



2011

The Kentucky Agricultural Economic Outlook for 2012

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The Kentucky Agricultural Economic Outlook for 2012

edited by Laura Powers and Kenny Burdine



The U.S. / Kentucky Agricultural Economy

Will Snell, Craig Infanger, Kenny Burdine

2011 Review: With a booming export market coupled with tight supplies for many agricultural commodities, U.S. agriculture has done extremely well this year despite a severe drought in some regions of the country. USDA is projecting U.S. net farm income will reach a record high of about \$104 billion, up 31% over last year and 54% higher than the 10 year average. Both crop and livestock receipts jumped, with crop receipts up 19% and livestock up 16%. However, production expenses also increased significantly during the year, up over 11%, with the biggest changes coming in feed costs to the livestock sector. With higher cash receipts, lower interest rates, and rising land values, the balance sheet for U.S. agriculture remains the strongest in years.

An important factor behind the improved financial returns in agriculture is the boom in U.S. agricultural exports over the last two years. After a plunge in 2009, farm exports jumped to \$109 billion last year and will be about \$137 billion this fiscal year – an all-time record high. Although export volume has not been overly impressive, soaring export prices drove the total value of U.S. exports to record-high levels

this year. Strong grain demand for biofuel production also played a key role in boosting income to record levels.

Reflecting national trends, Kentucky's farm economy also had a better year in 2011. With almost across-the-board improvement in returns for corn, soybeans, wheat, cattle, horses, hogs, and dairy, Kentucky farm cash receipts will exceed \$5 billion for the first time. Preliminary estimates of 2011 crop and livestock cash receipts for Kentucky farms are estimated to be \$5.2 to \$5.4 billion, up from \$4.4 billion last year. Net farm income is expected to rebound back above \$1 billion in 2011, compared to \$780 million in 2010. Government payments, which totaled \$320 million in 2010, likely fell in 2011 due to market-supported prices and dwindling tobacco buyout payments.

With more favorable growing conditions and substantially higher corn prices, poultry and corn are likely to be the top two sources of cash receipts. Even with improved returns, horses and cattle are likely to be second-tier sources of cash receipts, lagging behind corn and poultry.

2012 Outlook: The economic outlook for Kentucky agriculture next year is dependent on weather patterns, trade/global economies, and the responsiveness of U.S./world agriculture to

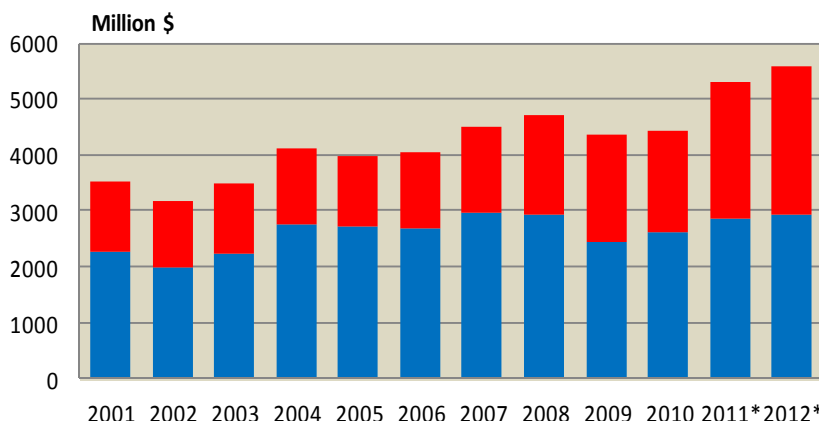
tight supply levels. While the weather is a constant risk, it seems clear that the boom in trade has lost steam. USDA is forecasting "steady" ag exports for the next fiscal year. While there is strong growth predicted for India, China, and Russia, the Euro-Zone, Japan, and Canada will experience more modest growth, reflecting continuing economic recovery. A wildcard is the chance that the value of the U.S. dollar remains weak in international currency markets, continuing to enhance the attractiveness of U.S. exports.

