STATE BANK & TRUST CO.

DOANE'S Farming for Profit®

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U.S. agriculture is facing financial challenges, but nowhere near the dark days of the mid-1980s. That was the bottom line assessment of the U.S. ag economy delivered to the House Ag Committee as they began work on the next U.S. farm bill. Low commodity prices have driven farm income to a fourth straight annual decline, raising financial stress, according to economists. "Producers are going to need every bit of the safety net that you can provide them," said Dr. Joe Outlaw, co-director of the Agricultural and Food Policy Center at Texas A&M University. USDA currently forecasts a drop in net farm income by 8.7% to $62.3 billion in 2017, which would be the lowest since 2002. "We will measure our requirements first and then determine what kind of a budget we will need to meet those needs," said House Ag Committee Chairman Mike Conaway (R-Texas).

U.S. cotton acreage will increase by 942,000 acres (9.4%) from last year to 11.0 million acres in 2017, according to the National Cotton Council's (NCC) annual survey. The top production state Texas is expected to account for 537,000 acres (57%) of the total increase, as producers there shift land away from wheat and corn. Assuming a normal abandonment and an average yield of 830 lbs. per acre, NCC projects crop size at 16.8 million bales.

The 90-day forecast from the National Weather Service (NWS) signals increased rainfall may be needed over the Southern Plains since temperatures are expected to be warmer than normal. Meanwhile, above-normal precipitation could push back field preparation and planting across the northern portion of the Corn Belt this spring. The forecast came soon after Australia's weather service suggested El Niño could return by summer. Having declared La Niña gone, the Australian Bureau of Meteorology is now expecting a warming trend in sea surface temperatures (SSTs) ahead and notes El Niño is now a possibility. The Australian agency cautions the forecast period is in transition, and that makes accuracy less reliable. In January, U.S. government forecasters forecast neutral conditions would arrive this month, but La-Niña-like weather impacts could still be seen.

Iowa's Supreme Court recently ruled that Des Moines Water Works (DMWW) cannot sue upstream counties for agricultural runoff. The company was seeking damages for excess nitrates in the Raccoon and Des Moines Rivers. The court's opinion says the basis of the DMWW lawsuit is not supported by law. But court documents also state that while no law was broken, it's critical that farmers be good stewards of the land. Lawsuits from DMWW aren't over just yet, however. On the federal stage, DMWW is asking that tile lines change from nonpoint source pollution to point source, which would require farmers to get permits for any potential runoff. The federal trial is scheduled to begin June 28, 2017.

A recently released study from the food and agriculture investment platform AgFunder found that global investment in ag tech startups dropped 30% in 2016 as investor interest in companies offering drones and satellite-guided farm machines cooled from record levels in 2015. Conversely, the number of deals grew 10% from 2015 to a record 580, and the $3.23 billion invested by venture capitalists and others was the second highest annual total on record for the sector. The pullback outpaced declines in the broader global venture capital market.

Farm Manager Focus

Mixed Outlook for Farm Income in 2017

Net farm income, the broadest measure of farm income, is forecast at $62.3 billion this year, down $6 billion (8.8%) from a revised $68.3 billion in 2016 to the lowest level since 2009. This would be the fourth consecutive yearly drop, with the current forecast being down nearly 50% from the 2013 peak, when net income totaled $123.7 billion.

On the bright side, the rate of decline is slowing. Also, USDA boosted its estimate of 2016 net farm income $1.4 billion to $68.3 billion. In contrast to lower net farm income, net cash income is expected to rise $1.6 billion (1.8%) this year to $93.6 billion and would mark the first increase in four years. Unfortunately, the increase isn't driven by larger crop receipts or larger government payments, but by an expected increase in farm-related income, which includes revenue from machine hire, custom work and insurance indemnities for crops. Insurance indemnities accounts for $3.25 of the $4.75 billion increase in farm-related revenue.

The largest farm income revenue components are cash receipts for crops and livestock. Crop receipts stabilized in 2016 and are forecast to hold about steady this year at $186.7 billion. Livestock receipts fell sharply in 2015 and again in 2016, plunging $21.7 billion last year to $168.1 billion. Most livestock categories were lower.

After declining the past two years from the 2014 peak at $390 billion, nominal production expenses are expected to hold steady in 2017 at $350 billion. While some key expenses are forecast to decline this year, others increase, leaving overall expenses little changed. For crops, reduced plantings are reducing expenses for pesticides (-3.4%), fertilizer (-9.2%) and seed (-3.0%). With respect to livestock, feed costs and the cost of livestock purchased are projected to be lower. But USDA projects higher fuel (13.1%), labor (5.5%) and interest (15.0%) expenses.

While there isn't an imminent crisis, the financial condition of the agriculture sector is declining. The debt to equity ratio has climbed during the past four years and is forecast to increase again in 2017 to the highest level since 2002.

Doane's MARKETING MENTOR

CORN

South American growing conditions appear quite favorable at this point, as indicated by news that Brazil's CONAB revised its forecast for the country's crop to a record 86.5 million metric tons (MMT). Estimates of the Argentine crop are rising as well. Having these big output totals added to plentiful global supplies certainly seems bearish for the outlook. But underlying demand strength appears to be stifling the negative impact on prices. Torrid U.S. ethanol production is absorbing a great deal of grain, and export numbers remain surprisingly robust. Indeed, USDA revised its corn for ethanol estimate 25 million bushels higher to 5.35 billion and boosted corn for other industrial up by 10 million in its February Supply/Demand (WASDE) report. Its export forecast was unchanged, but will probably be raised in a future report. Doane does harbor concerns about the ongoing build in domestic ethanol stocks, since it implies cutbacks could be looming; but early-2017 price strength has been impressive.

