

Input Prices: Where Are They Now and Where Are They Going?

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Goal Today

- Overview of Input (and Output) Prices
 - Where they are now and where they are going
- Strategies for dealing with input and output price uncertainty and general economic uncertainty

Where are fertilizer prices going?

■ Fall 2008

- N prices should be about same to only a little higher: Anhydrous will be \$750-\$800 a ton
- P prices: DAP will be \$950-\$1000 a ton
- K prices: Potash will be around \$600 a ton

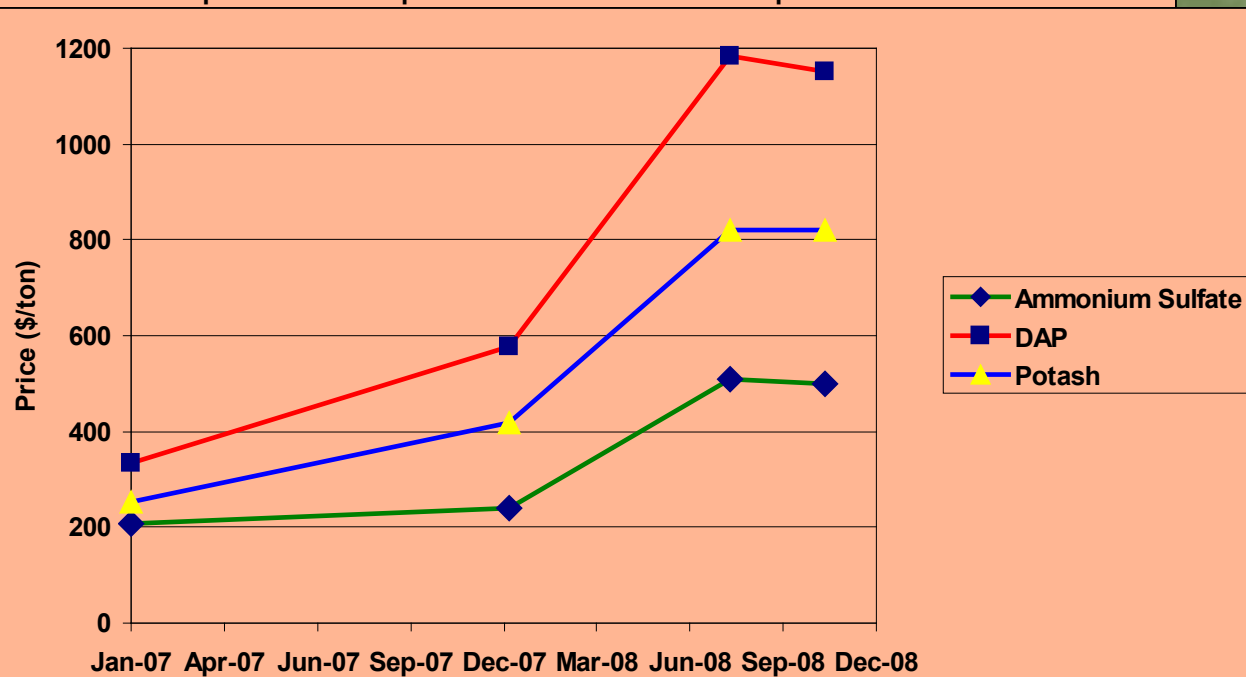
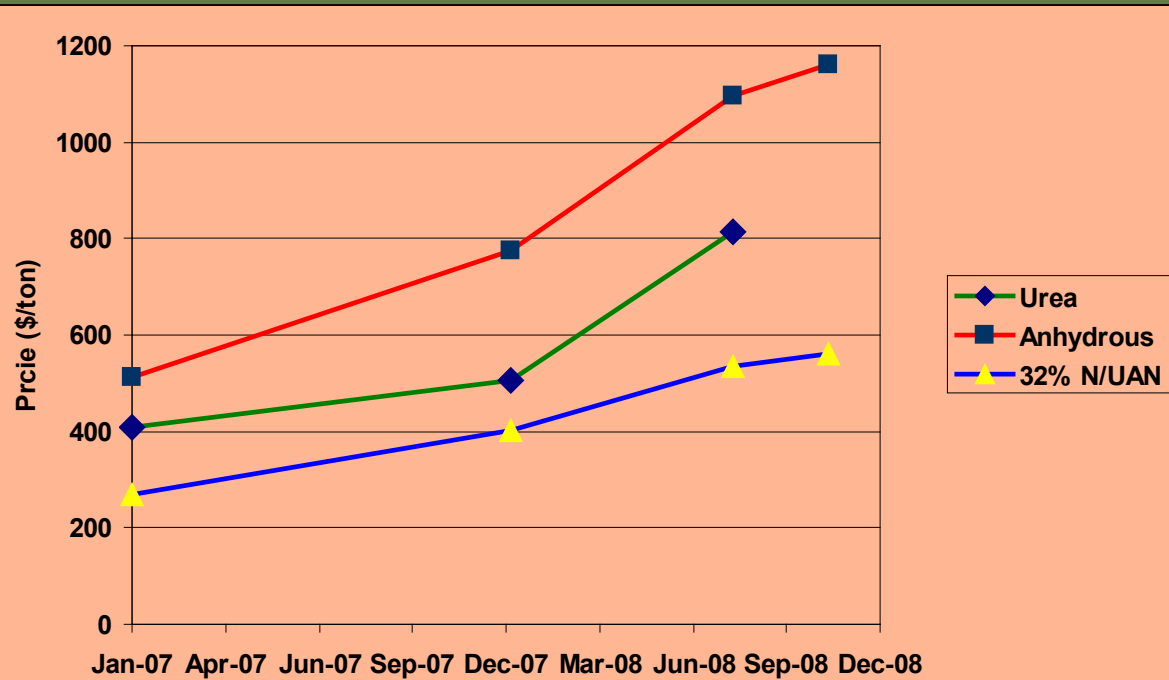
■ Long term

- Supply-side factors will catch up as new production comes on line and put some downward pressure on prices
- Exchange rates? Energy prices?