On the livestock side, drought in Texas and Oklahoma coupled with competition for grazing and hay ground will likely result in fewer beef cows in 2012 and further support feeder cattle prices. Strong equine sales in 2011 were partially the result of pent-up demand, tax incentives, and some very large dispersals, so continued strength in sales and stud fees will be needed to sustain that level in 2012. Steady poultry production and a modest improvement in prices should result in higher poultry receipts in 2012. On a national level, expansion appears to be under way in the dairy sector, which will likely put pressure on farm-level milk prices next year.

On the crop side, tight grain supplies, energy mandates, and export demand are expected to keep grain prices relatively high, encouraging additional grain acreage out of other crops and pasture. Tobacco contract poundage offered may stabilize given growing dark consumption and limited quality burley stocks, but acreage could continue to decline given more profitable opportunities in other enterprises. Decent weather will enable cash receipts for fruits and vegetables to increase given increasing demands of local consumers. Collectively, crop receipts are expected to exceed \$2.5 billion in 2012, compared to averaging \$1.7 billion during the 2006-2010 period.

Given reasonable weather, continued economic recovery in the U.S., and a sustained high level of exports, there is every reason to forecast farm cash receipts in the range of \$5.3 to \$5.7 billion in 2012 – another record-high.

Kentucky Agricultural Cash Receipts



Source: KY Ag Stats/NASS and UK estimates for 2011

■ Livestock ■ Crops

*2011 estimate
 *2012 forecast

Tobacco *Will Snell*

2011 Burley Review: Kentucky burley farmers entered 2011 with many of the same adverse market conditions they experienced in recent years – declining domestic cigarette sales, excess world burley supplies, slumping exports, and regulatory uncertainty on both the domestic and international front. As a result, aggregate burley contract volume was likely reduced again in 2011, but some buyers actually boosted contract volume for some growers in response to tight high-quality burley stocks following subpar-quality crops in recent years. In addition, some traditional burley tobacco farmers opted to exit production on their own given better returns anticipated in alternative ag enterprises. Consequently, Kentucky farmers reduced their burley acreage by more than 10% (U.S. burley acreage off 9%). While some growers experienced timely moisture, burley yields were below average in response to excessive heat and dry conditions in parts of the burley belt. According to the USDA, the U.S. burley crop is expected to total 173 million pounds in 2011– 8% below last year.

On the demand side, the decline in U.S. cigarette sales slowed in 2011 as consumers adjusted to recent price/tax hikes, which may boost/stabilize domestic U.S. burley demand given existing inventory levels. Limited high-quality stocks on the world market combined with a continued weak U.S. dollar enabled U.S. burley exports to stabilize in 2011, following a drop of more than 50% since 2007 due to excessive foreign burley supplies of lower-quality leaf. Lower production, tight quality stocks, stabilizing use, and a decent quality crop will likely cause top-quality contracted U.S. burley prices to rebound back into the \$1.70s and \$1.80s per pound for the 2011-12 marketing season after the extremely poor quality 2010 crop averaged \$1.50 per pound. Limited auction offerings of good-quality burley should also sell well in this marketing environment.

2011 Dark Review: Dark tobacco producers continued to benefit from growing domestic snuff sales (increasing around 5% annually) as consumers responded to successful marketing efforts, new products introduced by smokeless tobacco companies, smoking restrictions, and perceptions of lower health risks for smokeless products relative to cigarettes. Following a couple years of supply adjustment, it appears the industry has moved toward an acceptable supply/demand balance. Kentucky's dark tobacco acreage was up 3,000 acres in 2011, and a better growing season (plus access to irrigation) boosted yields. Total U.S. dark-fired production is pegged by USDA at 52.4 million pounds, compared to 48.4 million pounds in 2010. For dark air-cured, USDA is projecting a

2011 crop of 15.6 million pounds, up slightly from last year. While buyers may become more selective on some lower-quality leaf, dark tobacco prices for top-quality leaf will remain near recent levels (\$2.25+ per pound for dark air-cured and \$2.50+ per pound for dark fire-cured) for the 2011-2012 marketing year. This market situation will enable dark tobacco production to comprise around 1/3 of the projected \$320 million tobacco crop in Kentucky for 2011.

