is expected to limit declines in total corn use to just 2 percent. Corn ethanol use is projected to increase nearly 1 billion bushels or 32 percent in 2008/09, boosting domestic corn disappearance 3 percent despite lower year-to-year feed and residual use. Feed and residual use is projected 11 percent lower reflecting increased availability of distillers grains (a co-product of ethanol production), lower animal numbers, and reduced residual use. As currently projected, food, seed, and industrial use, which includes ethanol, will exceed feed and residual use for the first time in 2008/09 with ethanol alone accounting for 32 percent of total corn use.

U.S. corn disappearance is projected to exceed production in 2008/09 by 515 million bushels as rising ethanol corn use offsets expected reductions in feed and residual use and exports. Ending stocks for 2008/09 are projected down 31 percent from last year to the lowest level in 5 years. Rising world coarse grain supplies, reduced prospects for global corn feeding, and broader financial market concerns are expected to pressure corn prices in 2008/09. Declines in futures and cash prices continue to undermine price prospects for producers with the current season-average farm price projected at \$4.00 to \$4.80 per bushel. This compares with the 2007/08 record of \$4.20 per bushel. Farm prices in 2008/09 are expected to be supported above cash market values reflecting forward pricing opportunities that were well above current market levels.

Domestic corn use is expected to continue to increase over the coming years as the demand for ethanol grows to satisfy the higher mandated ethanol use in the Energy Independence and Security Act of 2007. This Act mandates that U.S. gasoline consumption must include 9 billion gallons of renewable fuel in calendar year 2008, with total renewable biofuel use, including corn-based ethanol, biodiesel, and cellulosic ethanol rising to 20.5 billion gallons by 2015. By 2015, the maximum allowable use of corn-based ethanol that counts against the Renewable Fuels Standard reaches a maximum of 15 billion gallons.

Annual U.S. ethanol production capacity as of November 2008 exceeded 11 billion gallons and is expected to grow to 13.6 billion gallons over the next 24 months as plants under construction and existing plant expansion projects are completed. Current USDA projections put ethanol plant capacity at 12.5 billion gallons by the end of the current marketing year in August 2009. Declining gasoline consumption and lower gasoline prices are expected to pressure ethanol producer margins over the coming months with plant capacity utilization rates expected to fall from 100 percent in recent months to 90 percent by the end of the 2008/09 marketing year.

Soybeans

In 2007, the rapid rise in U.S. ethanol production boosted corn prices and led to an unprecedented shift in planted acres from soybeans to corn. U.S. producers reduced planted soybean area by 14 percent, or 10.8 million acres. In addition, the expanded use of biodiesel around the world, especially in Europe and the U.S., had a dramatic impact on global vegetable oil markets. As a result, soybean and other vegetable oil prices rose sharply through the summer of 2008.

In the 2007/08 marketing year, reduced soybean production, increased demand for biodiesel use, and strong export markets for soybean meal and oil reduced U.S. soybean stocks by 64 percent, helping to drive soybean prices to the highest level on record. Thus, the record high ending U.S. soybean stocks in 2006/07 that helped to buffer the impact of lower plantings for the 2007/08 marketing year were largely depleted. As a result, prices firmed and U.S. acreage rebounded sharply in 2008, reaching 75.9 million acres, a 17 percent increase.

The 2007 Energy Act mandates that U.S. biodiesel use must reach 500 million gallons by 2009, and rise to 1 billion gallons by 2012. For 2007/08, soybean oil-based biodiesel accounted for about 406 million gallons of biodiesel production. When other fats and oils are included, biodiesel production exceeded the 500-million-gallon level mandated for 2009 by the 2007/08 marketing year, well ahead of schedule.

Based on figures reported by the National Biodiesel Board in the fall of 2008, annual existing production capacity for biodiesel stands at 2.55 billion gallons per year with another 850 million gallons of annual capacity planned for development. But, only about 25 percent of existing capacity is currently being utilized. Although soybean oil prices have fallen sharply, so have diesel prices, so net returns for producing biodiesel are not highly favorable. Even with current soybean oil prices near 35 cents per pound, down from 70 cents this past summer, net returns are negative for many plants even with the \$1.00 per gallon tax credit for blending. In the market environment expected for 2008/09, food processors are likely to continue to bid vegetable oil prices to levels that leave biodiesel production margins low. If not, food processors' vegetable oil supplies would be at risk due to the substantially idle biodiesel production capacity which exists.

To meet the 2012 mandated levels of biodiesel use laid out in the 2007 Energy Act, a sharp increase in biodiesel supplies will be needed. In recent months, it appears from U.S. Census Bureau data that non-soybean-based fats and oils may provide much of the needed supplies. In 2007/08, other fats and oils accounted for 39 percent of total methyl ester production, up from only 16 percent in 2006/07. To the extent this trend continues, it appears that the 1.0 billion gallon mandate can be met without severe adjustments to the soybean oil balance sheet.

U.S. oilseed production for 2008/09 is projected at 88.0 million tons, up 7 percent from 2007/08. Higher soybean production accounts for most of the increase. Peanut, sunflowerseed, and canola are also projected higher, with only cottonseed projected to decline from 2007/08 levels. Based on a yield of 39.3 bushels per acre and with 74.4 million harvested acres, soybean production is projected at 2.9 billion bushels, up 245 million bushels from 2007/08. Soybean supplies are projected at 3.1 billion bushels, down 3.9 percent from 2007/08 despite higher production. Production gains are more than offset by sharply lower beginning stocks.

