

The Kentucky Agricultural Economic Outlook for 2006

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Kentucky Agricultural Economy

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2005 Review: Despite weather and market uncertainties, 2005 was another good year for Kentucky agriculture. We estimate that 2005 farm cash receipts, while probably not breaking the record 2004 record, will be slightly over \$4 billion. Record cash receipts coupled with government and tobacco buyout payments will enable net farm income for 2005 to remain relatively strong, despite significant increases in energy-based input prices and rising interest rates.

Livestock cash receipts gained an estimated 6.3% (2005 over 2004) while crop cash receipts declined 19%. Livestock sectors registering significant increases (estimated) included equine, cattle and poultry. These three enterprises collectively represented 89% of all livestock cash receipts in the Commonwealth. Equine receipts exceeded \$1 billion for the second time. Poultry (all poultry categories) is again the second largest category of cash receipts with an estimated \$907 million, up 11% above the 2004 level. Beef cattle receipts increased to \$652 million, a 5% gain. Dairy receipts declined due to lower milk prices.

The decline in crop receipts was led by more than a \$150 million decline in tobacco farm cash receipts and a \$123 million decline in cash receipts of the state's major row crops including corn, soybeans and wheat. The only crop sector registering an increase was floriculture/ornamental, increasing by \$8 million (10%).

2006 Outlook: Given normal weather and continued world economic growth, we expect Kentucky farm cash receipts to potentially reach a new record of \$4.14 billion in 2006. Cash receipts increases are expected in the equine, poultry, floriculture/ornamental, corn and tobacco. Cash receipts for soybeans, dairy and cattle are expected to decline slightly. But the 2006 outlook for the entire sector suggests a continuation of relatively strong net farm income in response to ag sales, government payments and buyout checks.

The bulk of equine, poultry, and grain income is generally concentrated to a relatively small percentage of Kentucky farms and geographic regions. Once the lump sum buyout checks are received, some tobacco dependent regions of central and eastern Kentucky may face the prospects of significant declines in net farm income beyond 2005/06 as many producers have few alternatives for offsetting the decline in tobacco income.

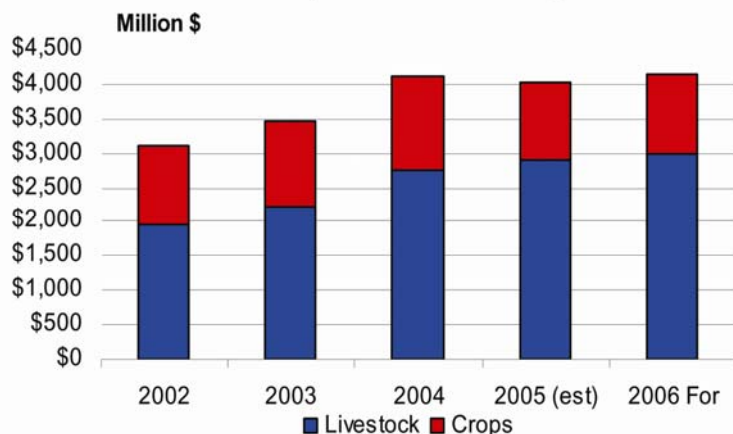
Tobacco

Will Snell

2005 Review: This past year was a historic one for Kentucky tobacco farmers as they produced a crop for the first time in more than 60 years without any production controls or safety nets. A large percentage of tobacco farmers opted to exit the industry in 2005. For the remaining growers, lower anticipated prices, along with increasing market uncertainty, labor and barn space constraints, and a very challenging growing season resulted in burley production falling by more than 30%. This occurred during a period of expanding leaf exports and tightening world supplies for quality tobaccos. Pre-buyout pool stocks buffered the shortfall, along with some additional burley production from non-traditional areas. Dark tobacco production fared much better in response to improving product demand and contract price incentives. Collectively, Kentucky tobacco cash receipts likely fell to around \$250-\$275 million. However, Kentucky tobacco farmers did receive around \$240 million for their first installment of the tobacco buyout, with additional buyout dollars flowing in 2005 as many farmers opted for a lump sum payment for the remaining nine payments. Tobacco farmers also received two grower lawsuit payments and their last Phase II distribution, together totaling nearly 200 million additional dollars for Kentucky tobacco farmers in 2005.

