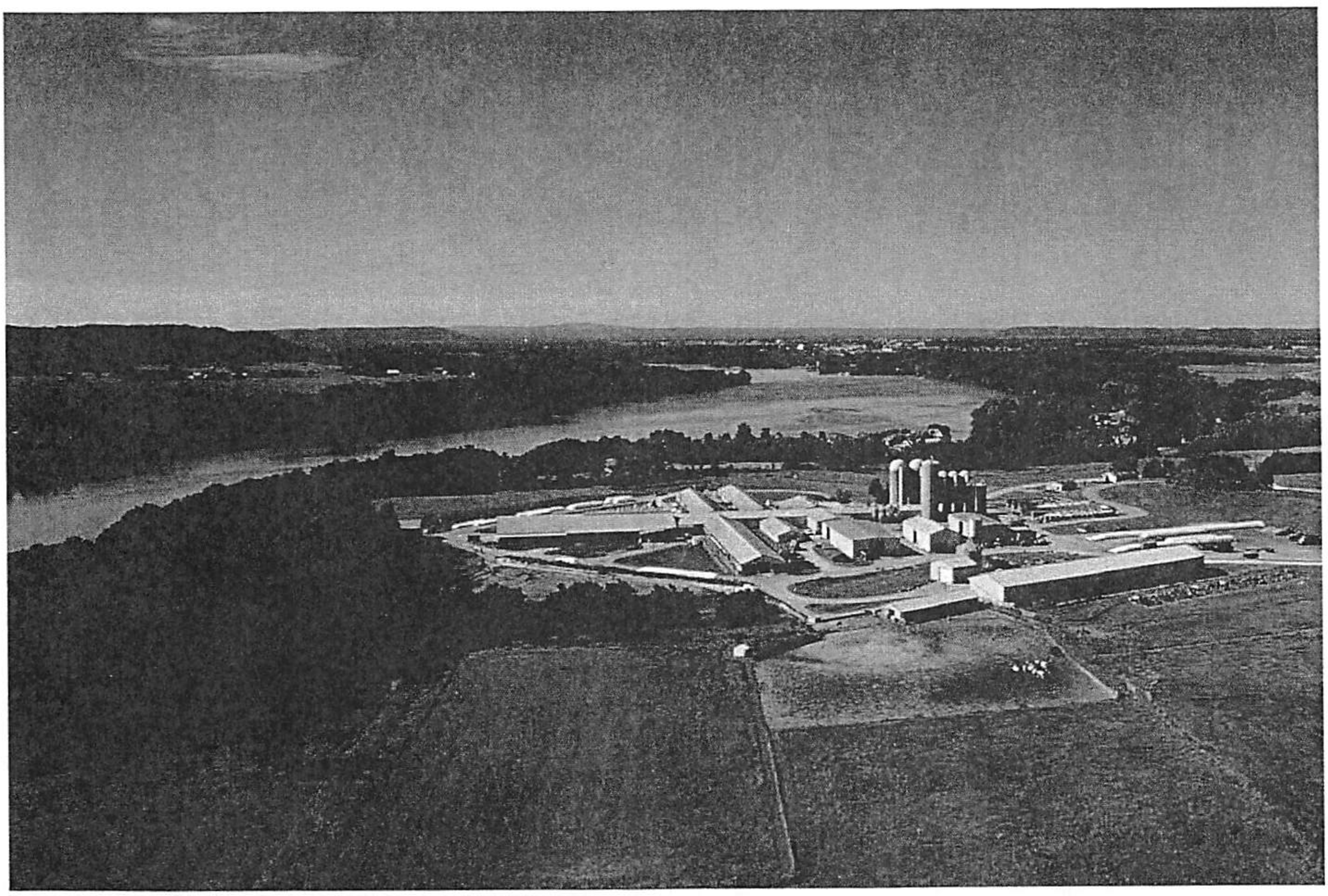
Wisconsin Agricultural Economics Outlook Forum

