

WILL THE GOOD TIMES LAST?

by Maud Roucan-Kane and Dr. Mike Boehlje

Editor's Note: This is the second article in a two-part series.

There's an ongoing debate within production agriculture. Most people agree that the industry is experiencing some of the best times in recent years; however, they question and disagree on whether the current trend is sustainable. Coming to a consensus on when change will occur is difficult, but assessing the supply and demand forces shaping the situation will provide some insight.

In our first column, we described how three forces — ethanol and energy, the exchange rate and global production — are affecting the industry. The final two forces — food and fuel, along with weather and wheat — add further implications for continuing strong prices and incomes for the next three to five years.

FORCE 4: FOOD AND FUEL

Before the recent growth in energy-driven demand for agricultural raw materials, U.S. producers looked at other countries' increasing dependence on animal proteins for long-term opportunity. As Asian consumers' incomes grew, they began transitioning from a vegetable-based diet to one fortified with animal protein. Those consumers now face higher prices at the store due to the increased cost of production, namely feed costs, for animal proteins driven by the biofuel industry. At higher

prices, many consumers in the developing world can't afford animal products.

If the biofuel industry's demand for agricultural raw materials continues to keep meat and animal product prices high, the growth in global animal protein consumption may be inhibited. This potential slowdown, combined with the increased worldwide expansion of animal production, and the increasingly skeptical attitude in the U.S. about the value of exports and free trade, present serious challenges to U.S. participation in global animal protein markets.

FORCE 5: WEATHER AND WHEAT

Weather continues to have an impact on production and supplies, even in spite of new genetics. In fact, world wheat output has suffered from yield-reducing weather events over the past five years. Weather patterns are clearly unpredictable, but a continued occurrence of weather-shortened wheat crops is not likely.

Ultimately, the crop to watch in terms of acreage, yield and production may be wheat. Current high prices encourage expansion in global production. Plus, wheat is more adaptable to a variety of soil and weather conditions, thus, production capacity expansion is much less limited compared to corn and soybeans. The global weather conditions also may not be as unfavorable to wheat production in the near future as they have been in the past. The old pricing adage "wheat caps corn" may soon hold true again. For example, if increased wheat supplies would result in prices declining to \$5, it would again be difficult to maintain corn prices much above \$4.50 because of the 10% higher nutritional value (energy basis) of wheat in livestock rations.

AND THE LIST CONTINUES

Other forces within agriculture, as well as outside the industry, could certainly have important implications for continuing strong prices

and incomes over the next three to five years. For example, a worldwide recession with high food prices would have a dampening effect on global food demand, prices and incomes. Weather-shortened global supplies could result in even further increases in commodity prices and incomes. Persistent rising cost of fertilizer, seed and chemicals, along with higher land prices and rents, will continue to eat away at the high margins we now see in crop production — total costs to produce the 2008 crop have increased by 50% to 60% from last year to approximately \$4 for corn, \$9 for soybeans and \$6 for wheat.

Along with tracking the various forces affecting the supply and demand of agricultural inputs and outputs, agri-marketers should prepare for a possible cyclical downturn. Continuing to manage relationships with loyal customers and maintaining a high level of service to help them through this period of uncertainty will allow agrimarketers to preserve a strong customer base. By focusing on preparation, instead of the ongoing debate, agri-marketers can position their businesses to weather the increased volatility that will accompany these good times. **AM**



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