2006 Outlook: After a year of "observing," many growers and buyers are still uncertain how the industry may evolve in the post-buyout era. As in 2005, there will likely be another noticeable exit of burley growers in 2006, with production continuing to shift to the areas that can consistently produce the quality attributes demanded by the companies at the lowest cost. However if price/profit incentives are provided in the 2006 contracts, some of the remaining growers will likely expand. Export demand may continue to exhibit some modest growth in 2006 and the percentage of imported tobacco utilized by domestic manufacturers is expected to decline. Consequently, disappearance (use) of U.S. burley will likely rebound in 2006 as buyers continue to adjust to the post-buyout marketing environment.

Kentucky Farm Cash Receipts



Source: KY Agricultural Statistics/ UK Estimates

Some growth in domestic burley use will be fulfilled by the utilization of pre-buyout pool stocks. Dark tobacco will continue to benefit from strong product demand, limited overseas competition, and the ongoing close relationship with domestic smokeless tobacco manufacturers. While the future for those remaining in the sector remains very uncertain, production and cash receipts for the Kentucky tobacco sector have the potential to expand in future years if growers are provided price/profit incentives to remain in production.

Grains Steve Riggins

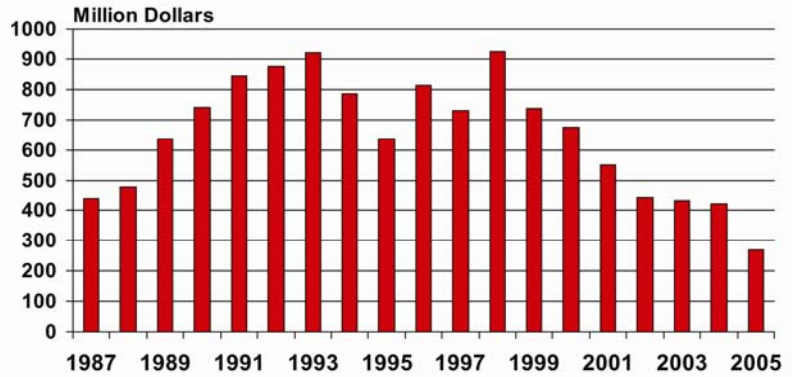
2005 Review: U.S. corn production for 2005 now looks to total over 11 billion bushels for a second consecutive year. USDA has forecast 2005 U.S. corn yield to average a second best ever of 148.4 bu./acre (November Crop Report). Even though 2005 corn yield is well below last season's exceptional average of 160.4 bu./acre, the 2005 corn crop will still be viewed as very interesting from a yield perspective. Illinois had a very dry spring and summer while Missouri, Kansas, significant sections of Indiana and Kentucky received less than normal moisture. These states achieved better than expected yields given the weather. The upper Midwest and western corn-belt states experienced very good yields. Total disappearance of U.S. produced corn is projected to exceed 10.8 billion bushels and this may be the last year, barring a crop short-fall, when total corn use is less than 11 billion bu.

The huge crop will result in an increase in carryover stocks and keep any price rallies in check. If corn exports and use for ethanol live up to expectations, prices might be somewhat higher than expected by many farmers, but they should still be below those of last season and well below those of two years ago.

The situation for soybeans is very similar to that for corn – a second year in a row of very large production (3+ billion bushels of soybeans), robust disappearance (but down slightly from last season's record level due to a slight drop in projected exports), and building stock levels with lower prices. Currently, USDA places U.S. average soybean yield at a record setting 42.7 bu/acre, up a half bu/acre over last year's record yield.

