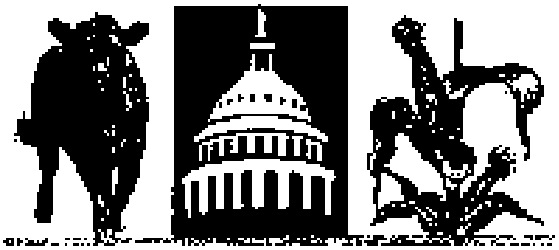
UK COOPERATIVE EXTENSION SERVICE
UNIVERSITY OF KENTUCKY — COLLEGE OF AGRICULTURE

ECONOMIC AND POLICY UPDATE



Vol. 8 No. 10 October 24, 2008

http://www.uky.edu/Ag/AgEcon/blueshee.html

Kenny Burdine, Alison Davis, and Greg Halich Editors

In this issue:

- **Grain Market Update – Cory Walters**
- **Beef Cattle Market Update – Kenny Burdine**
- **Family Living Expenses are Still on the Rise – Jennifer Rogers**
- **Low Capital Gains Rates Mean Opportunity – Rush Midkiff and Suzy Martin**
- **Farmers' Markets Grow Again in 2008 – Tim Woods and Sara Williamson**

Grain Market Update

Corn and soybean prices continue their steep decline due to negative fundamental news, declining energy prices, and recent economic concerns. As of October 24, 2008 the Chicago Board of Trade (CBOT) December 2008 corn contract was trading near $4.00, down about $1.33 or 25 percent from its value a month ago. New crop soybeans were trading just under $9.00, down $2.41 or 21 percent from a month ago.

During the economic meltdown on Wall Street in the first two weeks of October, the USDA released its October WASDE report. In that report, the corn crop is now projected at 12.2 billion bushels, 128 million bushels more than the September estimate. Projected yield was increased to 154 bushels per acre, up 1.7 bushels from September. Ending stocks were increased to 1.15 billion bushels, representing nine percent of usage, a very low value when compared to historical standards. On the consumption side, USDA increased projected corn use by 40 million bushels. Feed use was increased by 150 million bushels due to lower corn prices, ethanol use was decreased by 100 million bushels, and other industrial uses were decreased by 10 million bushels.

For soybeans, the report estimated an increase of 49 million bushels from September to 2.98 billion bushels. Projected yield was decreased by half a bushel to 39.5 bushels per acre resulting from a lack of rain during August. Harvested acres were increased by 2.1 million, for a forecast of 75.5 million. Ending stocks were raised to 220 million bushels, representing seven percent of usage, another very low percentage by historical standards. The same report increased soybean use by 26 million bushels. Soybean crush was reduced by 25 million bushels due to weaker demand for soybean meal, exports were increased by 50 million bushels due to lower prices, and residual was increased by 1 million bushels.

Now that we are in October, the supply side of the equation is becoming quite clear. Barring any major weather event, price movements for the rest of the year will primarily come from demand (energy prices, financial situation, feed usage, and the role of speculators).

Looking into next year, commodity price changes, high fertilizer prices, and weather will dominate planting outlook across all crops. With the recent decrease in corn prices, it makes it hard to get producers excited about either planting or expanding corn acres. For producers to be excited about planting corn, one of the following will have to happen: corn prices will have to increase, fertilizer prices will have to decrease or a combination of both. With the current volatility in grain prices, successful marketing will require risk management based upon reasonable profit expectations. We recommend a decision plan that

includes, but is not limited to, 1) selling the new crop in small percentages, preferably no more than 20 percent at any one time, 2) monitoring basis, 3) considering crop insurance to protect revenue against potential yield loss, and 4) managing your cost of production. (Cory Walters)

Beef Cattle Market Update

While 2007 will be remembered as an especially brutal year for beef producers, few will remember 2008 as much better. This year marked a second straight summer drought for most Kentucky cattle producers, who have also watched calf prices slide sharply from summer levels. As of the third week in October, 5wt feeder steer prices in KY were averaging in the very low $90's.

A price decline from late summer into fall is typical seasonally as larger numbers of weaned calves hit the market. However, in 2008, this occurred while markets were also processing a wide range of macroeconomic data that caused many to question the strength of beef demand in 2009. As the stock market fell, talk of financial problems escalated, and the poor state of the US economy became the hottest topic on TV, all commodity markets sank lower.

