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2015–2016 Kentucky Agricultural Economic Situation and Outlook

Kenneth H. Burdine

University of Kentucky, kburdine@uky.edu

Todd Davis

University of Kentucky, todd.davis@uky.edu

Timothy A. Woods

University of Kentucky, tim.woods@uky.edu

William M. Snell

University of Kentucky, will.snell@uky.edu

Lee Meyer

University of Kentucky, lmeyer@uky.edu

See next page for additional authors

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Authors

Kenneth H. Burdine, Todd Davis, Timothy A. Woods, William M. Snell, Lee Meyer, and Jeffrey W. Stringer

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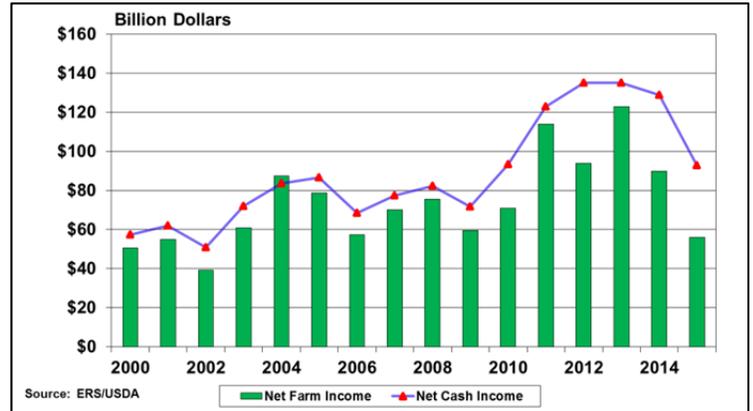
University of Kentucky College of Agriculture, Food and Environment

Contributors: Kenny Burdine, Todd Davis, Tim Woods, Will Snell, Lee Meyer (Ag Economics) and Jeff Stringer (Forestry)

United States' Agricultural Economy

Following record breaking years, the Kentucky agricultural economy, like the overall U.S. agricultural economy, slumped in 2015, with concern looming for 2016. On the national front, USDA is projecting 2015 net farm income to plummet to \$56 billion, down 28% from 2014 levels and 55% off the record high established in 2013. In response to mounting supplies and depressed demand, prices for most crops and livestock are falling from their record high levels of recent years. U.S. agricultural exports declined from its peak in response to a strengthening U.S. dollar, sluggish economic growth overseas, and abundant supplies. Land values and crop rents appear to be slowly adjusting to the declining ag economy. Anticipated increases in interest rates coupled with lower expected returns from agriculture will likely put downward pressure on land values. Despite the sharp downturn in the U.S. ag economy, lenders are reporting that the financial position of U.S. agriculture is still relatively strong following a period of extraordinarily high income levels. However, concerns are mounting for some high debt farming operations given the continued depressed outlook for most U.S. agricultural sectors in 2016.