Land devoted to wheat production in the U.S. continued to decline in 2005, but at a slower pace than has been the case since the 1996 farm bill. Wheat acres harvested for grain have stabilized at last year's level. Yield for the 2005 harvest averaged 42 bu/acre, just under the two prior crop years. Total U.S. wheat production from the 2005 crop is

Kentucky Tobacco Cash Receipts



Source: Ky Ag Stats/NASS, UK Estimates for 2005

about 90 million bushels less than the expected total disappearance of 2.19 billion bushels. Stable U.S. stocks coupled with adequate global wheat and corn production will serve to restrain any price rallies in U.S. wheat.

Outlook for 2006: The price outlook for U.S. corn, wheat and soybeans over the next several months will be heavily dependent on production prospects for corn and especially soybeans in the southern hemisphere, weekly export sales, China corn and soybean trade, and livestock feed demand in the U.S. By early spring, the driving force behind the price outlook will be expectations about acres planted to principal crops in the U.S. and South American soybean production. U.S. production prospects will then dominate the market news until at least mid-summer.

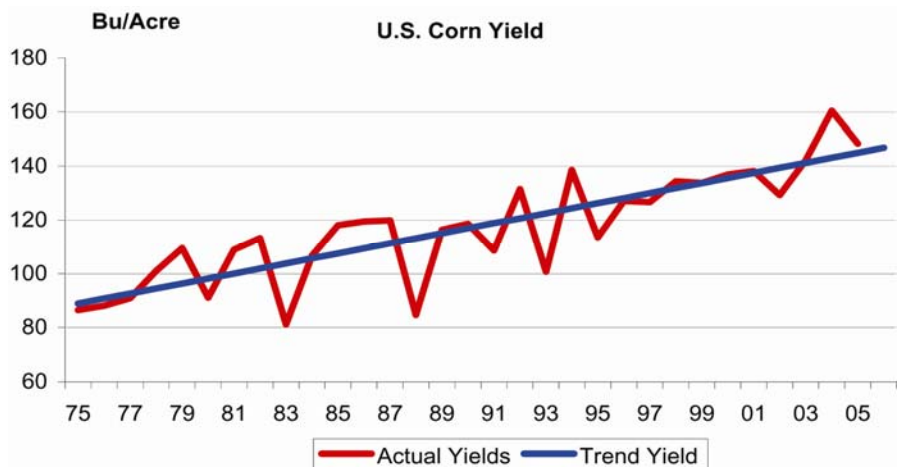
USDA's forecast calls for a 10% increase in U.S. corn exports while wheat exports are expected to decline for a second year in a row (6%). Cumulative weekly corn sales and export inspections are slightly disappointing compared to both last year and to the average weekly pace needed to validate USDA's projection for total annual corn exports.

Cumulative weekly data for wheat is mixed as an indicator of eventual total annual U.S.

wheat exports. The sales data is running somewhat ahead of the pace needed while the cumulative inspection data is slightly behind the required total.

Soybean exports are projected to be strong at 1.075 billion bushels, the second best year ever, but down from last year's record of 1.103 billion bushels. Even though China has been buying a large percentage of weekly U.S. soybean sales, their pace is behind the record setting level of last season. The market is currently very concerned about the impact of a possible spread of Asian bird flu on feed demand in general.

large supplies of soybeans, wheat and corn in the global market and (forecast) record large production of soybeans by South America next spring should serve to restrain commodity prices this winter. However, low commodity prices have stimulated record or near record setting usage rates for these commodities. In addition, the increasing percentage of U.S. produced corn that goes into domestic ethanol production (14%) will support corn prices. More new ethanol plants are expected to come into production and the production of biodiesel should increase significantly (three fold) due to recent tax changes, the new energy bill and the rising prices of energy sources.



Livestock and Meats

Lee Meyer and Kenny Burdine

2005 Review: Consumer demand and trade have been key economic factors impacting the prices of beef, pork, chicken and goat. In general, 2005 has been a profitable year for many of those in the meat industry. Hog, poultry and feeder cattle producers had profitable years. Feedlots in general have not done well in spite of low feed costs. The Livestock Marketing Information Center estimates that feedlots have lost money in seven out of the past 10 months.