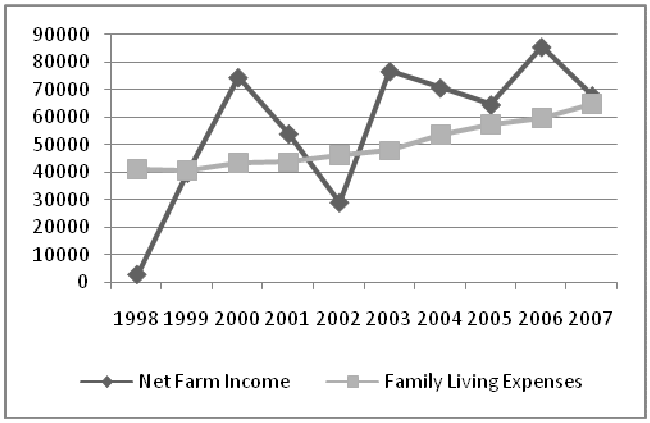
Beef is the most expensive of the main three meats on the American table (pork and chicken being the other two). As consumer incomes become strapped, it is logical that beef would be the most vulnerable to substitution. This vulnerability is the reason why live cattle have been trading in the low $90's, when they were expected to be trading well above $1 per lb back in the summer. This same impact on deferred live cattle futures has pushed feeder cattle prices down by nearly $20 per cwt. from their spring highs.

While it is easy to be pessimistic given the changes that have been seen recently, many fundamentals remain quite positive. Cattle-on-feed numbers remain pretty low, corn price has fallen, and the export market for US beef is steadily picking up. Demand remains the wild card, and the primary reason why we have such drastic price declines this fall.

Of course calf prices are only part of the story as production costs are clearly as high as they have ever been. In the face of these challenges, beef producers are responding by reducing the size of the US cowherd. Nationally, beef cow numbers are likely to be down by 2% or more by year's end. At the same time, I expect Kentucky beef cow numbers to be down even more. (Kenny Burdine)

Family Living Expenses are Still on the Rise

According to data from the Kentucky Farm Business Management Program, average family living expenses increased 9% from 2006 to 2007 despite a 21% decline in family net farm incomes. The average net farm income for the 86 families who provided family living information in 2007 was $67,939, down from $85,642 for 123 families, just a year prior. Average net non-farm incomes were also down in 2007, dropping from $43,641 in 2006 to $39,535. This represents a $21,809 decrease in earned income for the average family. However, despite these depressed incomes, family living expenses continued to rise, up $5,280 in 2007 to $64,784. As the chart below shows, although net farm incomes have fluctuated from year to year, family living expenses have continued to increase.



Depending upon the sources of income that are available to fund the family, family living expenses can have a significant impact on the sustainability of the farm. This is especially true when there are limited or no sources of off-farm income, indicating that the farm must provide funds for farm operating expenses, debt repayment, capital replacement, and funds to support the family. While some family living expenses are necessary (food, shelter), the concern is that family living can take vital funds

from the farming operation. It is important to note that family living expenses in this study include only contributions, medical expenses, life insurance, family expendables, and capital purchases (vehicles, boats, appliances). Taxes, principle payments, and savings or other investments are not included.

Tracking all expenses that go to family living is not done by most farming operations. However, it is essential that all farming operations are aware of how much money is leaving the farm for non-farm uses. When non-farm uses of farm funds exceed net farm income, the farming operation is in danger. Borrowing funds to pay for farm expenses or investments that will provide for more productivity or increased income for the farm is important for growth and continuity of the farming operation. However, when borrowed funds are used to fund family living expenses, it can not only drain the borrowing capacity of the farming operation, but also does not add to its productivity or growth. At some point, the farm will not be able to borrow additional funds. Then, without surplus earnings, the operation will not be able to make debt payments, leading to a detrimental financial situation for both the farming operation and the family. (Jennifer Rogers)

Low Capital Gains Rates Mean Opportunity

With current discount rates and low capital gains tax rates, now might be the time to "cash out" your FSA tobacco buyout quota contracts. First, taxpayers whose federal ordinary income tax rate is 10% or 15% have a reduced long term capital gain rate of 0% for 2008, 2009, and 2010. Secondly, the FSA tobacco buyout payments are exempt from Kentucky income tax. Therefore, cashing them out would be tax free for people in the lowest two income tax brackets.