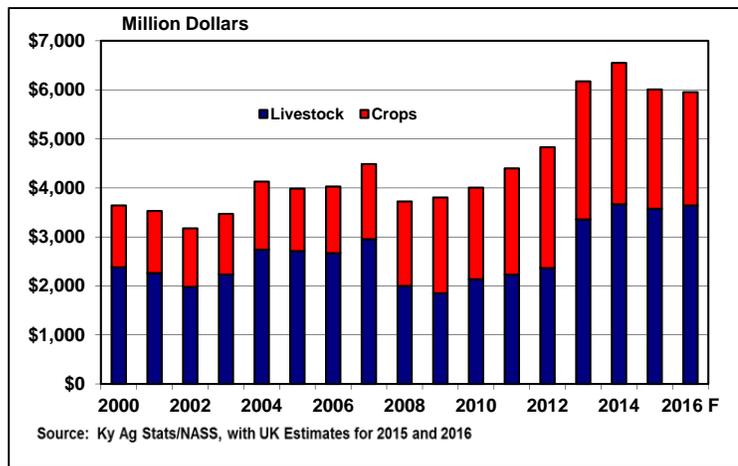
U.S. Net Farm and Cash Income



Kentucky's Agricultural Economy

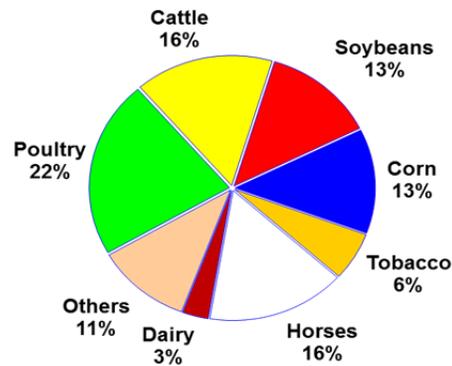
Kentucky agricultural cash receipts set a record \$6.5 billion in 2014, up from the previous record high of \$6.2 billion in 2013. UK's Department of Agricultural Economics is projecting that Kentucky ag sales will fall to \$6.0 billion in 2015, off 8% from 2014, but still the third highest on record. Record high grain yields and strong spring/summer cattle prices, coupled with solid years for Kentucky poultry and equine sectors, helped partially offset depressed fall cattle and grain prices and disappointing tobacco acres and yields. Crop receipts are expected to decline 16%, with livestock down 3% in 2015. For 2016, Kentucky ag cash receipts are expected to fall another 1% as anticipated gains in poultry, equine, and hogs are projected to counter losses in cattle, grains, and tobacco.

Kentucky Agricultural Cash Receipts



Poultry remained Kentucky's number one ag enterprise, accounting for 22% of projected 2015 sales, followed by equine (16%), cattle (16%), soybeans (13%) and corn (13%).

Distribution of 2015 KY Ag Cash Receipts



According to USDA/NASS, Kentucky net cash income peaked at \$2.75 billion in 2013, before slipping to \$2.5 billion in 2014. Declining cash receipts (\$-500 million), coupled with the ending of tobacco buyout payments (loss of approximately \$150 million annually) will likely cause Kentucky net cash income to dip below \$2 billion in 2015 and approach the 2010-2012 average of \$1.4 billion in 2016.

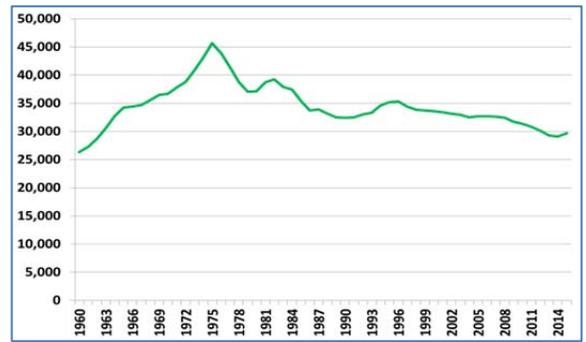
Looking into 2016 for Kentucky agriculture, profitability in the grain sector will continue to be challenged and increasing livestock/meat inventories will put downward pressure on prices. The equine and poultry industries are expected to have solid years. Tobacco reductions may stabilize in response to an improving global world/supply demand balance. Cash flow/working capital will become concerns for some highly leveraged producers as profit margins deteriorate. Look for a continued growing demand for local produce and value-added agriculture.

Specific highlights include the following:

Beef

- Fall 2015 prices fell \$50 to \$70/cwt from last fall due to growing calf crop, lower exports, increased slaughter weights, and meat competition
- Cow herd will continue to grow in 2016, weather permitting, as prices remain above production costs
- Calf markets to improve into the spring of 2016, but overall downward trend to continue down as beef herd grows
- Backgrounders and stocker operators should be opportunistic about placement and protect downside price risk

U.S. Beef Cow Inventory (1000 head)



Poultry

- Exports decline in 2015 due to the stronger dollar and avian flu
- Broiler prices decline in 2015, but sector remains healthy
- Poultry production expansion will likely continue in 2016

Equine

- Sales/receipts hold gains from last few years as 2015 September yearling and November breeding stock sales slightly higher
- Indications of higher stud fees for 2016

Hogs

- Prices are down over 30% from 2014 as supplies increase by 7%
- Production growth will slow, but remain positive for 2016
- Hog prices lower again in 2016, with highest prices in the summer

