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2017 – 2018 Kentucky Agricultural Economic Situation and Outlook

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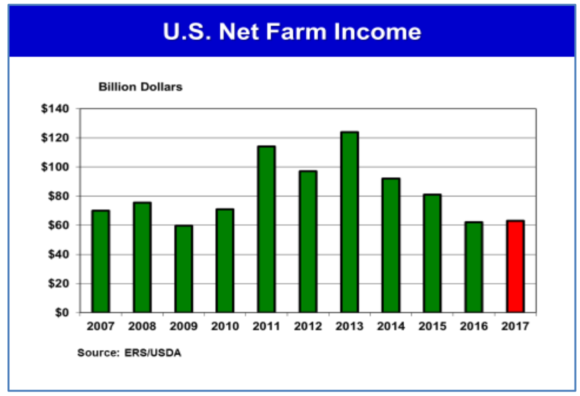
U.S. Agricultural Economy



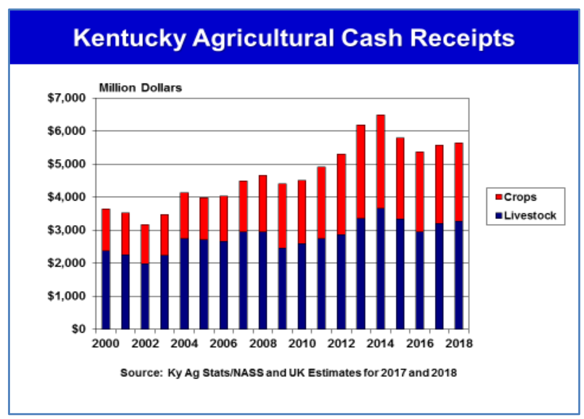
The U.S. agricultural economy entered 2017 following three straight years of declining income and prices, after an unprecedented/record breaking period of growth during the 2007-2013 period. USDA is projecting 2017 net farm income to total $63.2 billion, up $1.7 billion (+2.7%) relative to 2016, but still off nearly 50% from the record high established in 2013. U.S. ag cash receipts are forecast to be 2.4% higher in 2017 in response to improved livestock sales (+7.6%) versus slightly lower crop receipts (-2%). Production expenses were up slightly (+1.5%) with higher labor, fuel, livestock, and interest costs, but lower feed, seed, fertilizer and chemical expenses. Government farm payments fell to $11.2 billion (-$1.8 billion) as large declines in Agricultural Risk Coverage (ARC) payments offset higher Price Loss Coverage (PLC) payments. These direct government payments (excludes crop insurance indemnities) accounted for 17.6% of the U.S. net farm income in 2017 vs 21.1% in 2016.

Despite a lot of political discussion and ag-related concerns about trade this past year, U.S. agricultural exports rebound to $140.5 billion (+8%), in FY 2017, benefitting from a weaker U.S. dollar, an improving global economy, and abundant U.S. supplies. The U.S. exports agricultural commodities/products to nearly 200 nations, but our top three foreign customers – China, Mexico, and Canada, account for nearly one-half of the U.S. ag export value. Undoubtedly the strong export market helped support ag prices in 2017 in the midst of abundant global supplies. Any future disruption in trade could put additional downward pressure on prices.

Ag lenders remain cautious in the midst of a prolonged downturn in the farm economy. Relatively low interest rates (along with cash purchases) have constrained growth in farm debt levels and also provided support to land values in the midst of the sharp-downturn in the U.S. ag economy. Despite the slumping farm economy, the overall balance sheet for U.S. agriculture as a whole remains relatively strong compared to the farm crisis days of the early 1980s. However, available cash flow/working capital for lower-tiered managers and some highly leveraged/young producers remains a concern for bankers, especially if the current economic conditions lingers.

Without a major supply shock, prices for most ag commodities will likely remain relatively low in 2018 (compared to levels observed during the 2011-2014 period) in response to abundant global grain supplies, growing meat supplies, and potentially a stronger U.S. dollar. Politically, agriculture will continue to monitor changes in trade policy, tax, health care, and immigration reform, along with debate over the 2018 farm bill and the increasing concentration among agricultural input suppliers and processors. Food price inflation remained benign in 2017 and is expected to remain below historical levels in 2018 as consumers benefit from intense competition in the grocery sector, abundant ag/food supplies, and continued food marketing efficiencies and innovations.