Furthermore, current discount rates are averaging roughly 87%. A taxpayer with $10,000 remaining on their contract could receive a lump sum payment of $8,700 and pay no taxes on that income. Please keep in mind that the 0% capital gains rate is only for people in the 10 or 15% income tax bracket. Those paying higher rates are subject to the 15% capital gains rate.

Another point to remember is that this tax treatment is only for the quota contracts. Grower contracts will always be taxed at your ordinary income tax rates and are likely to be subject to self-employment tax. As always, it is a good idea to consult with your tax preparer prior to making changes to your income. (Rush Midkiff and Suzy Martin)

Farmers' Markets Grow Again in 2008

The number of farmers' markets has grown by 20% since 2004, according to the 2008 Kentucky Farmers' Market Report, posted by the Kentucky Department of Agriculture. With 120 markets and more than 1,900 vendors statewide in 2008, most Kentucky counties now have a farmers' market at least one day per week during peak produce growing season. These numbers don't include roadside stands or additional direct marketing outlets.

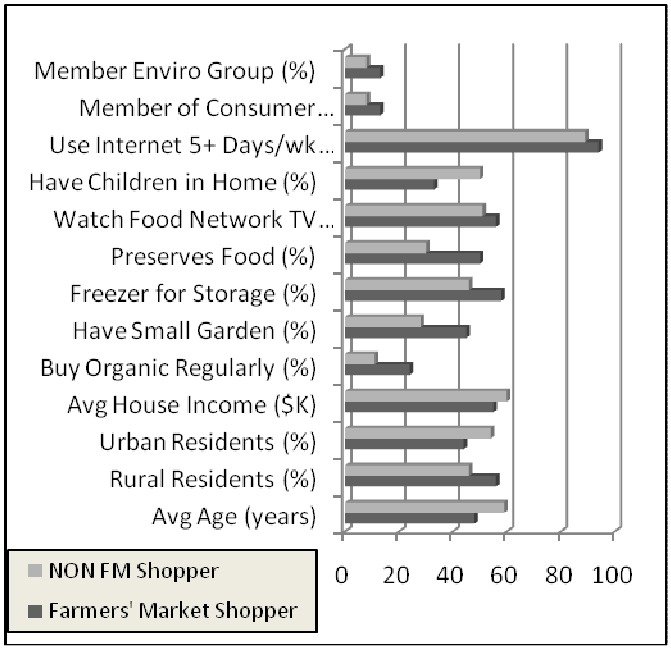
The report suggests that market vendors are doing a good job at diversifying from "just produce", which is a promising progression as shoppers are making fewer stops to account for rising fuel prices. Due to recent legislation, farmers' market vendors may now offer samples of their products for customers to try. More than 50% (1,000+) of vendors and several extension agents have completed the Good Agricultural Practices training offered by the KDA this year, and more than 700 of those vendors completed a special module for sampling of raw food at the market.

Food Products (aside from produce)	**# markets**	**% markets**
Herbs	83	70%
Baked Goods	76	64%
Eggs	64	54%
Meat	35	24%
Sorghum	27	23%
Mushrooms	20	17%
Cheese	14	12%
Fish/Shrimp	13	11%
Wine	7	6%

2008 Farmers' Market Report, The KY Dept of Agriculture

The gross sales estimate for farmers' markets in 2007 was $8 million. The season included a late freeze and a drought. Many will remember the terrible impact on one of the markets' most popular categories: fruit. It can be anticipated, that with a better fruit crop and growth in the number of markets, that gross sales in 2008 will exceed $8 million.

Data collected via the Kentucky Food Consumers Panel indicated that farmers' market shoppers demonstrate significantly different demographics and behaviors. The average age was almost 10 years younger than panelists who did not shop at a market, and the market shoppers were more likely to preserve food, use a freezer for extra storage, or belong to an environmental / consumer group. This consumer data offers the observation that farmers' markets continue to serve as a niche for food shoppers. (Tim Woods and Sara Williamson)



The Kentucky Food Consumers Panel, 2008

University of Kentucky
Department of Agricultural Economics
400 Charles E. Barnhart Bldg.
Lexington, KY 40546-0276
Phone: 859-257-5762
Fax: 859-323-1913
http://www.uky.edu/Ag/AgEcon/