Cattle: Most analysts thought that 2004 was going to be the top feeder cattle price year in this cattle cycle. Feeder cattle prices were up 15% from 2003, with steers averaging about \$105 at Oklahoma City. However, we were wrong and 2005 prices moved even higher, as they were up \$5 per cwt. from the 2004 level.

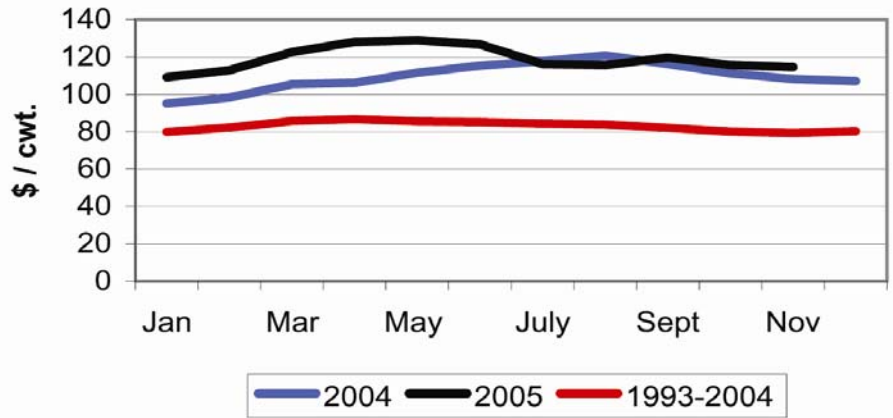
For the year, cattle slaughter was down slightly, but higher weights modestly increased total beef supplies. Demand may have declined slightly, but still remained strong for the year. The amount of beef available to U.S. consumers was boosted by increased imports, which totaled about 11 pounds per person out of the 67 total. Slaughter cattle prices averaged in the upper \$80s, with the lowest prices during the third quarter at \$82/cwt., and the highest prices in the low \$90s late in the last quarter of the year. Feeder cattle prices were also at very high levels. The highest prices for the year were in May and June, Kentucky prices for 500 to 600 lb. steers and will average over \$120/cwt. for the year.

Hogs: Prices dropped slightly (about \$2/cwt., to \$49/cwt. live weight basis) from the 2004 level in 2005, but still stayed at profitable levels. According to data from the Kentucky Farm Business Management program, the five year average cost of production is about \$38/cwt. so 2005 will have been another profitable year. While production for the year was up slightly, per capita supplies actually dropped by 1.5 pounds as exports rose by 22% for the year.

Broilers: Chicken production stayed on its long term track with another year of increasing production. For 2005, production was up almost 4% from the 2004 level. The 12 city, wholesale broiler price actually dropped slightly in 2005, averaging about \$.73 per pound. Exports continued to rise, jumping by 12%.

Goats: The goat enterprise in Kentucky seems to be maturing. Though year-to-year comparisons are not available, production is probably continuing to expand modestly. Prices have been strong. The benchmark

Ky Feeder Cattle Prices 500 - 600 lb. M#1 Steers



price of 40-60 lb. kids at San Angelo, Texas averaged \$98/cwt. in 2003, and increased to \$123/cwt. for 2005. Kentucky prices – for kids sold at the special Graded and Tel-O-Auction sales have been at similar levels, with the highest prices from December to May, followed by declines of \$15 to \$20 per cwt. into the summer and fall.

Outlook for 2006:

Cattle: The small increases in U.S. cattle numbers leave little room for dramatic increases in beef production. In fact, if herd managers expand their cow herds as expected, the heifers held for replacements will actually cause slaughter from domestic sources to decline.

The reality is that the U.S. does not have an isolated beef system. It is a North American system with the U.S. as its leader. Mexican imports add about 4% to the U.S. feeder cattle supply. Before the BSE problem, Mexico was the third largest buyer of U.S. beef. It is currently first, given the trade embargo to the Pacific Rim countries. Canada is also an important part of the beef supply equation, sending both slaughter cattle and processed beef to the U.S.

