March 2013 – Crop Market Update
Public Policy Department
Budget & Economic Analysis Team

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The General Economy

The sequester has now been in place for nearly two weeks at this writing and last I checked, the sky was still in place, airplanes were still flying and cattle were still being harvested. For all of the evils that have been placed at the feet of this relatively small effort at deficit reduction, there may well be some good if it is possible for us to take a little time and understand the message.

Recall that we got into this mess as a result of the first debt limit extension under the Obama administration. The negotiations to raise that debt limit went on for months and became the subject of a book by Robert Woodward titled Price of Politics. This book has raised some controversy by clearly laying the responsibility for suggesting a sequester mechanism within the White House. It is frankly a very depressing read. For pages after pages the White House and the House Republicans, in the form of Speaker Boehner, spend days and days talking past one another, with neither side really listening to the other. Options that one side supports today are off the table by the end of the negotiations. Coming out of those discussions, however, was the creation of the so-called Super Committee that was given the task of either finding $1.2 trillion in deficit reduction actions – could have been a combination of spending cuts and revenue increases – or the government would face a sequester starting in January, 2013.

The Super Committee failed miserably.

The sequester mechanism starts with the $1.2 trillion target for 2013 through 2021. Congress – always more than willing to give itself credit for work not yet completed – recognized that if the deficit was to be reduced, then there would be less interest payments needed. So right off the bat, they gave themselves $219 billion in credit for reductions in those interest payments, dropping the total amount they were looking for to $984 billion over the 9 years. This was divided in half between defense and non-defense programs, meaning each side of the split needs $492 billion spread evenly over the 9 years or $54.5 billion per year.

But with the fiscal cliff package, Congress said, 'whoa, we can't start those cuts in January,' moved the start of the sequester back to March 1 and lowered the annual total needed to $85.3 billion. Again, this is divided in half so defense takes $42.7 billion and non-defense takes a similar $42.7 billion nick. And you will have any number of pundits saying this amounts to only a 2.5 percent reduction in the overall spending levels, so what is the big deal? And these pundits are not wrong. In the grand scheme of the federal budget, these are very minor cuts.

The big deal is the seven pages of very small type that is part of the Budget Control Act that details all of the programs that are exempt from a sequester. These range from wages for our military personnel (who is going to argue with that one) to Supplemental Nutrition Assistance Program benefits, from Conservation Reserve Program contracts (getting pretty close to meddling here) to a limit of only 2 percent on Medicare payments. This piles these cuts up on all the other programs on the table.

Take Defense spending for example. As already discussed, military pay is exempt from the sequester. This will back the effect of the cuts up almost entirely into research, development and acquisitions. And those categories will take nearly an 8 percent hit. Cuts are allowed to Medicare, but are limited to no more than 2 percent of overall spending, again, backing up the 'fair share' into other programs. And to top things off, $1.8 trillion of federal spending is totally exempt from cuts. Read this mainly as entitlement programs.

And none of this talks about tax expenditures which are tax cuts that come very close to being direct subsidies.

Let's be very clear about this, reducing government spending and getting our deficit back into control is a good thing. Over the long term, any number of studies show that lower government debt leads to higher economic growth. When the government doesn't have to completely overwhelm the credit markets as it is doing now, the rest of the economy can access credit and make the investments the market needs. Remember all the old stories of crowding out.

There will be an economic drag in the short term, however. Recall that the formula for GDP is given as the sum of consumptive expenditures (what you spend on goods and services), net investment (businesses building or drawing down inventory or buying new computers), net exports, and government consumptive expenditures – like when they buy airplanes, paper, or gasoline. Over the next few years, it is very likely that government consumptive expenditures will pull the economy down by around half a percent from what growth would have otherwise been. But over a ten year period of time, we will more than make up for this drag through the other parts of the economy.

In the mean time, the real debate needs to come back to all components of government spending, entitlements included. And yes, probably some things on the other side of the ledger as well. To date, all of these cuts have been focused on that one slice of government – essentially the discretionary spending accounts. It is time we took on the rest of the pie.

Crop Update

The March *WASDE* was not expected to provide dramatic changes to the Supply and Use balance sheets because the first survey on *Prospective Plantings* and the latest quarterly *Grain Stocks* survey will not be reported until March 29. In general, the report offered some surprises, as well as some disappointments in changes that were not made, based on expectations before the report was released.

The pre-report forecasts were for a slight increase in corn ending stocks because corn exports remain very sluggish. The *WASDE* reduced the projected corn exports by 75 million bushels to 825 million bushels. Recall that the 2010-11 corn exports were 1.834 billion bushels so corn exports are projected to be reduced by 55 percent from the 2010-11 marketing-year level. The other surprise was an increase in feed use by 100 million bushels to 4.55 billion bushels. This adjustment was surprising as the grain stocks survey will be released later this month and it is rare for adjustments to be made so close to the release of this stocks report. The projected ending stocks did not change from the February report and remains at 632 million bushels which is a 5.6 percent stocks-use or about 20 days of corn available on September 1. The projected marketing-year average price was reduced by $0.10 per bushel to $7.10 which would be a record if achieved.

The March *WASDE* made no adjustments to the soybean balance sheet and kept ending stocks at 125 million bushels. The pre-report projections were for a slight decrease in ending-stocks reflecting the very strong pace of exports and news that ships in Brazil are waiting nearly two months to load soybeans. Some buyers may switch to the U.S. even at a higher price to source their soybeans faster. The U.S. marketing-year average price is projected at $14.30 per bushel with the report reducing the lower and upper projected prices by $0.25 per bushel. Soybean stocks are still at historically low levels with the projected stocks-use at 4.06 percent or about 15 days of inventory available at the end of the marketing-year.