Fertilizer prices are still high, but showing signs of slowing

Fertilizer	Jan 2007 ^a	Jan 2008 ^a	Feb 2008 ^b	Aug 2008 ^c	Nov 2008 ^a
Urea	410	505	500	815	---
Anhydrous	515	775	715	1095	1160
32% N Solution	270	405	405	535	560
Ammonium Sulfate	210	240	325	510	500
DAP	335	580	625	1185	1150
Potash	255	420	515	820	820

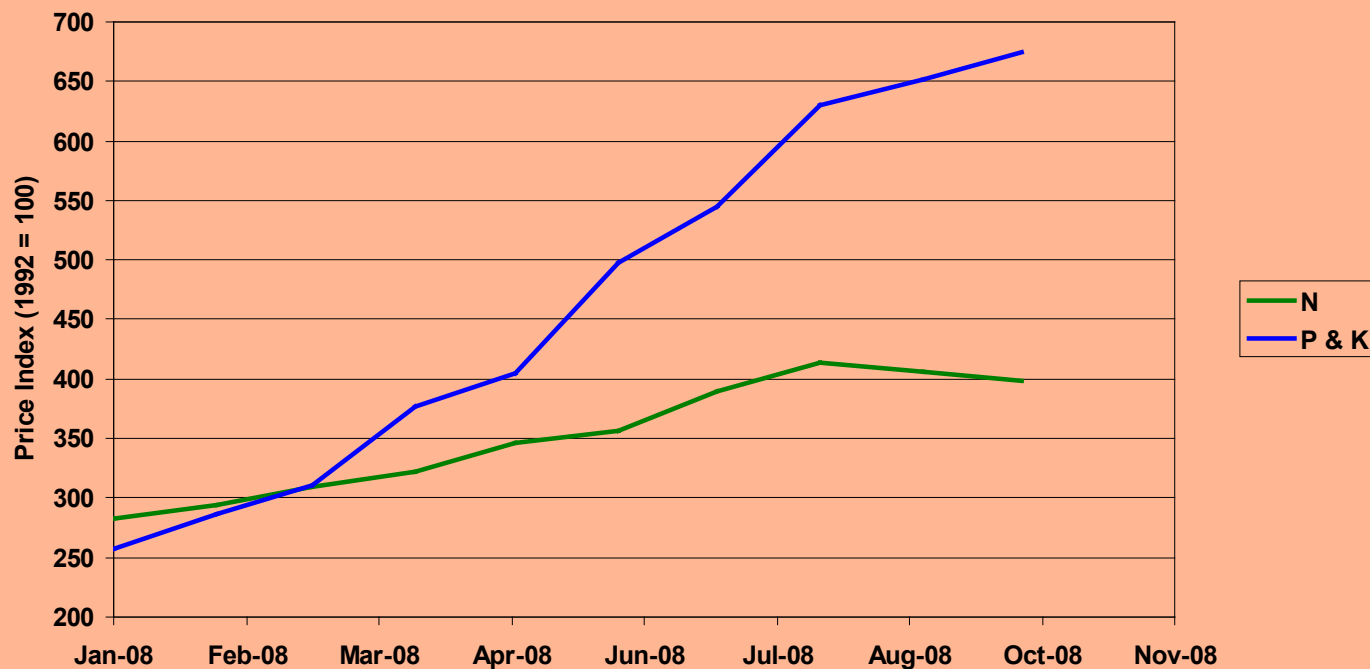
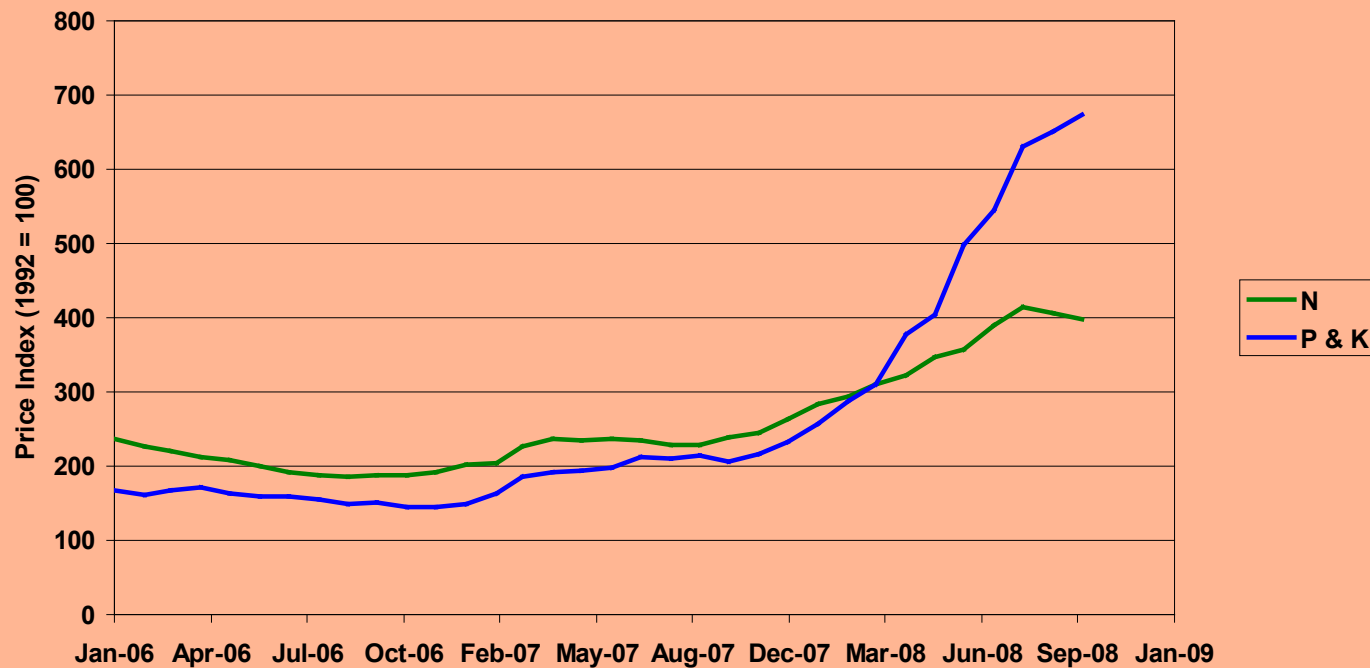
^aLandmark Coop ^bFrontier FS Coop ^cInformal Survey Average