For 2006, beef production in the U.S. is likely to increase 2% to 4%. Slaughter cattle prices are forecast to drop about \$5 per cwt. but will still be at historically high levels. Feedlots will still struggle to earn a profit because of the high prices they have paid for feeders late in 2005 to be marketed during the first half of 2006. The low prices for feed grains and protein have been positive factors.

Feeder cattle prices will continue at strong levels on the strength of high slaughter cattle prices, but will be lower than 2005. The fact that, from feedlots' perspectives, feeder cattle prices have been too high and that feeding costs for all of 2006 (corn, fuel, etc.) are likely to increase a small amount will cause feeder cattle prices to be \$5 to \$10 per cwt. lower for 2006.

Longer run prices will be affected by the continuing expansion phase of the cattle cycle begun in 2004. Still, prices are expected to remain at profitable levels for three to five years, before supplies increase to burdensome levels and put significant downward pressure on prices. A drop in consumer demand is the key risk factor.

Hogs: Pork production for 2006 is expected to increase by 1% to 3%. Prices will decline unless the production increases are offset by stronger demand. While domestic demand has been slipping, the USDA projects continued strong net exports for 2006 – taking a total of about 8% of production.

Prices for the year will be 5% to 8% under the 2005 level, averaging in the low \$60s per cwt. of carcass. This is about \$45 to \$50/cwt. on a live weight basis and is still at profitable levels for most producers.

Broilers: The year 2006 is not expected to be much different for the chicken market. U.S. production will continue to climb. Kentucky will continue to add production capacity, increasing more quickly than the 3% forecast for the entire U.S. Trade will again be a key price-determining factor. Most likely, broiler prices will continue in the low \$70s.

Goats: The goat market will continue to be strong, following the other meats with continued strength of demand and growing ethnic populations. Prices for 40-60 lb., Selection 2 kids should average in the \$120s per cwt., with the typical seasonal pattern of the highest prices in the first half of the year. Many Kentucky goat producers will not receive prices even close to the \$120/lb. mark because of the still poorly developed market system they use. However, those who participate in the "Graded and Tel-O-Auction" sales can expect very competitive prices.

Horticulture

Matt Ernst and Tim Woods

2005 Review: Kentucky's produce (vegetables/fruit) industry and green (nursery/greenhouse) industry continued growth and diversification in 2005. Despite challenging weather and volatile markets, gross produce receipts rose slightly in 2005 as producers benefited from more direct market channels, especially farmers' markets. Over 1,800 vendors sold in farmers markets in 2005 and the number increases each year. A strong overall economy offset by higher energy costs resulted in modest growth for Kentucky's green industry, increasing slightly from decade-high gross sales of \$77 million in 2004.

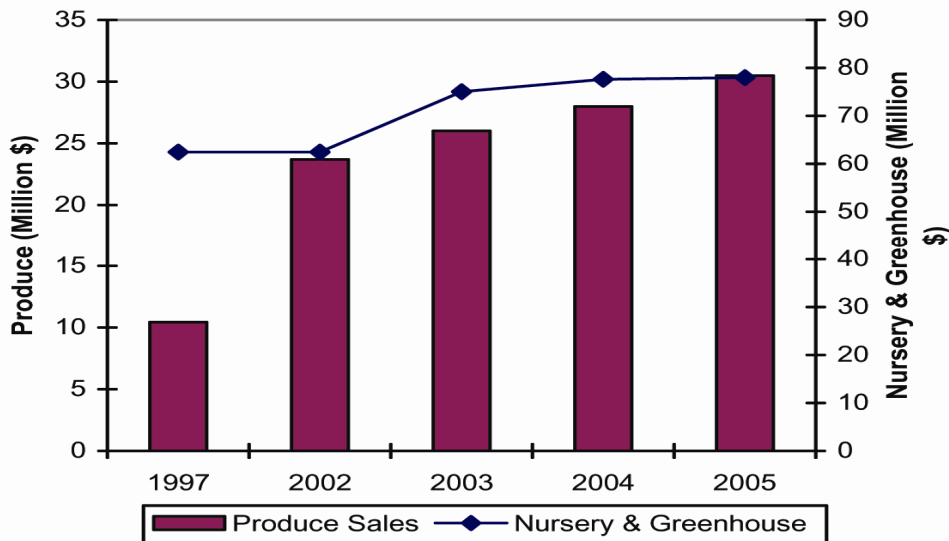
Commercial Vegetables: Kentucky posted the second highest rate of growth (53%) in vegetable acres harvested among U.S. states between 1997 and 2002. The value of commercial vegetables harvested in Kentucky during 2005 increased by about 5%. Direct marketers continued diversifying product offerings, while wholesale vegetable prices were exceptionally strong across all crops during Kentucky's season. Volume of vegetables marketed through auctions and to restaurants was up in 2005, due to expanded marketing by the two larger auctions (Fairview, Christian County; Lincoln County), as well as the pilot produce-purchasing program through the state park restaurants.