January 21, 2016

Executive Summary



Sevie Kenyon photo

USDA Dairy Forage Research Center

2016 Wisconsin Agricultural Economic Outlook Forum

Thursday, January 21, 2016
Varsity Hall III, Union South,
11:30 AM - 2:30 PM

Agenda

11:30am	Registration
11:45	Welcome and Introductions – Bruce Jones
	Dean Kathryn VandenBosch – College of Ag & Life Sciences
	Chancellor Rebecca Blank - University of Wisconsin
	Dean Richard Klemme – UW Extension
	Chancellor Cathy Sandeen – UW Extension
	Renk Scholars
	Luncheon
12:30 - 2:30	**2016 Wisconsin Agricultural Economic Outlook Forum**
12:45	Bruce Jones – Status of Wisconsin Farm Economy
1:00	Steve Deller – Macroeconomic Trends and Outlook
1:15	Mark Stephenson – Dairy Situation and Outlook
1:30	Brenda Boetel – Grain and Livestock Market Outlook
1:50	Bruce Jones – Farm Production Costs
2:05	Panel Speakers – Question & Answer Period
2:30	Close

Status of the Wisconsin Farm Economy

- Wisconsin farms profits were significantly lower in 2015 compared to 2014. It is estimated that net farm earnings fell nearly $1.6 billion, largely because milk sale receipts were down a like amount. The decline in milk prices was not unexpected. After averaging about $24.50 per hundredweight (CWT) in 2014, milk prices were expected to be down about $7 per CWT in 2015. Unfortunately this expectation was realized and income from milk sales was down dramatically. Milk receipts would have been even lower had Wisconsin dairy producers not increased milk production by just over 4%.

- The decline in net farm income will be a challenge for Wisconsin farms in 2016. Fortunately, it should not cause severe financial hardships for most farm households, since the vast majority of Wisconsin farm families also have non-farm incomes. This is particularly true in the case of the smallest farming operations (less than $100,000 in annual sales), which get most of their household income from off-farm sources.

- The balance sheet for Wisconsin farms was strong heading out of 2013, and it got even stronger over the course of 2014, the most recent year for which balance sheet data are available for Wisconsin farms. Farm assets rose in value by nearly $6 billion that year, while total liabilities increased about $700 million. As such, the equity of Wisconsin farms grew a bit more than $5.5 billion in 2014.

- The capital structure of Wisconsin farms, as reflected by the equity-to-asset ratio, has stayed fairly close to 87% for the past few years. This is an extremely strong financial position in that only 13% of farm assets are being financed with debt. This low level of borrowing means there is plenty of collateral available to secure additional loans to farmers.

- The liquidity position of Wisconsin farms appears to have slipped a bit the last couple of years. In 2012 Wisconsin farms held $8.3 billion of current assets against $2.4 billion of current liabilities, for a net working capital position of $5.9 billion. By 2014, net working capital had fallen to $3.3 billion. This sizeable decline in the net working capital of Wisconsin farms is an indication farmers have been drawing down cash reserves. Further declines in farm liquidity are likely in the near term if farmer income does not rebound soon. This is a concern because farmers will likely have more difficulty getting operating loans as net working capital declines.

Renk Agribusiness Institute

This document was prepared by the Renk Agribusiness Institute in January, 2016.

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Macroeconomic Trends: Past, Current and Future Outlooks

- The national economy has entered a period of sustained, but modest economic growth. The historical average quarterly growth rate (annualized) since 1947 has been 3.2%, and the consensus forecast over the next year is 2.6%.

- The unemployment rate is expected to stabilize between 4.5% and 4.7% over the next two years. Since 1947, the average monthly unemployment rate has been 5.8%. Note: The unemployment rate does not reflect the level of discouraged workers who have left the labor market or are working below their potential (underemployment).