SORGHUM

USDA revised the sorghum demand components in the February WASDE report, but the revisions offset, leaving total use unchanged at 480 million bushels. But total usage is down 103 million bushels from a year ago. USDA raised sorghum feed use 25 million bushels from January to 130 million bushels. Conversely, sluggish exports, particularly to China, caused USDA to cut its export projection to 225 million bushels. That's down 25 million bushels from January and 114 million bushels below year-ago. China is subsiding domestic corn consumption in order to cut their excess supply. Since China accounted for 80% to 90% of total U.S. sorghum exports the past three years, a change in China's import policy could have a large impact on U.S. sorghum export prospects. U.S. sorghum export commitments to China so far this year total 102 million bushels, down 89 million from the 2016 pace.

SOYBEANS

Forthcoming Brazilian sales of that country's widely anticipated record harvest represent a threat to the U.S. soybean market. And yet, old-crop futures challenged their January highs in mid-February before setting back on profit-taking. Old-crop soybean export sales the week ended Feb. 9 of 890,000 metric tons topped expectations and strong demand lifted Gulf basis. Strong sales to other countries in recent months suggest robust Chinese buying is the tip of an iceberg. While underlying global demand strength is supporting the market, other factors are also in play. Slow Brazilian farmer sales and delays in getting those soybeans to that country's ports are keeping the U.S. export window open. Having Brazil's real currency recently reach a 21-month high versus the dollar also encouraged bulls.

WHEAT

Continued strong export sales tallies have provided surprising support for the wheat market since last fall. This has also forced shippers and elevators to boost spot bids in order to meet the demand. Thus, the Midwest basis has improved and seconded the futures advance. Areas of the South-Central U.S. warmed dramatically in mid-February, triggering concerns about premature HRW wheat emergence from dormancy. The risk of major damage to wheat if/when a late-winter cold snap hits the Southern Plains rises accordingly. Industry concerns on this point played a big role in the February rally. The HRS wheat share of mid-February export sales disappointed. That news may have caused traders to abandon HRS versus winter spreads, especially with the risk of freeze damage to winter wheat climbing along with temps. The HRS uptrend clearly suffered.

CATTLE

We believe the big January drop in steer weights signaled active producer marketings and tightening market-ready fed cattle supplies. But slaughter rates have remained relatively high, especially when compared to the low early-year totals of 2015 and 2016. The annualized price losses seen in recent weeks at least partially reflect the increase in production, but we would also point out prices are holding up much better than previously anticipated. Again, consumer demand has apparently improved after grocers finally became more aggressive in cutting retail beef prices last year. The market's history of seasonally declining supplies into early spring suggests persistent price support is likely, as does the tendency for improved demand as grilling season looms. We are cautiously optimistic about spring price prospects, since slaughter totals generally hit annual lows in March, but the long-term price trend is clearly pointing lower.

HOGS

The CME Lean Hog Index continued marching higher through early February, reaching $75.31 on Feb. 14. However, the hog/pork industry is clearly not confident about the spring outlook, as indicated by the discount to the cash index built into April futures. While such discounts aren't unusual, the fact that June futures were trading less than $5 premium to the February contract as it expired is rather rare. Over the past 10 years, the June cash peak has averaged $15.00 above the February high. We strongly suspect the swine industry is anticipating a fresh surge in hog supplies during spring, which would explain the modest summer premiums. We tend to think the spring-summer market could prove quite strong, especially if the two pork packing plants scheduled to open in July do so on time. Ironically, recent talk of a bacon shortage could power a premature first-quarter rally, which would probably stifle spring-summer consumer demand and limit the usual mid-year hog market advance.

FEEDER CATTLE

USDA issued its annual Cattle Inventory Report in late January. An estimate of the feeder cattle supply outside feedlots as of January 1, which is calculated from the inventory totals, indicates calf and yearling numbers at 26.6 million head, up 2.2% from a year ago. The added supply will likely keep pressure on prices again in 2017. Even so, feeder prices tend to strengthen from late winter through the spring and summer. The CME feeder cattle index has drifted lower since mid-January, dropping about $5/cwt to $128/cwt. Prices should establish a seasonal low within the next few weeks and begin a gradual recovery. Feedlot buying interest should be solid as feeding margins are expected to improve this year. As always, much depends upon events in the fed cattle market.

DAIRY

Late last summer USDA indicated a strong acceleration of the long-term upward trend in the U.S. dairy cow herd, but negated the seeming increase on subsequent reports. However, the USDA's January Milk Production Report revised the November cow herd up 8,000 and added another 11,000 in December. The December average reached 9.358 million head, the highest since 1999 at the latest. This certainly appears to be the start of a vigorous growth trend in response to the sustained milk and product strength witnessed in late 2016. USDA stated December 2016 U.S. milk production at 17.859 billion pounds (up 2.2% annually) and boosted its 2017 forecast to 217.4 billion, up 2.3% from 2016, in its February WASDE report. Although dairy demand apparently remains quite robust, this suggests increasing pressure upon prices.