2012 Outlook: Demand for burley tobacco in 2012 may show signs of stability as the domestic cigarette market eases, the international market rebounds in response to competitive U.S. burley prices (assuming the U.S. dollar remains weak), and quality burley stocks available to manufacturers and dealers worldwide remain tight. But burley acreage may continue to decline (unless growers receive additional price incentives) in the midst of better income opportunities from other enterprises, expanded contract requirements, escalating labor costs, and regulatory challenges/uncertainty. Dark tobacco prices and acreage should stay relatively constant in response to anticipated strong domestic sales of smokeless tobacco products amidst increasing supplies from the 2011 crop. Accounting for the anticipated drop in burley acres, the total value of tobacco production in Kentucky may struggle to exceed \$300 million in the coming years, following an average of \$340 million during the 2005-2010 post-buyout era.

Grains *Cory Walters*

2011 Review: Corn, soybean, and wheat prices all continue to trend upward (up 29%, 16%, and 30%, respectively) compared to last year. Kentucky producers responded to these higher prices by increasing planted acreage. State average yields were also higher for all three commodities in 2011. Higher prices, increased acreage, and higher yields resulted in a significant increase in revenue.

The November 2011 World Agricultural Supply and Demand (WASDE) report placed the 2011 U.S. corn crop at 12.31 billion bushels, down 1% from 2010. U.S. acreage was up more than 4% over last year, but yields were down by 4%.

Corn use (feed, exports, food, seed, and industrial) is expected to decrease more than 3% from 2010, to a total of 12.61 billion bushels. The largest decrease in use is expected in exports, dropping almost 13% from a year ago. With use exceeding production, ending stocks are expected to decrease by about 25% from the previous year, coming in at 843 million bushels. On the global market, ending stocks are expected to drop by a little less than 5%.

USDA is projecting a 3.28 billion bushel soybean crop in 2011, which will be about 8.5% smaller than 2010. US acreage was down over 3% from 2010, and yields were down a little more than 5% from last year.

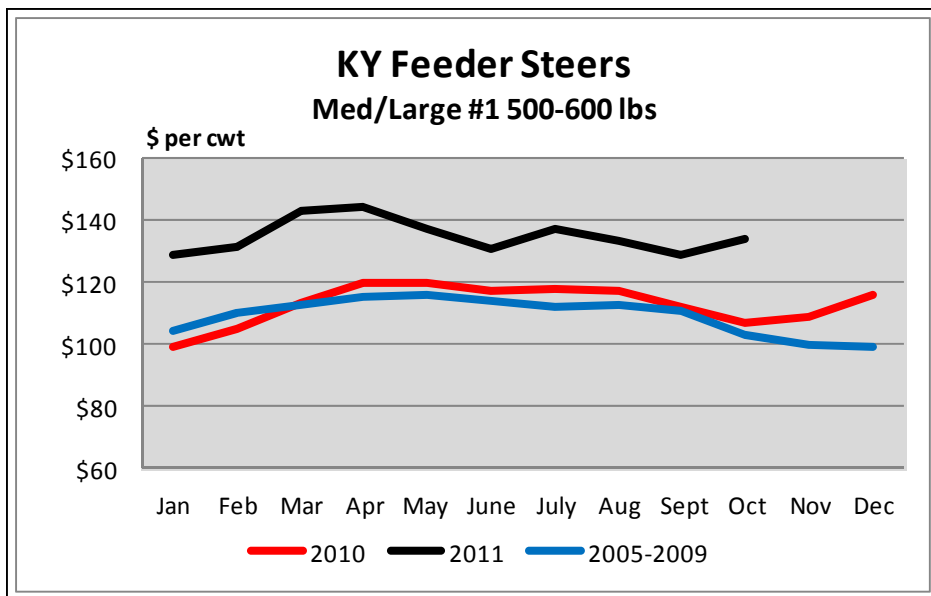
Soybean use for crushing, exports, seed, and residual are all expected to decrease for a total use of 3.08 billion bushels, a decrease of over 6% percent from 2010. The largest expected decrease is in exports, estimated to be down nearly 13% from 2010. Ending stocks are expected to decrease by more than 9% to 195 million bushels. Global ending stocks are expected to decrease 8%, primarily due to decreases in both U.S. and Brazilian ending stocks.