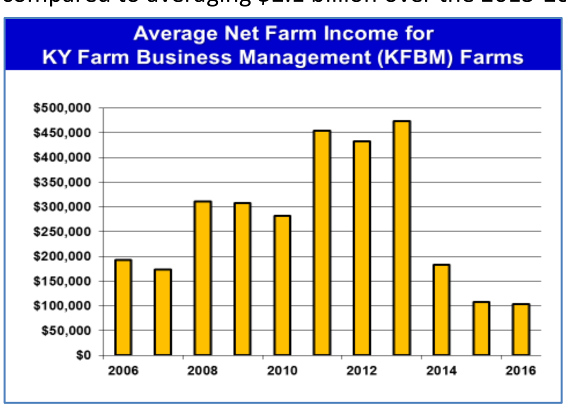
Kentucky's Agricultural Economy

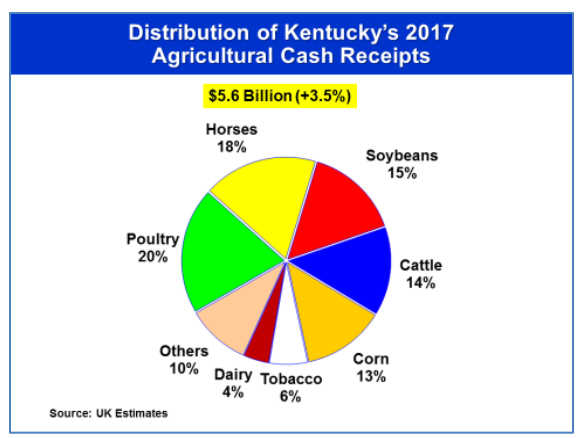


The University of Kentucky's Department of Agricultural Economics is forecasting that Kentucky ag cash receipts will rebound in 2017 to $5.6 billion, 3.5% higher than last year, but well below the record $6.5 billion in 2014. Improved prices will enable sales growth for most Kentucky livestock enterprises --poultry (+10%), horses (+10%), cattle (+5%), dairy (+12%), and hogs (+11%). Poultry also benefitted from a rebound from avian influenza outbreaks, which constrained growth the past two years. Increased soybean acres and record yields are expected to elevate soybean production to record levels. Potentially record corn yields will help offset lower acres and depressed prices. Kentucky's tobacco sector rebounded from a poor crop in 2016, with sales expected to once again exceed $300 million.

Poultry remained Kentucky's number one ag enterprise, accounting for 20% of projected 2017 sales, followed by equine (18%), soybeans (15%), cattle (14%) and corn (13%). For 2018, Kentucky ag cash receipts are expected to be relatively flat ($5.7 billion) with modest gains in poultry, horses, and soybeans, offsetting expected losses in tobacco, corn, and cattle. Look for continued growing demand for local produce/meats, nursery items, and value-added agriculture.

Kentucky net farm income has followed national trends, falling to $1 billion in 2016 compared to averaging $2.1 billion over the 2013-2015 period. Average net farm income for farms participating in Kentucky's Farm Business Management (KFBM) program declined to around $100,000 in 2015 and 2016, down from record highs exceeding $400,000 during 2011-2013, and compared to a ten year average of $283,000. Preliminary indications reveal that KFBM average net farm income will improve modestly in 2017 due primarily to higher crop yields, improved livestock prices, and stable input prices.





Commodity Spotlights (2017-2018)

Beef Cattle

- Calf prices rallied from fall 2016 levels and are roughly $30 per cwt higher than one year ago.
- Growth in the beef cow herd still ongoing, but has likely slowed.
- Increases in production for all major meats will pressure beef (and cattle) prices in 2018.
- Backgrounding/stocker operations should be opportunistic on placement and aggressive with price risk management strategies.

Poultry

- Wholesale broiler prices are up from 2016 levels.
- Sector largely back on track following avian influenza outbreaks in recent years.
- Production likely to increase another 2% nationally in 2018, with continued growth in Kentucky.