Commercial Fruit: Tree fruit growers overcame generally dry conditions to report good apple quality and an outstanding fall festival season. Berry growers continued to increase acreage, utilizing more value-added and local grocery sales. Kentucky wineries report purchasing more local grapes in 2004 and bottling more wine.

Green Industry: The green industry nationwide is fueled by new home construction and healthy consumer spending. Kentucky's growth in this sector is largely confined to larger greenhouses, but landscapers and mid-size nursery businesses also reported growth. This sector grew rapidly between 2002-04, with growth leveling out slightly this year. Opportunities for farm producers in this sector lie in direct marketing and services accompanying nursery product sales.

2006 Outlook: The outlook is mixed for commercial vegetable production in Kentucky for 2006. Co-op acreage will continue decreasing, but auction and grower-shipper wholesale sales will again increase. Gross sales will continue to be driven by higher-value direct marketing at farmers' markets, directly off the farm, and to foodservice. Overall vegetable acreage could be down slightly in 2006, but higher-

Ky. Horticulture Sales (Producer Value)



value market channels should keep sales steady.

New grape and berry plantings continue to reach fruiting age. There are approximately 250 bearing acres of wine grapes in Kentucky with many new plantings going in. There is plenty of room for growth in local markets for berries; some wholesale opportunities to local processors may also gel in 2006. Wine production is expected to continue its increase in 2006 as more wineries come into production.

Nursery/Greenhouse: Green industry growth could be hampered by higher energy costs and housing market slowdowns in 2006. While well-managed firms will weather tighter profits, smaller firms could face exit or consolidation. Several larger, high technology systems have been developed that have contributed substantially to the wholesale dimension of the business in Kentucky. Service-oriented firms, like landscapers and retail centers, however, may be better positioned for growth in 2006.

to increased production per cow. It jumped about 3% in 2005, as availability of BST increased. U.S. monthly milk production was over year earlier levels for the eight months (ending in October) for which data were available.

The National Agricultural Statistics Service estimated Kentucky dairy cow numbers at 110,000 on January 1, 2005 a slight decrease from 2004. Kentucky mailbox prices fell below \$14 per cwt. in June, but rallied back above \$15 per cwt. in July, August, and September. The 2005 annual price is likely to average around \$1 per cwt. lower than the lofty levels of 2004.

2006 Outlook: The USDA is projecting 2006 increases in the number of milk cows in production, milk per cow, and total milk production. A production increase of around 2.5% is expected, putting downward pressure on milk prices. Strong demand could ease some of this price pressure. The USDA is forecasting a price decrease of \$1 to \$2 per cwt., which, if correct, would place 2006 prices closer to the historical levels.

Dairy

Kenny Burdine and Lee Meyer

2005 Review: In general, 2005 has been a good year for dairy producers. Although milk prices have not been quite as strong as they were in 2004, they have remained above breakeven levels and provided dairy farmers with another profitable year. The U.S. "All Milk" price will average above \$15 per hundredweight for only the second time in the last seven years.

The primary reason for the lower prices seen in 2005 was higher milk production levels. By year's end, 2005 milk production should be about 3.5% higher than 2004. Although a small share of this increase may have been due to more cows in production, more is due

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