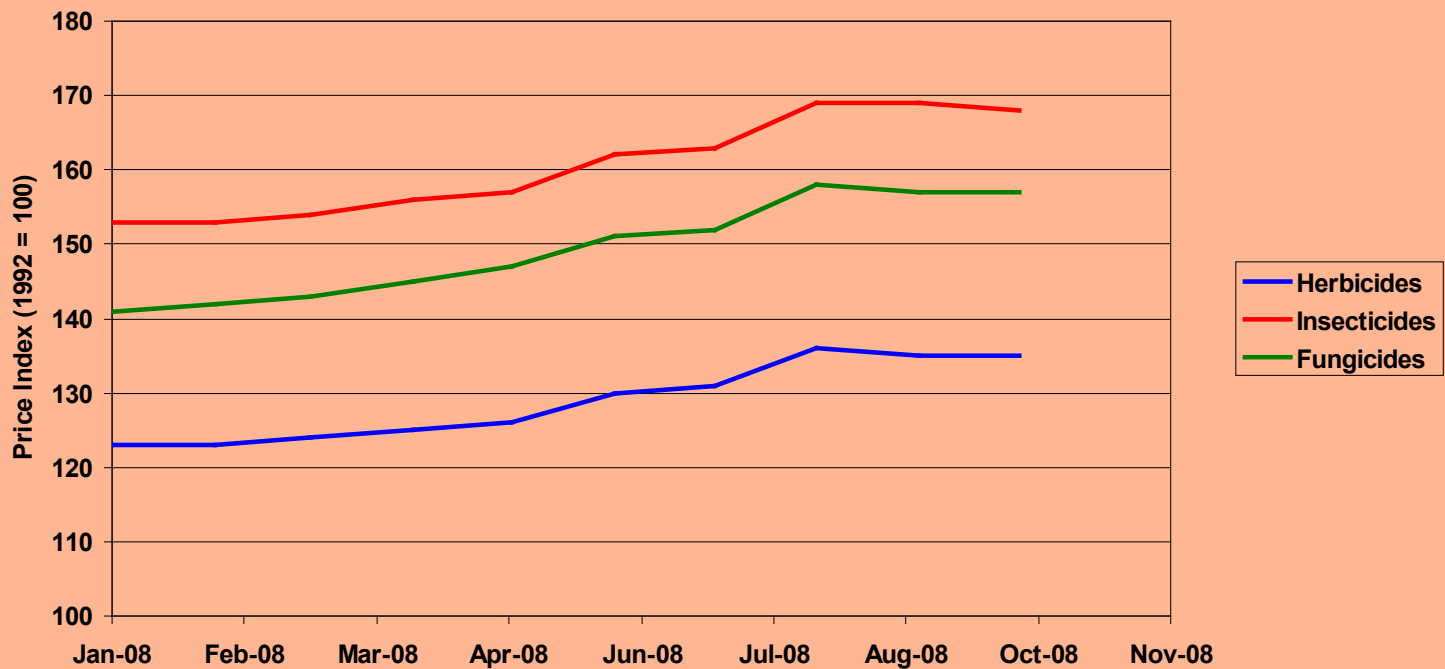
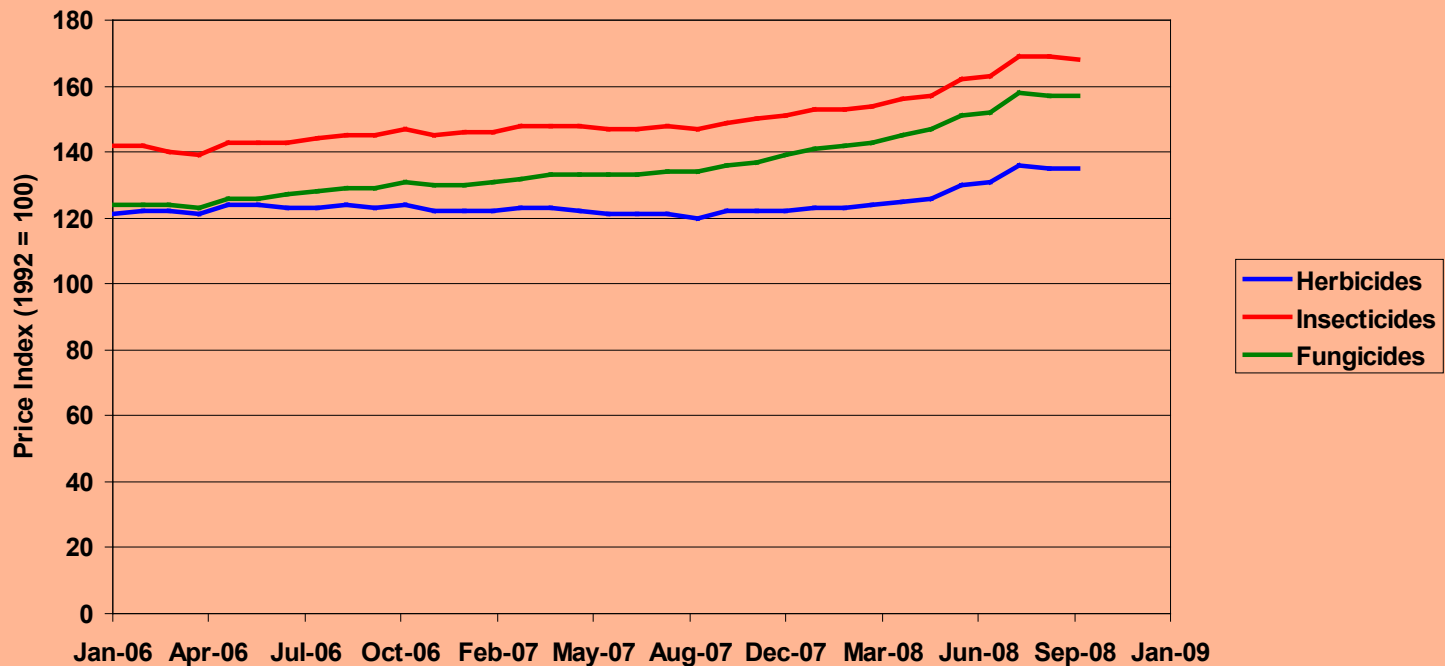
Price Indexes

