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OUTLOOK FOR U.S. AGRICULTURE IN 2012

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Thanks, Madam Secretary. I too would like to welcome everyone to USDA's 88th annual Agricultural Outlook Forum. I will briefly give an overview of the major economic trends affecting U.S. agriculture and offer a few thoughts about 2012.

2011 was a very good year for much of US agriculture. We saw record prices for many commodities, record agricultural exports and record farm income. Not surprising, record prices have prompted record production for many commodities and as we saw over the last half of 2011, prices for grains, oilseeds and cotton have come down, reflecting strong production levels.

World wheat and cotton stocks have rebounded and while supplies still remain tight for feed grains, slowing growth in biofuels and a return to trend yields should result in a rebound in corn stocks. This should help relieve some of the volatility that have roiled markets over the past 5 years and improve prospects for future livestock expansion.

The Outlook for US Agricultural Exports

The global economic recovery has slowed in 2012 with negative GDP growth forecast in Europe as a result of the sovereign debt crisis [figure 1]. Yet despite slower growth, 2012 should be another good year for US agricultural exports. The lower dollar will more than compensate for the expectations of slower world growth. [figure 2]. With a slow economic recovery in the United States, U.S. agricultural products will likely remain competitively priced in global markets over the next few years.

FY 2012 US agricultural exports are forecast at $131 billion, down $1 billion from the November forecast, but are still forecast to be the second highest on record in both nominal and real terms. [figure 3] The decline from record exports in FY 2011 reflects record global crop production which has weakened prices and export volumes.

Imports are projected at $106.5 billion for FY 2012, up $12 billion from FY 2011 levels. The net trade balance for FY 2012 is forecast at $24.5 billion. This compares with a trade surplus of near $43 billion in FY 2011.

China was the largest destination for US agricultural exports in FY 2011, importing just shy of $20 billion. Just five years ago they were our 5th largest destination after Canada, Mexico, Japan and the EU. [figure 4] Exports to China are expected to fall by 15% this year reflecting the concentration of trade in bulk commodities like soybeans and cotton which accounted for 75 percent of total US agricultural exports to China in 2011. [figure 5]

Yet while US exports to China are anticipated to fall in 2012, China import demand is expected to remain strong in 2012, accounting for over 60% of total world soybean imports and over 50% of world cotton imports.

The Outlook for US Crops

Rather than going through the individual balance sheets, I will briefly touch on what I see are some of the main drivers in the current supply and demand outlook.

Record world crops. Record prices in late 2010 and through the first half of 2011 resulted in increased plantings and record production for grains and cotton. [figure 6]. Soybean production, while off last year's record, was still the third highest on record.

Global demand has largely kept pace with production. [figure 7] Total wheat consumption topped 680 million metric tons, total corn use was over 867 million metric tons, and total rice use was 480 million tons, milled basis. All of these figures were records. At 258 million metric tons, global soybean use was also a record in 2012. Unlike grains and oilseeds, demand for world cotton declined last year, reflecting sluggish world growth, particularly in the developed economies.

With the exception of corn and soybeans, strong production response in 2011/12 has resulted in stock rebuilding for most commodities. [figure 8]. Wheat and rice stocks have rebuilt from low levels reached in 2007/08, though demand remains strong. Corn stocks have tightened further in 2011/12. World ending stocks for corn for 2011/12 expressed in terms of use are estimated at about 52.3 days of use, the lowest level since 1973/74.

Ethanol production slows as blend wall constrains expansion. After increasing by almost 700 million bushels per year over 2005-10, corn use for ethanol has flattened and is projected to fall by 21 million bushels in 2011/12.

Under the 2007 Energy Act, the maximum amount of conventional biofuels that may be applied towards the Renewable Fuel Standard (RFS) is 13.2 billion gallons in 2012. Current ethanol production capacity is estimated at 14.75 billion gallons. The expiration of the Volumetric Ethanol Excise Tax Credit (VEETC) and the other duty and charges (ODC) on imported ethanol on December 31, 2011 has meant that corn-based ethanol produced beyond the 13.2-billion-gallon mandate will have to be attractively priced to be profitably blended with gasoline.

Weekly ethanol production in December 2011 was running close to capacity as ethanol producers increased production just prior to expiration of the VEETC and ODC. Ethanol production levels have dropped about 4 percent since January 1, but still remain at almost 14.2 billion gallons, on an annualized basis. [figure 9] Margins for ethanol producers have fallen as well in recent weeks, reflecting the drop in ethanol prices. [figure 10]

The longer run issue for corn-based ethanol is how much ethanol can be absorbed in the domestic gasoline supply—the so-called blend wall. At the time the Energy Act of 2007 was passed, forecasts by the Energy Information Administration for gasoline consumption implied almost 150 billion gallons of blended gasoline by 2013. With the recession and subsequent sluggish economic recovery, however, forecasts for transportation fuel demand have been revised downward. Current EIA forecasts of blended gasoline fuel consumption in 2013 suggest less than 134 billion gallons, 16 billion less than forecasts made in 2007. The current penetration rate of ethanol at roughly 10 percent implies a blend wall of about 13.5 billion gallons. Ethanol produced in excess of 13.5 billion must be held as stocks or exported.

U.S. ethanol exports hit record levels in 2011. An estimated 909 million gallons of denatured ethanol was exported 2011, about 43 percent going to Brazil [figure 11]. With world sugar prices falling, exports to Brazil will likely fall this year. Because of the expected decline in ethanol exports, corn use for ethanol is expected to fall by 50 million bushels in 2012/13 to 4.95 billion bushels.