2011 U.S. wheat production was more than 9% lower than 2010. Use is expected to be lower by almost 11%, primarily driven by a sharp decrease in exports of 24%. As for the world balance sheet, ending stocks are expected to increase by about 3%.

2012 Outlook: Revenue streams from crop production will hinge on crop price dynamics. Given lower stocks-to-use ratios in U.S. and world markets (slight increase in wheat), it is almost certain that as new information enters the market, prices will change significantly. Given the expectation that corn ending stocks will be the lowest since 1995, it could very well be the price direction leader for all three commodities. Increases in price volatility make it more important to have a marketing plan, because when prices hit pre-determined goals they may not stay there long. Prices could very well go higher than expectations and this risk can be handled by selling in smaller percentages, not being overrun with emotion from selling at lower prices when prices keep rising, and being ready to make additional sales as prices rise. Higher volatility implies higher highs and lower lows. Producers need an exit plan to handle lower prices by using decision dates in making sales. If price expectations are not met by a certain date, producers should make sales at the current cash prices.

Livestock and Meats *Kenny Burdine and Lee Meyer*

Equine 2011 Review: Kentucky equine receipts topped \$1 billion for three straight years before a drastic drop in 2009 and another substantial decrease in 2010. Sales and stud fees both contributed to the decline as 2010 farm-level equine receipts totaled 700 million. However, 2011 September yearling and November breeding stock sales showed marked improvement. With relatively steady stud fees, 2011 equine receipts are likely to show a moderate improvement from 2010, a welcome sign for a struggling market.



Equine 2012 Outlook: Looking ahead to 2011, stud fees will likely be steady and may show slight improvement in some cases. Sustaining sales at 2011 levels will likely be challenging, as strong 2011 sales were likely supported by pent up demand, tax incentives, and some significant dispersals. However, if the market remains relatively strong, receipts should remain steady.

Cattle 2011 Review: Feeder cattle prices in Kentucky showed substantial improvement in 2011. The strength in the market was driven by many factors, but tight supplies were the underlying driver. The year 2011 was also impacted by massive drought in Texas and Oklahoma that resulted in higher cow slaughter and an unusually large number of light calves placed on feed during the summer. Given these weather challenges and heifer development estimates, beef cow numbers are likely to show another decrease to start 2012. High feed prices are also creating opportunities for backgrounders in Kentucky who are responding to a market that appears to be seeking feeder cattle at heavier placement weights.

Cattle 2012 Outlook: Much like 2011, tight supplies should provide solid underpinning for the 2012 feeder cattle market. An expected decrease in beef cow numbers should result in an even smaller calf crop. Due to the time lag of heifer retention, once expansion of the cowherd begins, it will be at least two years before larger calf crops are actually weaned and marketed. While wild cards such as grain prices, weather, and the U.S. economy certainly exist, supply fundamentals remain incredibly positive in the cattle markets. Despite the strong fundamentals, feed prices, market volatility, and access to credit are creating challenges for many Kentucky cattle producers.

Dairy 2011 Review: The U.S. All Milk Price will average around \$20 per cwt in 2011, which is

welcome relief for dairy producers recovering from a brutal 2009 when the U.S. All Milk Price averaged less than \$13 per cwt, and a 2010 market, when prices averaged a little over \$16 per cwt. Prices have been supported in 2011 by strong component prices as cheese, dry whey, butter and non-fat dry milk prices all improved from 2010. According to USDA's January estimates, Kentucky began the year with 77 thousand dairy cows in production.

Dairy 2012 Outlook: As usual, strong farm-level milk prices have led to increases in production in the second half of 2011. As this expansion continues, larger dairy cow inventory and generally increasing milk per cow should result in higher production levels for 2012. As production increases, increased supply is likely to put some downward pressure on farm-level milk prices in 2012.

