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2019-2020 Kentucky Agricultural Economic Situation and Outlook

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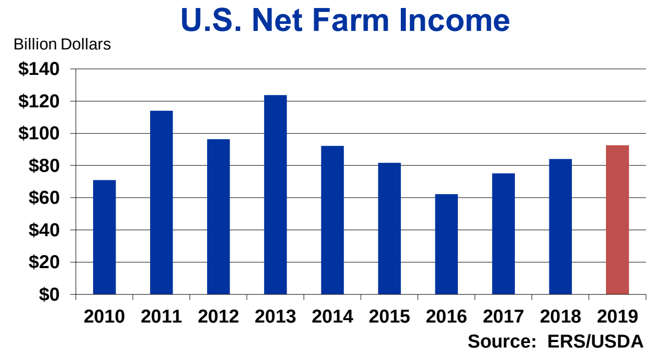
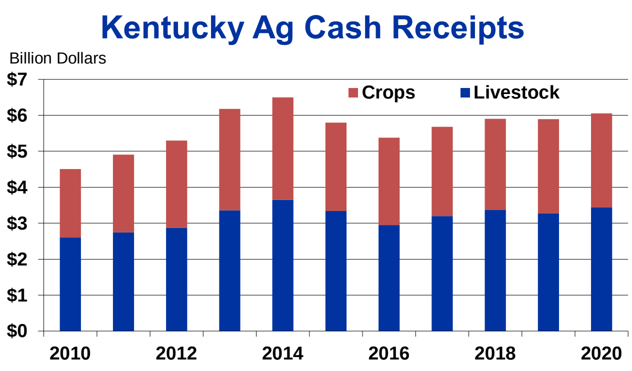
U.S. Agricultural Economy



Despite weather and trade challenges, the USDA is forecasting that U.S. net farm income will total $92.5 billion in 2019, up 10.2% from last year, but still 25% below the record high of $123.7 billion in 2013. Adjusted for inflation, 2019 U.S. net farm income has rebounded 10.8% over the 2014-2018 average. Ag cash receipts and production expenses remained relatively stable in 2019. The major factor boosting net farm income in 2019 was an $8.8 billion (64%) increase in direct government payments, primarily in response to two series of Market Facilitation Program (MFP) payments offered to support farmers amidst trade disruptions adversely impacting farm prices and income. Direct government payments coupled with crop insurance indemnities, accounted for 31% of U.S. net farm income this year. Without government assistance, U.S. net farm income would have declined to $63.6 billion (-24.3%) in 2019.

Export data through September reveals that U.S. ag exports will likely decline around 4% in 2019 in response to a higher valued U.S. dollar, competition from other markets with abundant export supplies, along with fallout from the on-going trade disruptions. U.S. meat exports remained relatively strong in 2019, especially U.S. pork, which was boosted by the outbreak of African Swine Fever (ASF) in China. Soybean exports to China exhibited some recovery from a dismal 2018, but were limited in response to continued tariffs and reduced feed demand due to ASF. U.S. ag imports increased to record levels, causing U.S. agriculture to flirt with a trade deficit for the first time since the 1950s.

Amidst a prolonged dip in the farm economy, ag lenders are observing financial stress among some of their highly leveraged customers. While U.S. farm asset levels remained relatively stable, farm debt hit record levels in 2019, causing a reduction in farm equity and working capital to meet short-term debt obligations and sparking an escalation in farm bankruptcies. Unlike during the depressed farm economy of the early 1980s, relatively low interest rates have constrained the damage evolving from the latest downturn by supporting land values and keeping a lid on debt payments and the value of the U.S. dollar.



Source: KY Ag Stats/NASS and UK Estimates for 2019 and 2020

Kentucky's Agricultural Economy

The University of Kentucky's Department of Agricultural Economics is forecasting that Kentucky ag cash receipts will total $5.9 billion in 2019, flat from last year's level, but still well below the record $6.5 billion in 2014. Sales continue to be plagued by relatively low commodity prices, but were aided by better than expected grain yields. Increased corn, wheat, dairy, and hemp receipts offset lower poultry, soybean, cattle, tobacco, and hog receipts. Despite a setback in 2019, poultry will remain Kentucky's largest ag enterprise, accounting for 21% of projected 2019 sales, followed by equine (18%), corn (14%), soybeans (14%), and cattle (12%). Producers of local produce/meats, value-added agriculture and greenhouse/nursery sales continued to experience growth, but the forestry sector was challenged by adverse trade conditions. Two rounds of MFP payments will likely boost Kentucky direct government payments to more $300 million in 2019, which may allow Kentucky net farm income to exceed $1.8 billion in 2019, compared to averaging $1.6 billion over the past five years.