In the short run, growth in corn use for ethanol will be driven principally by the mandated levels under the RFS and the blend wall. Over the longer term, further expansion will largely be determined by relative attractiveness of ethanol prices to gasoline prices and the ability to market ethanol blends of more than 10 percent.

Dry weather conditions persist in the Southern United States. Devastating drought conditions prevailed over much of the Southern Plains causing poor yields and high abandonment rates in 2011/12. [figure 12] Unfortunately, dry conditions have persisted in the region and worsened in the Southeast. It is still premature to conclude much concerning yield prospects for 2012.crops and much can happen between now and planting time. Nonetheless, weather will be a key concern this year, particularly in Texas.

2012 Plantings and Crop Price Prospects

Figure 13 shows our forecasts for planted acreage of the major field crops for 2012. Expected returns for soybeans and corn are again historically high reflecting strong new-crop futures and cash forward prices.

CRP enrollments are also down again for 2012/13 with total CRP area projected at 30 million acres, 6.8 million acres lower than at its peak enrollment in 2007/08. Corn plantings are estimated at 94 million acres. If realized, this would be the largest plantings since 1944.

Soybeans are projected at 75 million acres, unchanged from 2011, but down 1.6 million from last year's intentions which were not achieved partly due to excessive moisture during planting, especially in the Upper Midwest.

Wheat acreage is expected to increase 3.6 million acres to 58.0 million. Winter wheat area at 41.9 million acres, is up 1.3 million from last year. Spring wheat plantings should rebound from last year's levels when excessive spring and early summer wetness limited seedings.

Lower prices will likely result in a decline in upland cotton area to 13 million acres. Rice plantings will likely increase 2.3 percent to 2.8 million acres. Most of the increase will occur in long grain rice in the Delta where farmers were prevented from planting substantial intended acreage by early season flooding.

Farm prices for most field crops will be lower, reflecting larger world and domestic supplies [figure 14]. A return to trend yields will likely push corn prices down significantly as stock levels rebuild. Corn prices are forecast to average $5.00 per bushel in 2012/13, down almost 20 percent from 2011/12's record levels. Cotton prices are expected to decline by more than 10 percent to 80 cents per pound for 2012/13, reflecting larger supplies worldwide. Rice prices are anticipated to remain strong, in part reflecting strong world demand which will likely boost US rice exports in 2012/13.

The Outlook for US Livestock, Dairy and Poultry

Livestock and dairy producers have faced tight margins for most of the past 5 years. Despite higher product prices, little expansion has occurred. The January 1 cattle inventory was at its lowest level since 1952. Most of the modest hog expansion seen in 2011 has been due to productivity gains rather than increased farrowings.

Feed price ratios have been low for the past 5 years for livestock, dairy and poultry, reflecting high feed costs [figure 15]. Lower prices for corn, wheat and soybeans will help moderate feed prices, particularly when 2012 crops are harvested. Margins are expected to improve somewhat, particularly by the fourth quarter of 2012.

Per capita domestic disappearance for meat and poultry has declined over the past 5 years. Some of the decline is due to higher prices, but consumption has also been affected by the weak economy as well as changing demographics. [figure 16].

Exports have become a key driver in producer returns. [figure 17] Beef, pork and broiler exports were at record levels in 2011. Export outlook should be strong in 2012 as well, with the major constraint being tight supplies.

Prices for livestock, dairy and poultry were either at record levels in 2011 or expected to hit record levels in 2012 [figure 18]. The all milk price is expected to decline by almost 9 percent as record high prices have resulted in increased milk production. Prices are expected to fall in the first quarter but should rise throughout the second half of the year.

Food Prices to Moderate

Food prices were closely watched in 2011 as year-over-year inflation rates for all food rose from 1.8 percent in January 2011 to 4.7 percent in November [figure 19]. Food at home inflation peaked at 6.2 percent, year-over-year, in October 2011.

Inflation estimates for January 2012 suggest food prices have begun to moderate. Year-over-year inflation rates for all food were estimated by BLS at 4.4 percent and for food-at-home at 5.0 percent.

ERS currently is forecasting inflation rates for all food and food at home to be between 2.5 and 3.5 percent for 2012.

Farm Income

Agriculture's strong performance is projected to ease in 2012. Net cash income for 2012 is forecast at $96.3 billion, down 11.5 percent from 2011, but still the second highest in nominal terms on record [figure 20]. Cash receipts for 2012 are forecast at $364.1 billion, a record high in nominal terms. Total expenses are projected to increase $12.5 billion.

Farm asset values are likely to increase by more than 5 percent for the third consecutive year. Debt is expected to rise 3.8 percent. The inflation-adjusted value of the farm sector's equity is expected to establish a new record high.

Conclusions

It is gratifying for an economist to watch markets follow the basic laws of supply and demand. High prices have prompted a global production response for most commodities. As a result of increased plantings and generally favorable yields, record production levels have been reached this year which have helped moderate prices for most crop prices.

Slowing demand for ethanol means that corn stocks will likely increase in 2012/12 assuming a return to trend yields. This should help moderate record feed grain prices.Livestock markets should see increasing margins towards the end of 2012 as the new crop is harvested bringing down feed costs.

There are still a number of key uncertainties starting with the size of the South American corn and soybean crops and the persistent dry areas of the Southern US. Nonetheless, prospects for US agriculture continue to be strong with record income in 2011 and a strong balance sheet.

Thanks again and enjoy the 88th annual Outlook Forum celebrating the 150th year of the Department of Agriculture.