- The inflation rate is expected to rise and then stabilize at about 2.2%. Since 1947, the average rate of inflation using the standard Consumer Prices Index has been 3.6%. Therefore, inflation is expected to remain modest for the foreseeable future. Note: Care must be taken when looking at inflation rates because of strong swings in food and energy prices. Recent forecasts of energy prices, particularly oil prices, have been wildly inaccurate. That's in part because the price of oil is controlled by relatively few influencers, and their behavior can be difficult to predict.

- Interest rates are expected to tick upward over the next few years. The Federal Reserve recently increased the Federal Fund Rate from zero to 0.25%, and the Federal Fund Rate is expected to rise to about 2.2% in two years' time. The interest rate for prime industrial bonds is expected to trend upward to about 3.5% over the next years.

- The Wisconsin economy is in a weak recovery from the Great Recession. Job growth is below what we would expect given national growth rates and historical patterns. Unemployment rates are reasonable, but the number of discouraged workers remains an issue.

- A major "structural" problem for the U.S. economy and Wisconsin is the declining middle class or widening income inequality. What this means for the economy's future is unclear, which introduces uncertainty into the system.

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Dairy Situation and Outlook

- U.S. milk production went up just a little over 1% in 2015, a modest increase over 2014 levels. However, the milk production story was very different across the country. Drought-induced high feed costs and relatively low milk prices resulted in California's milk production being down by more than 3%. In contrast, milk supplies in the Northeast and Michigan exceeded plant capacity, causing a fair amount of milk to be dumped. Wisconsin's milk production was up about 4%.

- U.S. unemployment is now down to 5% and the economy has been quite robust. This yielded strong domestic sales of most dairy products in 2015. Fluid milk sales continue to decline, but within that category, demand for whole milk and creams are noticeably up. Butter sales have been particularly strong and butter prices have defied the downward pressure seen in milk powder markets.

- The buoyancy of domestic dairy sales are in stark contrast to our export performance. Export sales had represented about 16% of milk production in the beginning of 2015, but then declined to almost 14% by the end of the year. That extra 2% of milk production not leaving our shores caused cheese inventories to build by the end of the year.

- As we look ahead at 2016, export opportunities will define our milk price. New Zealand is a major competitor for those sales but its milk production has been down by more than 1% and may decline further if the building El Niño dries up pastures. However, the European Union has increased milk production since production quotas came off in 2015. In fact, a few countries of the EU have increased production substantially and world stocks of dairy products are still large.

- The world's two largest importers of dairy products are China and Russia. China's growth in GDP has slowed considerably and is reflected in the smaller amount of dairy purchases. Russia has suffered from the effect of sanctions and low oil prices. Their imports of dairy products are well below peak levels.

- As we look ahead to dairy trade in 2016, much of the year will be spent trying to work down international stocks of dairy products. This will keep downward pressure on U.S. milk prices and will postpone any milk price recovery until late in the year.

- 2016 average milk prices will be at or slightly below 2015 levels. First quarter 2016 prices will fall well below the same quarter of 2015, but the last quarter should show the beginning of a price rebound. The good news is that feed prices will remain well below the levels of the last few years.

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Grain and Livestock Market Outlook

- Corn: Corn price is down approximately 10% from a year ago, and will remain steady throughout spring. Projected stocks-to-use ratio is 12.9% for 2015/16, slightly above the 10-year average of 11.4%. Corn acreage is likely to increase in 2016, with the USDA forecasting an additional 2.1 million acres of corn planted. A trend yield of 168.1 bushels per acre and projected harvested acres of 82.7 million indicates 13.9 billion bushel production in 2016, up 1.8% from 2015. Demand would likely closely match production, and the stocks-to-use ratio would increase. Given these conditions, 2016 harvest price would likely be $0.05 to $0.10 per bushel lower than 2015.

- Soybeans: Compared to a year ago, soybean price is down 15%, while soybean meal price is down approximately 27%. South American production and increased acreage in the U.S., combined with a large carryover from 2015, will continue to push soybean prices lower in 2016. Soybean acreage is expected to fall in 2016 to 82 million acres. With a trend line yield of 46.7 bushels/acre, production would be approximately 4.9% lower in 2016 than in 2015. Harvest price in 2016 will be approximately $0.25 lower than in 2015 at $8.65 per bushel. Current soybean-to-corn ratio is 2.31, which indicates slightly higher corn returns.