2011 Hogs Review: After dismal prices two years ago, 2010 prices rebounded to average in the low \$50s. The year 2011 saw continued price improvement, with prices moving up another 20% to average over \$60/cwt (live weight basis). Clearly, demand has been strong because the price increase came along with a (small) increase in production. Per capita consumption has been declining and is down to 46 lbs from a recent high of 50 lbs only two years ago. Over 20% of domestic production was exported in 2011, making exports a key factor in the high prices.

2012 Hogs Outlook: High prices are not having much impact on production. Based on the September USDA report and other data, 2012 pork production should only increase slightly. Extremely high feed costs continue to be a constraining factor. Exports are expected to remain strong, with the USDA estimating another 3% increase. Prices are forecast to remain near 2011 levels, with prices highest in the third

quarter.

2011 Poultry Review: Chicken production dropped in 2009, due to losses from high feed costs. But in 2010 and again in 2011, production rebounded. Even though feed costs during 2011 returned to high levels, prices of about \$.80 per pound have stabilized the industry. While exports declined slightly, they still accounted for 17% of U.S. production. Chicken consumption, on a per-capita basis, is now at 84 pounds, making it the dominant meat in U.S. diets.

2012 Poultry Outlook: Chicken production is forecast to decline slightly in 2012, while exports continue to grow. Lower production and higher export levels will leave less meat on the domestic market, and per-capita consumption may decline by 2 to 3 pounds. The tighter supply is expected to be the stimulus for higher prices, probably up about \$.02 to \$.04 per pound. Breast prices will average about \$1.30 per pound, near the long-term average, but down from last year. Leg prices, in contrast, have risen by about 25% and are averaging in the mid \$.60s.

2011 Sheep and Goats Review: Slaughter lamb prices continue to move to ever higher levels. Lamb prices rose 25% in 2010 and another 43% in 2011, averaging about \$1.70 per pound on national markets. The size of the sheep herd (both U.S. and Kentucky) continues to decline, and the domestic industry is very much a niche. Production during 2011 declined by 8% and per-capita consumption is less than one pound per person per year. Imports continue to increase and now exceed domestic production by 15%. The U.S. goat herd stands at about 3 million head, compared to 5.5 million sheep. While the U.S. goat herd is down slightly from 2010, Kentucky's goat herd declined by 8%. (Unlike the U.S. as a whole, there are more than twice as many goats as there are sheep in Kentucky). Goat prices have remained at high levels, with 40-60 pound, Selection 2 kids averaging about \$1.90 for the year, with the highest prices in the spring.

2012 Sheep and Goat Outlook: Lamb production is forecast to continue dropping in 2012, probably by another 5% to 10%. Imports may make up the difference but could be affected by foreign exchange rates. Prices are likely to stay near the high prices of 2012. Kentucky lamb producers who take advantage of direct and local graded markets may get an average price of about \$2 per pound. The goat market should follow the lamb market with continued high prices. Kid goats are likely to sell for over \$2 per pound at graded sales in the first half of the year and could average about \$1.90 for the year.

Horticulture

Tim Woods

2011 Review: Just 10 years ago when Kentucky was starting to make a concerted push toward diversification and development of the horticulture industry, the value of all horticulture farm cash receipts was \$78.6 million; floriculture, nursery, greenhouse, and sod was at \$59.7 million, and produce was at \$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 more negatively impacted during the slow recovery. Current industry sales trends point toward 2011 gross sales winding up somewhere around \$115-\$120 million, up about 10% from 2010.

Produce Industry: Gross produce receipts have steadily increased each year for the past decade as more producers have benefited from additional direct market channels, especially farmers' markets, and more auction sales. We could easily see record 2011 Kentucky produce sales, particularly with vegetables. Producer numbers and acreage have continued to expand. Generally good growing conditions prevailed for most of the state. Direct markets remain an important channel for most of our producers. Over 2,300 vendors sold in farmers' markets in 2011, and the number increases each year. Auctions and other wholesale channels have experienced significant growth in the number and scale of markets as well as producer numbers with the sustained interest in local produce in Kentucky markets.

The most recent planting intentions data indicates a total of around 13,000 acres of produce crops in Kentucky. Fruit crop acreage was an estimated 3,000 acres and vegetable crop acres were estimated at 10,000. Kentucky had around 10,500 produce acres in 2002. While Kentucky remains a relatively minor produce supplier compared to surrounding states, the sales growth in Kentucky has significantly outpaced that of surrounding states, especially for fruit.