Dairy

- After a phenomenal 2014, milk price down by \$7 per cwt for 2015
- Production growth still likely to result in lower prices for 2016, with trade being an important factor impacting dairy's outlook

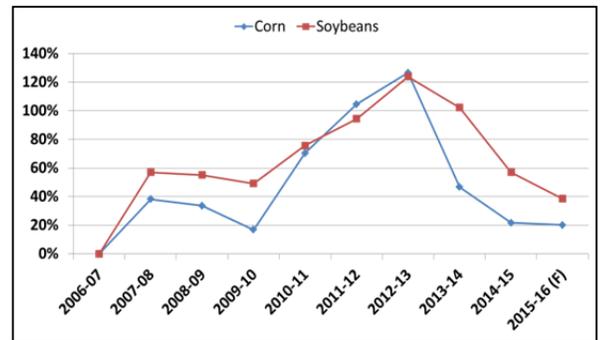
Small ruminants

- Goat numbers continue to grow in KY with sheep numbers down slightly in 2015, but up 50% from 2008
- Interest and growth to persist as price levels remain strong

Corn

- Ending stocks projected at 1.76 billion bushels, largest since 2005-06
- Corn price increased 120% from 2006-07 to 2012-13 due to drought-stricken tight stocks and strong demand
- 2015-16 marketing-year average forecast price of \$3.65 is only 20% above average price in 2005-06 with inputs, machinery and land costs increasing by more than 20% since 2005-06
- Profit margins will be challenged again in 2016

Marketing Year Average Prices as Percentage of 2006-07 Price



Soybeans

- Ending stocks projected at 465 million bushels would be the largest since 2006-07 and 274 million bushels more than 2014-15 levels
- 2015-16 marketing-year average forecast price of \$8.90 is 40% above the average price in 2005-06 but significantly lower than the 120% increase from 2005-06 to 2011-12
- Large stocks in South America coupled with strong U.S. dollar could limit export growth
- Profit margins will be challenged again in 2016

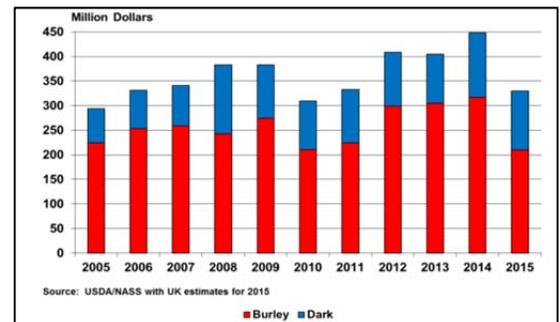
Wheat

- Stocks projected to build to 911 million bushels, the largest since 2009-10 and representing a 165 day supply
- Wheat exports could be the lowest since 1971-72 due to exchange rates and global export competition
- 2015-16 marketing-year average price projected at \$5/bushel which is \$0.99 less than the previous year.

Tobacco

- Burley facing an improved global supply/demand balance entering 2016 which may minimize changes in 2016 burley contract volumes
- Slowing snuff sales will lead to relatively stable dark production for 2016
- After a post-buyout high level of \$448 million in 2014, the value of KY tobacco production will likely fall below \$350 million in 2015 and 2016

Value of Kentucky Tobacco Production



Horticulture

- Excessive rain and cooler summer temperatures in 2015 resulted in modest increases in produce sales of \$40 million
- Strong local demand should bode well for produce markets again in 2016
- Stronger greenhouse sales should offset slower nursery sales and reach a total of \$96 million in 2015. Growth in 2016 will be driven by the regional housing market and retail economy

Forestry

- A modest increase in the US economy, housing starts, and exports will continue to keep hardwood sawlog and mill production on a moderate upward trajectory in 2016 resulting in stable statewide prices and demand for hardwood timber
- White oak timber will be in high demand statewide in 2016 with the bourbon whisky and white oak lumber industries forecasting greater demand producing a seller's market for landowners with quality white oak
- A collapse in pulpwood demand is predicted for western Kentucky with the Verso plant closing (\$400 million loss), impacting 100 logging firms, and landowners ability to sell pulpwood, with reductions in overall timber values of \$40 to \$200 per acre