- USDA NASS publishes monthly price indexes for many ag outputs and inputs
- <http://usda.mannlib.cornell.edu/MannUsda/viewDocumentInfo.do?documentID=1002>
- National average price for the many items in a category, weighted by sales volumes
- Many categories not reported here
- Normalized so 1990-1992 Average = 100

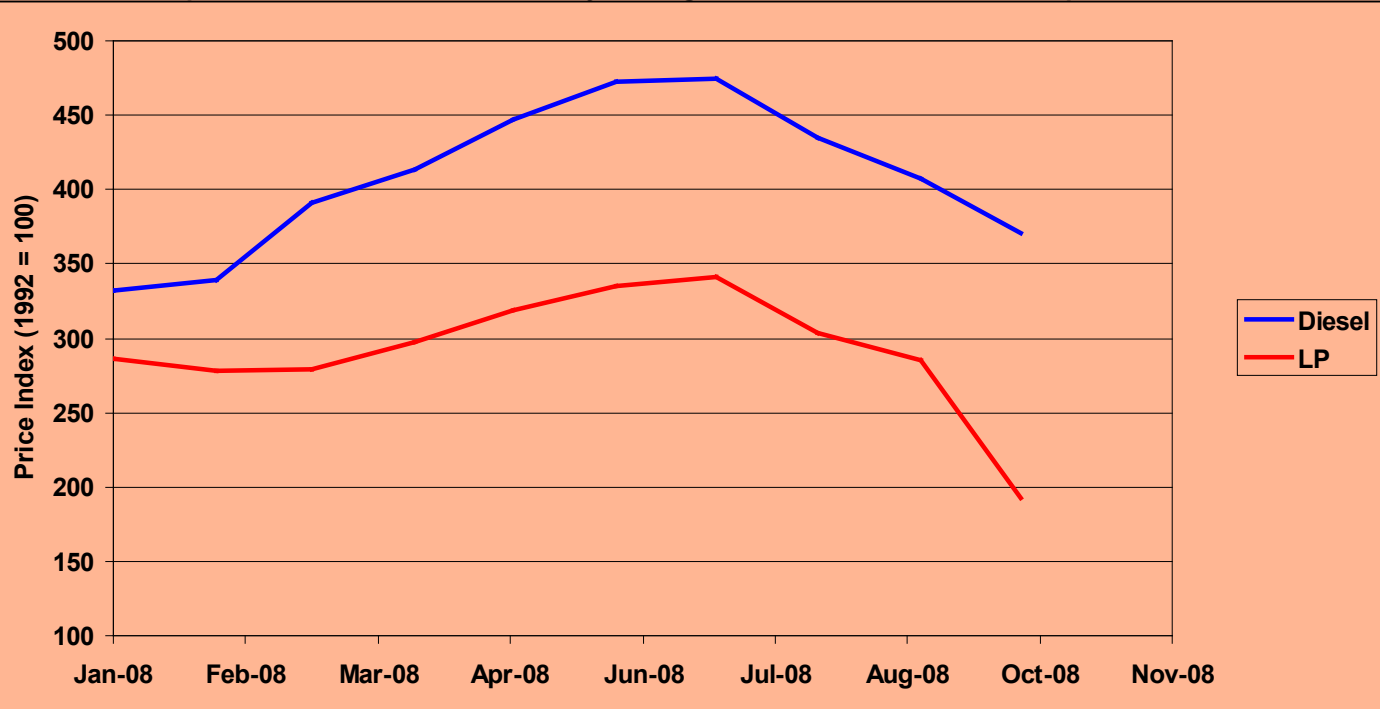
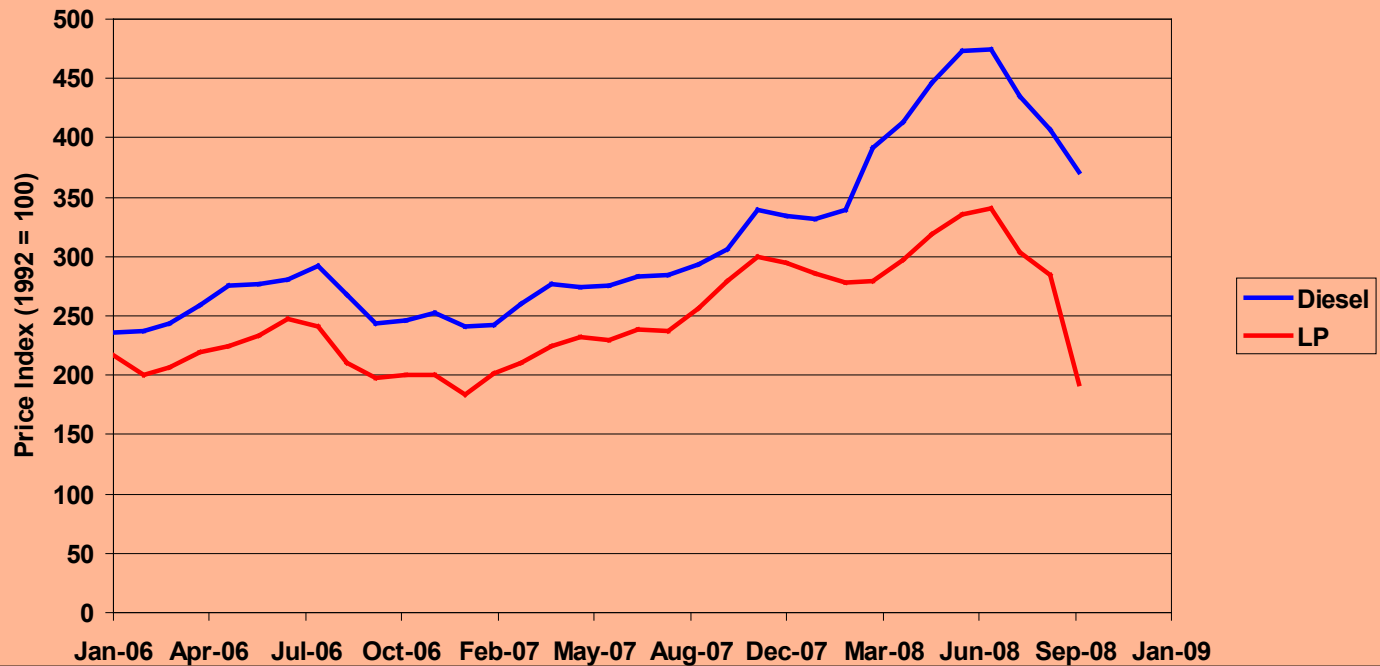
Fertilizer Prices



Pesticide Prices



Fuel Prices



Fertilizer Prices

- Urea: Has lower to go yet, most popular N fertilizer in world, world demand falling off, not clear how far it has to go
- Other types of N: Some price decrease may occur, but not much, could just as well keep climbing, but not as fast
- Potash and Phosphate: some downward pressure on prices as world demand falls, not clear how far it has to go
- A lot depends on how bad the financial crisis and recession becomes around the world