Hogs

- Kentucky inventory continues to grow, breeding herd up 7% in 2017.
- Eastern Corn belt hog prices to average $7 per cwt carcass basis higher in 2017.
- Sizeable production increase likely at national level for 2018, prices unlikely to hold at 2017 levels.

Equine

- Equine market has generally been steady since recovering from the global recession.
- Signs point to strength in 2017 --Keeneland yearling sale up 13%, Fasig Tipton yearling and breeding sale up as well.
- Equine likely to gross nearly $1 billion in Kentucky farm receipts for 2017, with modest growth in 2018.

Dairy

- Farm level milk prices increased by more than $1 per cwt in 2017, with lower feed and hay prices leading to improved margins.
- 2017 was a better year than 2016, but certainly not a good year for dairy producers.
- Kentucky dairy cow numbers continue to decline.
- Increase in U.S. cow numbers and milk per cow suggest another production increase and consequently lower farm prices in 2018.

Corn

- U.S. corn harvested area reduced by 3.6 million acres in 2017 to 83.1 million acres. A record U.S. yield of 175.4 bu./acre produced the 2nd largest crop of 14.6 billion bushels.
- Carryout expected to increase to 2.5 billion bushels, which is the largest quantity since 1987. The stocks-use ratio in 1987 was 55% but is 17% in 2017 because of strong use.
- The 2017 U.S. Marketing Year Average Farm Price projected at $3.20/bushel, which is only 5% above the 2006 U.S. MYA price.

Soybeans

- U.S. soybean planted area increased by 6.8 million acres in 2017 to 90.2 million acres. The 2nd largest U.S. yield of 52.5 bu./acre produced a record crop of 4.4 billion bushels.
- Carryout expected to increase to 425 million bushels, which is the largest quantity since 2006. The stocks-use ratio in 2006 was 19% but is 9.8% in 2017 because of strong use.
- The 2017 U.S. Marketing Year Average Farm Price projected at $9.30/bushel which is 45% above the 2006 U.S. MYA price.

Wheat

- Wheat harvested area reduced by 6.3 million acres in 2017 to 37.6 million acres. The 2017 yield was also reduced 6.4 bu./acre from last year to 46.3 bu./acre. The 2017 wheat crop is 568 million bushels smaller than last year to 1.7 billion bushels.
- Carryout expected to decrease by 246 million bushels to 936 million bushels. The stocks-use ratio in 2017 is 43.8%, and is below 50% for the first time since 2014.
- War of attrition on supply side is reducing stocks – not strong growth in demand.
- The 2017 U.S. Marketing Year Average Farm Price projected at $4.60/bushel, which is $0.71/bu. higher than last year. However, the 2017 U.S. MYA price is only 8% above the 2006 U.S. MYA price.

Tobacco

- Global burley supply and demand appears more balanced entering the 2017 marketing season, primarily in response to a 30% reduction in world burley production over the past three years.
- U.S. burley demand remains soft with exports down nearly 30% since 2015, domestic cigarette production down 8% so far this year, and imports currently accounting for nearly 2/3 of use by domestic manufacturers.
- A better quality crop and improved supply/demand balances should result in leaf prices being stable to slightly higher, boosting the value of Kentucky's tobacco crop to around $350 million in 2017 compared to a post-buyout low of $283 million in 2016.
- Anticipated ample burley supplies and softening demand will likely reduce U.S. burley contracts in 2018, with modest growth in snuff consumption enabling dark contracts to remain relatively stable.

Fruits, Vegetables and Greenhouse

- Markets were generally stronger for produce in Kentucky in 2017 as hurricane effects substantially elevated prices for late summer and fall crops.
- Market signals typically tied to nursery production and services (home improvement market, housing starts) have indicated steady recovery from the most recent recession.
- Accelerating local food movement and demand for value added products provides additional opportunities for growth, but labor uncertainties remain a major concern potentially constraining future growth.

Forestry

- Overall forestry sector increased to an estimated $14.5 billion in total economic contribution to Kentucky in 2017 with primary industries including sawmilling showing the largest increase of over 14% from 2016.
- Exports and high domestic demand for white oak and tie logs will remain strong in 2018 pushing overall timber prices up.
- Pulpwood markets still sluggish but potential re-opening of Wickliffe pulp and paper plant may positively affect markets in Western Kentucky.