Green Industry: The green industry nationwide is driven by new home construction and healthy consumer spending, both of which have been in a deep and extended slowdown for the past three years. Greenhouses, sod operations, landscapers, and mid-size nursery businesses grew rapidly from 2002 to 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, though slightly improved, marketing season for 2011. Demand has remained subdued for most

green products, particularly trees, shrubs, and sod.

2012 Outlook: Direct market, auction, and independent grower-shipper wholesale sales will likely increase again this next year. There are six active produce auctions in Kentucky, several opening within the last few years. A number of important issues, however, will shape commercial fruit and vegetable production in Kentucky. A recent survey of horticulture extension specialists in the southeast pointed to labor management and food safety standards and compliance as the top issues influencing production at this time. These issues will remain as 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.

The green industry should see a modest rebound in 2012 as the economy moves toward recovery. Floriculture and service-oriented enterprises should see an earlier response to the recovery, followed by nursery and sod. While nursery firms are continuing fairly conservative business strategies, a relatively high percentage (35%) indicated they were planning at least some capital improvements this year with a view to future growth. Gross sales for 2012 for all Kentucky horticulture could surpass the record high realized this year.

Forestry

Jeff Stringer, Andrew Stainback, Bobby Ammerman

2011 Review: Kentucky's forestry sector continued to face challenges associated with the economic downturn that has suppressed residential and commercial building and associated sectors (for example furniture and flooring) as well as paper consumption. Kentucky has lost 9% of its wood industries and is employing 21.6% fewer Kentuckians than it was in late 2008. Currently (2011), the Kentucky Forest Products Industry has 766 active industries directly employing over 17,000 individuals, plus nearly 3,000 loggers.

While the demand for Kentucky's primary forest products (green and dried lumber) and associated secondary products remained soft for a large number of important species including oaks and yellow-poplar, a few species/products provided some economic stability, including railway ties and a few lumber and veneer spe-

cies (for example black walnut). The tie market was pervasive and consistent, providing statewide opportunities for logging firms and woodland owners. Pulpwood production was stable compared to previous years with the exception of flooding periods that were common to western and west-central Kentucky in the spring and summer. Woodland-owner gate receipts for timber and pulpwood followed trends in lumber output and were especially affected in southeastern Kentucky. Round wood output from Kentucky's forests in 2009 totaled 136.3 million cubic feet, a 27% decrease from 2007. Surveys of forest industries indicate a 25-30% reduction in sawn lumber output compared to the relatively high outputs obtained within the last five years. The industry retained much of its capacity and is active in approximately 115 out of 120 counties.

2012 Outlook: The outlook for the forestry sector in 2012 will continue to be linked to domestic housing starts and the overall vigor of the economy. Overseas markets, including both the Pacific Rim and Europe, remain viable for Kentucky's forest industries. However, European sales may be impacted by the economic instability of the region and a softening of Asian markets, particularly China, may continue. Regardless, the export market will likely provide more opportunity for market expansion compared to domestic markets in 2012.

Chain-of-custody certification programs are emerging to facilitate overseas sales and supply chains of certified timber and pulpwood. Overall lumber sales, the main driver of woodland-owner gate receipts and overall stumpage values, are forecast to remain flat in 2012. Stable railroad tie production should be expected to continue, but the market for black walnut, a species that commanded some demand in 2011, is unknown.

While volume and output were relatively depressed in 2011, the sawmilling, pulp and paper, and logging sectors still maintain much of their capacity to respond to reasonable increases in market demand in 2012. For example, the number of Kentucky Master Loggers remains stable, and approximately 1,000 logging firms statewide are capable of harvesting timber and providing woodland owner stumpage revenues. However, significant increases in demand for wood products would likely strain supply chains and available timber supplies. Woodland owners in western and west- and south-central Kentucky who were negatively impacted by the ice storm of 2009 will continue to see degradation due to mortality and a net loss of volume due to rot associated with the damage. Markets are forecast to remain soft for a number of impacted species in these regions.