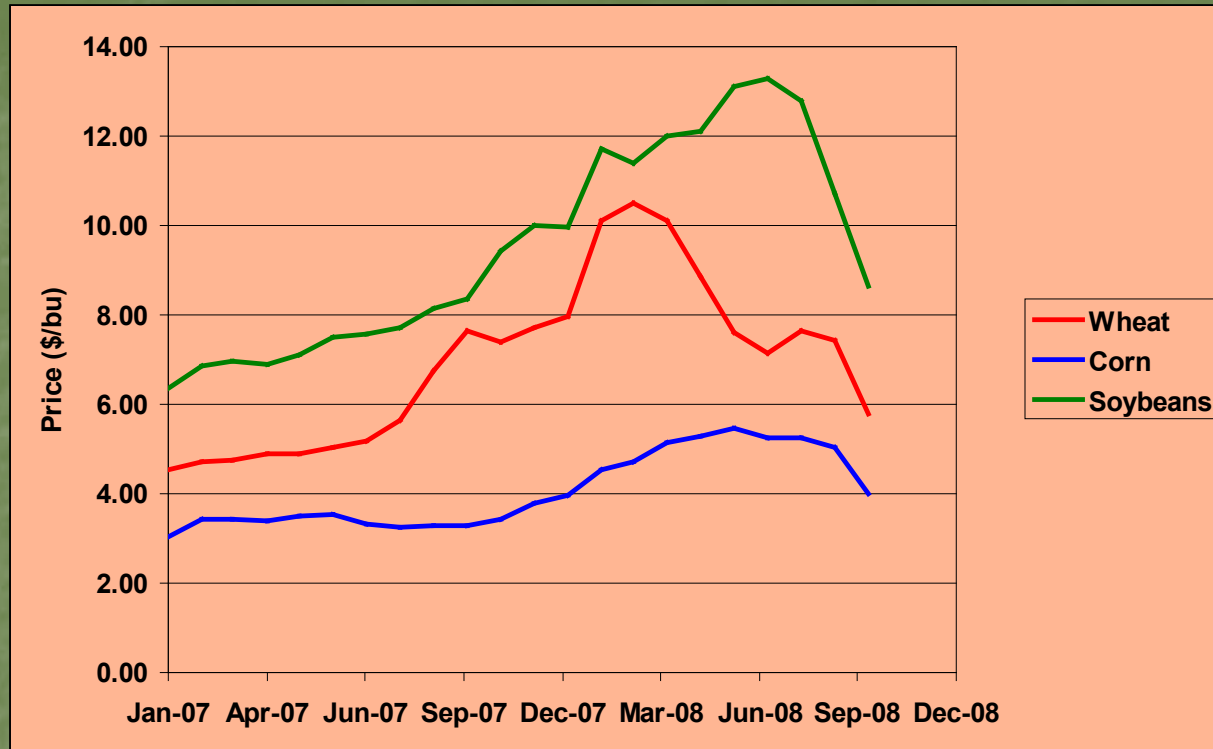
Chemical and Energy Prices

- Chemicals higher than last year (10%-20%)
 - Downward pressure as demand falls off
- Diesel: higher than last year, but falling
 - Aug 2008: 53% higher than in 2007
 - Oct 2008: 21% higher than in 2007
- LP was higher than last year, now lower
 - Aug 2008: 28% higher than in 2007
 - Oct 2007: 31% lower than in 2007
- A lot depends on how bad the financial crisis and recession becomes around the world