Soybean crush is projected to decrease 3 percent to 1.75 billion bushels, reflecting a lower domestic soybean meal use and a projected decline in soybean meal exports. Domestic consumption of soybean oil is projected to decline slightly as higher biodiesel use of soybean oil is more than offset by a continued decline in food use. Biodiesel production is projected to use 16 percent of total soybean oil production for 2008/09 compared with 15 percent in 2007/08. Soybean exports are projected at 1.02 billion bushels, down 141 million from 2007/08. Ending stocks for 2008/09 are projected at 205 million bushels, unchanged from 2007/08, leaving the stocks-to-use ratio at a relatively low 7 percent.

The U.S. season-average soybean price for 2008/09 is projected at \$9.10 to \$10.60 per bushel, compared with \$10.10 per bushel in 2007/08. Prices are expected to remain historically firm due to relatively strong corn and soybean meal and oil prices. Soybean meal prices are forecast at \$255 to \$315 per short ton, compared with \$335 per ton for 2007/08. Soybean oil prices are projected at 37.5 to 41.5 cents per pound compared with 52 cents per pound for 2007/08.

Global oilseed production for 2008/09 is projected at 418 million tons, up 26 million tons from 2007/08. Oilseed production is projected to recover from the first year-to-year decline in global oilseed production since 1995/96. U.S. oilseed production gains account for 22 percent of the global increase. Total foreign supplies are projected to increase by 5 percent from 2007/08.

Global oilseed ending stocks for 2008/09 are projected at 64.6 million tons, up 3 million tons from 2007/08. Most of the increase is due to higher projected soybean stocks in Argentina and canola stocks in Canada.

Over the next 10 years, China will remain the world's leading importer of soybeans. China's imports may approach 50 million tons. With little growth projected for domestic production, China's dependence on foreign supplies will rise even further from the projected 68 percent in 2008/09.

In coming years, expanded soybean production in South America is expected to satisfy the growing global demand for oilseeds and products as competition from corn limits soybean area in the United States.

Livestock and Red Meat

Total U.S. meat production, including poultry, in 2009 is projected to decline about 1 percent. Beef production in 2009 is projected to decline on tighter supplies of cattle. Cow inventories declined in 2007, and with relatively high cow slaughter expected in 2008, cattle inventories will be smaller and result in fewer cattle marketings during 2009. Marketable supplies of cattle also will tighten as producers begin retaining calves from this year's calf crop to rebuild herds. Pork production is expected to decline as producers reduce sows farrowing later this year and into next year in response to poor returns. Additionally, cattle and hog imports are expected to be lower reflecting reduced Canadian inventories.

Total meat exports, including poultry, are forecast to increase in 2008. However, total exports are forecast to decline in 2009 due to global economic weakness and a relatively stronger U.S. dollar. The recently announced agreement to re-open South Korea to imports of U.S. beef is expected to support increased exports beginning in mid-2008 and beef exports will expand through 2009 albeit at a slower pace. Pork exports for 2008 are forecast higher as imports by markets in Asia have increased sharply. However, growth has slowed in recent months and pork exports are forecast to decline in 2009, particularly as China's domestic pork supply situation improves. Broiler exports expanded sharply in the first 3 quarters of 2008 but are expected to slow later and decline in 2009. Beef imports in 2009 are expected to increase as U.S. cow slaughter declines. Pork imports are forecast to increase in 2009.

Recently implemented Mandatory Country of Origin Labeling (COOL) regulations add a level of uncertainty to livestock and meat trade between Canada (and Mexico) and the United States. COOL was initially enacted in 2002 as part of the 2002 Farm Bill, but subsequent legislation delayed implementation of mandatory COOL for meat derived from livestock until September 30, 2008. The interim final rule was published on August 1, 2008, and became effective on September 30, 2008. During the first 6 months of implementation, USDA is conducting an industry education and outreach program concerning the provisions and requirements of the rule. The regulations require retailers above a certain size to label ground and muscle cuts of beef, pork, lamb, goat, and chicken as to the country of origin according to 4 categories:

- 1) **Product of the U.S.:** meat from animals born, raised, and slaughtered in the United States or from animals present in the United States on or prior to July 15, 2008.
- 2) **Product of the U.S., Country X:** meat from animals born in Country X and raised and slaughtered in the United States
- 3) **Product of Country X, U.S.:** meat from animals imported into the United States for immediate slaughter.
- 4) **Product of Country X:** foreign meat imported into the United States.

Food service establishments and exports are exempt from the regulations.

It is difficult to gauge the impacts of COOL regulations in the short time since implementation. Some U.S. firms engaged in the slaughter of Canadian cattle or hogs have stated that they will indicate if the product is from Category 1 animals rather than exclusively use the Category 2 or 3 labels. However, one major meat packer has indicated that it will only purchase hogs that comply with Category 1. These actions could limit the marketing of both feeder pigs and slaughter hogs from Canada. However, some of the hogs that otherwise may have been shipped to the United States for finishing and/or slaughter instead may remain in Canada for slaughter. Then, some of this pork may be exported to the United States under Category 4. Unknown is whether major retailers will be willing to handle and label products of differing origins.

In 2009, livestock and poultry prices are generally forecast higher due to lower meat supplies. Cattle prices are forecast higher as supplies of cattle remain relatively tight. Hog prices are forecast higher due to tighter supplies and continued strength in domestic demand and relatively strong exports.

Thank you. I am prepared to address any questions you may have.

Tables and Charts:

The accompanying charts and tables provide additional details. Note: For additional details, see the November 10, 2008, *World Agricultural Supply and Demand Estimates* report at: <http://www.usda.gov/oce/commodity/wasde>.