The report reduced wheat exports by 25 million bushels to 1.025 billion bushels which increased ending-stocks by 25 million bushels. The pre-report forecasts expected an increase in stocks, but the March *WASDE* projection of 716 million bushels was slightly larger than the pre-report forecasts. The projected wheat stocks-use ratio is 29.5 percent or about 107 days of wheat available at the end of the marketing-year. The projected marketing-year average price was reduced $0.10 per bushel to $7.80 per bushel.

Cotton received some good news with an increase in projected exports by 250 thousand bales to a projected 12.75 million bales. This reduces ending-stocks to 4.2 million bales which is lower than the pre-report forecasts. Cotton has a 26 percent stocks-use ratio or about 94 days of cotton available at the end of the marketing-year which weighs on this market. The projected marketing-year average price increased slightly to $0.715 per bale.

What Happens if Corn Yields Rebound?

The latest USDA Agricultural Baseline Projections, released in February, provided a wake-up call to the market on how a return to trend-yields would impact prices over the next decade. These projections are used more as a budgeting tool for congress; however, the market looks at the forecasts as a projection of future supply and demand information during a time when U.S.

farmers are on the verge of planting. USDA is projecting that a return to trend-yields will allow ending stocks to increase and the corn stocks-use ratio could exceed 16 percent for the next two years and remain above 10 percent over the rest of the ten-year period. As a result, the risk premium for corn, due to tight stocks, will be reduced and the projected farm price would decrease from $7.60 in 2012-13 to $4.10 by 2013-14.

Table 1. Break-Even Prices Needed to Cover Variable Costs Plus Cash Rent and Revenue Protection Crop Insurance Projected Price for 2013.

	Break-Even Price			RP Projected Price	
State	**Rot. Corn**	**Con. Corn**	**Soybeans**	**Corn**	**Soybeans**
	---------- Non-Irrigated Production ----------				
Iowa	$3.78	$4.42	$9.52	$5.65	$12.87
Indiana	$4.15	$4.58	$8.39	$5.65	$12.87
SE North Dakota	$3.55		$7.18	$5.65	$12.87
SE Kansas	$3.89		$8.37	$5.65	$12.87
Arkansas	$3.46		$8.67	$5.82	$13.05
	---------- Irrigated Production ----------				
South Georgia	$3.53		$5.72	$6.05	$13.10
Mississippi Delta	$3.41		$5.75	$5.82	$13.05
Arkansas	$3.43		$5.95	$5.82	$13.05
Western Kansas	$3.10		$5.29	$5.65	$12.87

Source: Land Grant University Crop Extension Budgets

Table 1 illustrates the price needed to cover all production costs plus cash rents as determined by the most recent crop enterprise budgets developed by various Land Grant Universities. Recall that these budgets assume a projected yield and the production practices used are scaled to obtain this yield assuming normal weather. For example, the Iowa rotation corn budget suggests that corn sold at $3.78 per bushel would just cover all production costs and cash rent. The point is that a return to trend yields would allow stocks to rebuild and prices to decline. There would be a greater risk of a greatly reduced profit margin and some may not be able to fully cover production costs and cash rent payments. This risk appears greater for corn than soybeans although the ratcheting up of production costs and cash rents over the last six years is also impacting soybean profitability

Another point is the 2013 projected price for revenue protection insurance. Recognize that the protection provided to a producer depends upon the actual production history (APH) yield as well as the coverage level purchased. The projected price is determined by the futures market and the market has provided a price for producers to guarantee a large percentage of their expected revenue to reduce the risk of either a smaller crop or lower prices.

Table 2. Potential 2013-14 Corn Production, Ending Stocks and Market-Year Prices

	Thousand Acres		
Planted Acres	98,500	98,500	98,500
Harvested Acres	89,635	89,635	89,635
Yield	140	150	160
	Million Bushels		
Production	12,549	13,445	14,342
Beginning Stocks	632	632	632
Imports	10	10	10
Total Supply	13,191	14,087	14,984
Total Use	12,050	12,300	12,600
Ending Stocks	1,141	1,787	2,384
Stocks-Use	9.5%	14.5%	18.9%
Expected Price	$5.47	$5.27	$5.14
Price Range	$4.31 - $6.62	$3.97 - $6.57	$3.75 - $6.53

To further belabor this point, Table 2 provides the projected production, ending-stocks, and market-year prices for three potential corn yields – 140, 150, and 160 bushels per acre. Notice that a yield approaching the trend of 160 bushels per acre would produce a record crop of 14.3 billion bushels and provide the potential for stocks to increase substantially.

The expected price in this model is likely too high if stocks were to increase significantly as the model doesn't do a good job in forecasting either a sharp increase or decrease in price. Therefore, the price range is relevant in better understanding potential prices. You can see from Table 2 that a corn price in the low $4 range is not beyond the realm of possibility. While it is too early to pencil in a record crop, the market has been begging for acreage and begging for increased production. Remember the old proverb, "Be careful what you wish for," as a record crop and replenished stocks will place greater strain on profitability. Producers need to consider all available risk management tools – especially revenue protection insurance to guarantee a portion of their crop revenue.