What about 2020? Kentucky ag cash receipts are expected to slightly exceed $6.0 billion in 2020 with poultry, cattle and hogs rebounding from lower 2019 sales, while dairy and tobacco receipts decline. Given global supplies and export prospects, crop prices may not exhibit much improvement in 2020, absent any major weather event. Meat exports are expected to continue to grow in 2020, which will help support livestock prices. Overall, the USDA expects ag exports to increase $4.5 billion (+2.6%) in FY 2020, driven by higher soybean, pork, and dairy exports. U.S. agriculture awaits congressional action on the U.S. Mexico Canadian Agreement (USMCA) to sustain export levels from our top two largest trading partners. The recent trade agreement between the U.S. and Japan should provide some additional long-term benefits for U.S./KY meat exports (and other commodities) by leveling the playing field with major competitors in our fourth largest export market. Of course, the outcome of the trade negotiations with China, lifting of the U.S. poultry ban in China, and the lingering effects of the African Swine Fever loom huge for future U.S/KY grain, meat, and timber exports to China. Future MFP payments remain uncertain, which could constrain any additional rebounding in net farm income in the short-run, unless higher prices and profitable export gains evolve. Despite an expected increase in 2019 net farm income, the U.S./KY farm economy remains very vulnerable if a return to low crop yields, additional trade disruptions, elimination of MFP payments, higher interest rates, and/or decline in asset values materializes.

Selected Commodity Profiles

Cattle—Weather threw everything it had at cattle producers during 2019 including an extremely muddy 1st quarter, severe drought in the fall, and some unseasonably low November temperatures. Due to the rough 2018/2019 winter, we entered spring with a reduced hay supply, which was compounded by drought and early hay feeding this fall. Heavy feeder cattle prices held reasonably well for most of the year, but the calf market just couldn't seem to gain any traction. The fall calf market saw its lowest level since 2016, with a 550 lb Medium / Large farm 1-2 steer selling in the mid $130's per cwt. Many signs are pointing to a halt in expansion of the cow-herd, which is exactly what the calf market needs. Expect considerably better prices for calves in spring of 2020 and higher prices for calves in fall than were seen in 2019.

Poultry—The overall size of poultry sector continues to grow in Kentucky as more producers enter the business. However, lower broiler prices in 2019 do suggest that receipts may be slightly off 2018 levels. Like all meats, poultry has been negatively impacted by increased production across all proteins, which has led to lower prices. Spillover impacts from African Swine Fever have the potential to greatly impact the poultry markets and the recent announcement that China would resume imports of US poultry definitely opens up some additional doors for 2020.

Hogs—Nationally, pork production growth continued in 2019, but prices actually averaged slightly higher than 2018. Eastern Cornbelt hog prices will average just over $60 per cwt on a carcass weight basis for the year. Trade impacts have added a lot of volatility to the hog market with nearly a $30 per cwt spread between the monthly high and low for 2019. Pork production should increase again in 2020, but one simply cannot overstate the significance of African Swine Fever on the Chinese hog sector and pork exports to China have been steadily increasing through the year as a result. Prospects are for significantly better prices in 2020 and this is likely to spill over into all meat markets.

Equine—Kentucky equine receipts should increase in 2019 for the third straight year. On a percentage basis, the increase is likely to be smaller than 2018, but another year exceeding $1 billion is very welcome news. A relatively strong economy likely supported both sales and stud fees for 2019. The Keeneland September yearling sale was down slightly from 2018, but total sales were actually higher, largely due to the strength of the November breeding stock sale. Provided economic conditions don't drastically change, this strength should continue into 2020.

Dairy—After a brutal year in 2018 that saw a continued decline in Kentucky dairy numbers, things did improve somewhat during 2019, as US All Milk price increased by a little more than $2 per cwt for the year. Most of the improvement in price occurred in the second half of the year. The year 2019 also marked the first year of the Dairy Margin Coverage (DMC) program, which replaced the Margin Protection Program for Dairy. The new DMC program offers higher coverage levels, lower premiums, and provided margin support January through July.

Corn—U.S. planted and harvested area of corn increased by +.8 and 0.1 million acres, respectively, from 2018. The potential yield of 167 bushels/acre produced a U.S. corn crop totaling 13.6 billion, which is a 759 million bushel reduction from 2018. Total corn supply is projected to be 763 million bushels smaller than last year because of the slightly smaller carry-in. Total corn use is projected to be 559 million bushels smaller due to reduced exports and reduced feed/residual demand. Ending stocks are projected to be trimmed by 204 million bushels, which would support a higher U.S. marketing year average farm price of $3.85/bushel. The USDA currently projects 2020 planted area to increase by 4.6 million acres. Assuming trend yields, the USDA projects corn stocks to increase to over 2.7 billion bushels, with a U.S. MYA farm price of $3.40/bushel.

Soybeans—U.S. planted and harvested area of soybeans declined by 12.7 and 12.0 million acres, respectively, from 2018. The potential yield of 46.9 bushels per acre produces a 2019 soybean crop that is 878 million bushels smaller than last year's crop. Total soybean supply is reduced by 397 million bushels due to the large carry-in. Soybean use is projected to increase slightly from 2018 but is 289 million bushels less than the use for the 2017 crop. Ending stocks are projected almost to be halved from the previous year but are still the second largest in the last decade. The U.S. MYA price is projected to increase to $9.00/bushel. USDA projects 2020 soybean area to increase by 7.5 million acres with stocks to increase to over 530 million bushels.