What's Going on with Output Prices?

- Grain prices have decreased and become more volatile
 - Ethanol/biodiesel prices falling as crude oil and diesel prices decline
 - Dollar stronger, so export demand will decline
 - Livestock prices falling, so less grain demand
 - World demand uncertainty increased with the financial crisis/recession

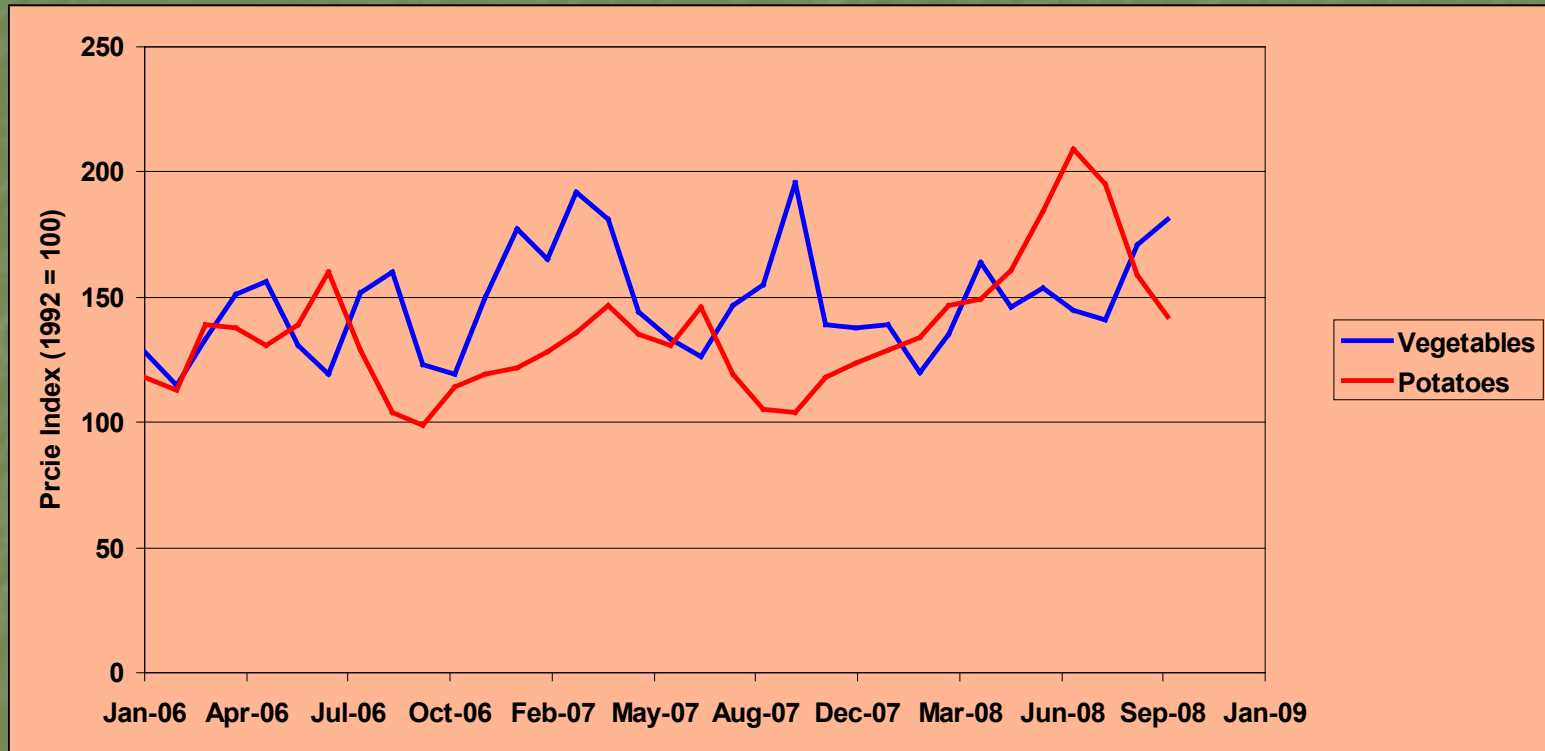
Monthly Average Grain Prices (USDA)