- Wheat: Wheat acreage will likely be lower in 2016. However, yield is expected to increase, leading to a slight increase in production. This increase in production, combined with larger beginning stocks, will lift total supply and will bring lower prices in 2016.

- Beef: Herd expansion has begun and will likely continue in 2016. Commercial beef production was down over 2%in 2015, but will be up almost 3.5% in 2016. Protein demand has remained strong for all proteins in 2015, but additional pork and poultry supplies put downward pressure on beef prices. The average 2015 finished cattle price was down slightly over 4% from 2014, while fourth quarter finished cattle prices were down almost 24%. Expect the average 2016 finished cattle price to be down approximately 7%, with the largest year-over-year declines in the first quarter. The average 2015 feeder prices were up about 1% over 2014 average prices, although fourth quarter prices were down between 22-29%. The average 2016 feeder prices will likely be approximately 20% lower than in 2015.

- Pork: Pork production was up slightly over 7% in 2015. Carcass based national average hog prices hit historic highs and averaged over $100/cwt in 2014, but were closer to $70 in 2015 with lowest prices in the fourth quarter. 2016 should see similar prices to 2015. The number of pigs per litter was up 3% and at a record high at 10.53 for September to November 2015. Breeding herd was up 1% in 2015 from 2014. Given increased breeding herd numbers, pigs per litter and higher market weights, pork production should increase slightly over 1% in 2016.

- Poultry: Fourth quarter 2015 saw composite chicken prices that were approximately 25% lower than fourth quarter 2014. Although there was only about a 4% increase in production in 2015, domestic supplies increased about 6% in 2015 due to lower exports. Turkey production was down about 2% in 2015 as compared to 2014. Poultry supplies are expected to remain about the same in 2016.

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Farm Production Costs

- The prices paid for farm inputs declined throughout most of 2015. This decrease was the first relief farmers have experienced for farm inputs since 2008.

- The drop in farm input costs coincides with worldwide declines in crude oil prices. The prices of diesel fuel and gasoline were both down substantially in the last year, as was the price of LP gas. Oil prices stayed close to $50 per barrel for most of 2015, and the Energy Information Agency of the U.S. Department of Energy is projecting oil prices to stay near this level through 2016.

- The prices of fertilizers have been trending downward at modest rates since 2012. This decline in fertilizer prices will likely continue in 2016, since farmer demand for fertilizer will likely ease due to low prices for corn and soybeans, as well as unchanged supply factors.

- While fuel and fertilizer prices have trended downward, seed prices have been rising. In recent years, however, seed prices have not increased as fast as they did when corn and soybean prices were higher. There is little reason to expect big increases in seed prices in the coming year because low prices for corn and soybeans will discourage farmers from upping their orders for seed.

- Cash rents have been rising over time, and the growth in rents has escalated in recent years in response to higher prices for cash crops. Now that corn and soybean prices are about half of what they were five or so years ago, cash rents have leveled off and are starting to decline. This adjustment in rents is needed because farmers' margins from raising corn and other cash crops have dropped dramatically as crop prices have fallen. Cash rents are not likely to fall as much as cropping margins, however, because of competition for rented land. This competition will prevent rents from dropping to levels that will allow farmers to break-even, let alone profit, from renting farmland.

- Credit should be plentiful for those farmers who can meet the cash flow and collateral standards of lenders. This credit will be a bit more expensive than in recent years because the Federal Reserve Bank (Fed) is finally allowing interest rates to rise. Big jumps in interest rates are unlikely because the Fed will not want to choke off economic growth. But interest rate hikes of 25 to 50 basis points could be in the works for 2016.

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Forum slides and presentations may be accessed following the program at: http://news.cals.wisc.edu/2016/01/04/2016-ag-outlook-materials/