Wheat—U.S. planted and harvested wheat are decreased by 2.6 and 2.4 million acres, respectively, from 2018. Harvested yield increased from last year to 51.7 bushels per acre. A smaller carry-in and reduced imports partially offset the effect of the larger 2019 wheat crop. Total use is projected to increase from 2018 with feed/residuals and exports driving the increase. The strong demand is expected to reduce stocks to a stocks-to-use ratio of 48.1%. Even with reduced stocks, the U.S. MYA price is projected lower than last year's price at $4.60/bushel. USDA is projecting 2020 wheat seeding to decline by 2.6 million acres with a slight reduction in ending stocks to 921 million bushels. If realized, the stocks would be the smallest quantity since the 2014-15 marketing year.

Tobacco—Kentucky's tobacco sector continued to shrink in 2019 as U.S. burley exports fell (-30%), while burley leaf imports grew (+40%) even in the midst of an accelerated decline in domestic cigarette sales (-5 to-6%). In addition, the dark tobacco sector is being adversely impacted by declining smokeless tobacco sales, following more than two decades of growth. Despite controversy, alternative tobacco products (vaping/e-cigarettes and heat-not-burn) are displacing some traditional tobacco products, with much uncertainty on their long-term impact on leaf tobaccos. The U.S. burley crop may total 80-85 million pounds (-15 to 20%) in 2019, while U.S. dark tobacco production may be around 75 million pounds (-10 to 15%). Despite lower production, leaf prices are not expected to change much from last year's levels, given contract price levels and some curing quality issues for burley. Overall, Kentucky tobacco cash receipts will likely fall below $300 million for 2019, compared to averaging $356 million over the past 5 years. Lower tobacco production levels may move the sector to a more balanced supply/demand levels for 2020, which may result in fairly stable contract volumes for the coming year. Grower profit margins continue to be squeezed with higher labor costs coupled with limited yield gains and stagnant leaf prices, resulting in continued concentration among growers.

Hemp—Kentucky's hemp sector continues to evolve, with opportunities, new challenges, and much regulatory and economic uncertainty. Interest in the crop swelled in Kentucky as well as across the nation, following the passage of the 2018 farm bill, coupled with promising income opportunities amidst a depressed ag economy. Hemp acreage across the nation increased from less than 100,000 acres in 2018 to reportedly over 500,000 licensed acres in 2019, with perhaps more than 250,000 acres harvested. Over 90% of Kentucky's planted acres (26,500) in 2019 were devoted to CBD production. As expected, the escalation of production outplaced the growing CBD product market, causing farm-level prices to decline by 50% or more. According to the Kentucky Department of Agriculture, hemp processors paid Kentucky growers $17.75 million in 2018. Based on price and production estimates, Kentucky farm-level hemp sales may total $55 to $65 million in 2019 (1% of Kentucky ag cash receipts). Adequate processing infrastructure, credit/transportation issues, weed control, seed identity, labor issues, and timely payments provided additional challenges this past year. With dozens of new states coming on board for 2020, supply expansion may continue to be a concern, despite an overall growing product market. Moving forward, growers are advised to closely monitor and evaluate their own personal risk tolerance, contract terms, and business relations as this industry matures amidst much regulatory and economic uncertainty.

Fruits, Vegetables and Greenhouse—Yields and markets for KY produce remained firm despite very dry growing conditions mid-summer. Produce sales continue to be made up substantially of farm market and other direct to consumer sales, contributing around 40 to 50% of the total. Record imports and labor costs have dampened produce markets nationally. The nursery industry benefitted from a 12 year high in housing starts in 2019. Consumer spending and disposable income, which also increased sharply in 2019, certainly helped contribute to stronger nursery markets, including plant sales.

Forestry—While the overall estimated 2019 economic contribution of the Kentucky forest sector remained stable at $13.2 billion, there was considerable volatility among products and species. The down-trending Asian export markets for wood products, exacerbated by tariffs, and coupled with a soft domestic market hit red oak hard, significantly reducing prices for red oak lumber and timber. The presence of red oak in many of our woodlands decreased their overall value and landowners made decisions not to sell timber. This negatively impacted logging and primary wood manufacturing and this situation will continue into 2020. There were some bright spots with the startup of the idled Phoenix paper mill in Wickliffe, KY igniting a dormant pulpwood market in western Kentucky. White oak and walnut logs remain in high demand, resulting in high prices which are expected to continue into 2020 and beyond. Increasing demand for white oak stave logs for whisky barrels, along with a stable market for crosstie logs has helped to prop up the logging sector and kept some primary wood manufacturing facilities from experiencing significant losses. While white oak markets will continue to increase and cross tie markets are estimated to remain stable through the first half of 2020, a significant amount of uncertainty in other wood product markets, not limited to red oak, will likely lead to lower stumpage prices in the near future.