Contract	Peak	Price*	Current	Decrease
Dec. Corn	June	7.99	3.86	-52%
Nov. Soybeans	July	16.37	9.22**	-44%
Dec. Wheat	March	12.75	5.34	-58%

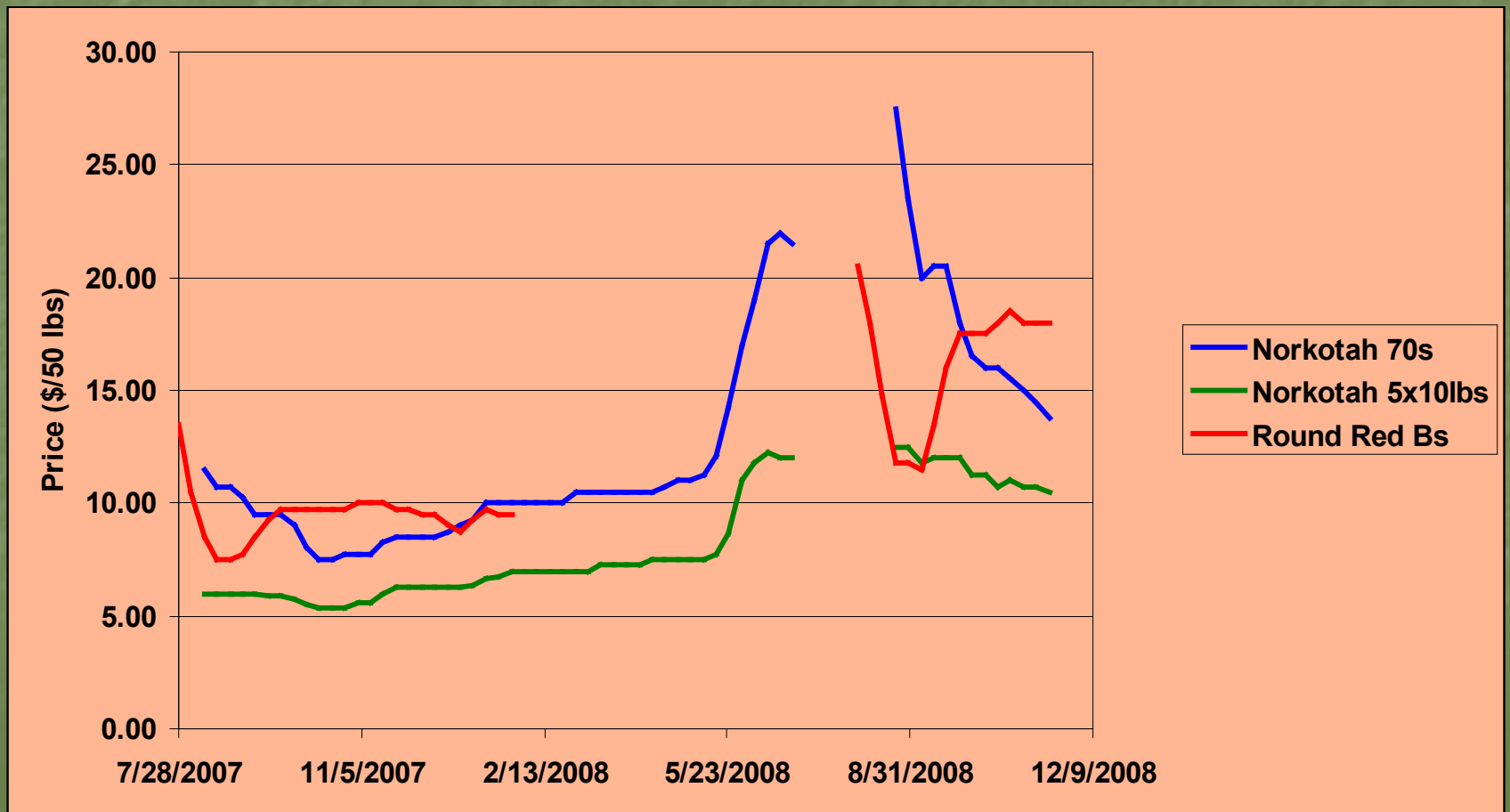
*Darrel Good (U of IL) ** USDA-RMA price for RA

What about Potatoes and Vegetables?



USDA-NASS National monthly price index for prices received by farmers

USDA-AMS weekly average prices received at terminal markets for Central Wisconsin fresh potatoes



Potato Prices

- Prices following “standard” post harvest patterns
- How low will Russets go before increasing?
- Retail demand for fresh potatoes will fall with lower consumer demand if income falls
 - Hseih et al. (2008)
 - For a 1% decrease in consumer income
 - 3%-5% drop in Russet demand
 - 2%-4% drop in white demand
 - 1.5%-2.5% drop in red demand
 - Small drop in frozen/refrigerated potato demand
 - 2.5%-4.% increase in dehydrated potato demand

Global Financial Crisis/Recession

- **Where are input and output prices going?**
- A lot depends on the severity of the global financial crisis and recession
 - Reduced consumer demand here and abroad
 - Lower food and energy prices
 - Strong dollar reduces foreign demand for
 - US grains/meat/vegetables
 - Ag inputs such as fertilizer and chemicals
 - Tightening of credit for agriculture in nations with large ag sectors reduces demand for ag inputs
 - China, India, Brazil, Argentina

Global Financial Crisis/Recession

- G20 met in DC last Friday and Saturday to coordinate on crisis response

Argentina	Germany	Russia
Australia	Great Britain	South Africa
Brazil	India	Saudi Arabia
Canada	Indonesia	South Korea
China	Italy	Turkey
European Union	Japan	United States
France	Mexico	

Current data on some G20 nations

Country	GDP Growth	Inflation	Unemploy- -ment	Stock Market Decline	Interest Rate
Brazil	5.2%	5.7%	7.7%	-44.2%	13.8%
China	9.7%	6.4%	4.0%	-64.9%	6.7%
Germany*	1.9%	2.9%	7.4%	-41.1%	3.3%
Great Britain*	1.0%	3.8%	5.4%	-34.2%	3.0%
India	7.9%	7.9%	7.8%	-51.5%	7.5%
Japan*	0.7%	1.9%	4.1%	-42.5%	0.3%
Russia	7.0%	14.0%	5.9%	-65.5%	11.0%
Saudi Arabia	5.9%	11.5%	13.0%	-50.5%	4.0%
South Africa	3.8%	11.8%	23.2%	-30.6%	12.0%
United States	1.6%	4.2%	5.6%	-33.1%	1.0%

Source: CNN web page

*Officially in recession (Great Britain "likely")

Main Point

- Looks like recession in some nations, with a slow down in rapidly growing economies
- Implies reduced demand for ag inputs and outputs and thus prices for both
 - How will this affect your margins?
- Where are input and output prices going?
 - I don't know!

Will crisis affect agriculture?

- Crisis was largely financial in origin
 - Sub-prime lending and credit default swaps
 - Liquidity dried up so good companies cannot get operating capital
 - \$700 billion bailout to help make credit available
 - Now worry about recession
 - Reduced consumer demand, less production needed, increased unemployment, etc.
- How will this affect agriculture?
 - Mostly recession worries, not credit problem

Crisis and Ag Credit System

- Ag credit system is good shape
 - Mostly not involved in problematic financial deals, plenty of liquidity available
- Banks will be under more scrutiny (FDIC)
 - Regulators will be looking at lending more
 - You may be asked for more details, better evidence of your credit worthiness
 - Solid/conservative budgets; clear info on costs, yields, marketing, insurance; Business Plan
 - Communicate with your lender(s)

Questions?

Strategies for dealing with all this market and margin uncertainty

- Plan for the Worst and Hope for the Best
 - Pray
 - Hunker down and wait out the storm
 - Take on risks, but do so wisely
- Trying to out guess the market is futile
 - Luck is going to be an important factor for input and output prices
 - Focus on the things you can control and get control of the things you can

Strategies for this uncertain market

- Develop realistic (conservative) enterprise budgets to identify your break even prices, then build a written marketing plan to achieve your goals
 - Build your own or use those available
 - Variable inputs are easy
 - Various methods exist for machinery
 - Overhead costs are up to you to allocate
 - I can give you places to start
 - www.aae.wisc.edu/mitchell/extension.htm

Strategies for this uncertain market

- Lock in inputs soon (if you haven't already) so you know your input costs for building your budgets & marketing plans
 - Make sure your costs make sense for your expected revenues
 - Shop around, buy different types of inputs from different dealers, are there cheaper alternatives?
 - Maybe wait on fertilizers and fuel to possibly save, but can you live with the uncertainty and delay?
 - Gives you control of an uncertain factor, really no other way to hedge or insure against input price risks

Strategies for this uncertain market

- Use of current (high) revenues/profits
 - Build liquidity/cash reserves (current ratio)
 - Improves your ability to survive bad luck
 - FDIC insured to \$250,000 to end of 2009
 - Pay down debt (especially short-term)
 - Refinance debts to fixed rates
 - Pay for 2009 input costs this year
 - Don't forget about income taxes

Strategies for this uncertain market

- Use of current (high) revenues/profits
 - Think carefully before buying machinery or land or improving/expanding facilities
 - Be sure investments generate return for business
 - Will be strapped with a cost for several years, which will affect future cash flows
 - If we have a bad recession, may slow (reverse?) trends in land values and machinery costs, making waiting prudent
 - If you buy it/expand, can you survive a string of bad luck and a few years of thin/negative margins?

Strategies for this uncertain market

- Land rental rates this year

- Because of the extreme uncertainty, consider using variable rental rates or share rents

$$\text{Base rent} \times \frac{\text{Act. Yld} \times \text{Act. Price}}{\text{Base Yld} \times \text{Base Price}}$$

- Share input costs and output gains
- Careful on rules for commodity program payments
- U of IL Farm DOC: useful pubs on variable rents
- If must use a fixed rate, set final rate in Mar/Apr:
 - Output prices clearer, inputs purchased, insurance guarantees set
 - Alternative: ask to allow renegotiation in Mar/Apr

Strategies for this uncertain market

- Use federal risk management programs
 - Help survive catastrophes or bad years
 - Allow more aggressive marketing based on crop insurance guarantees
 - Crop insurance
 - Generally prudent, at least catastrophic coverage
 - Biotech Yield Endorsement (BYE) for corn now
 - ACRE new alternative commodity program
 - SURE new disaster program

Strategies for this uncertain market

Judicious Input Use

- Use soil tests, nutrient crediting and recommended rates to control costs
- Properly calibrate application equipment or know which applicators do
- Scout for pests/diseases before losses occur
- Scout weeds, use right herbicides for the weeds you have and control when they are small
- Are there cheaper alternatives?
- UW Extension can help, just ask!

Questions?

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