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AGRIBANK INSIGHTS

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Livestock and Dairy Doldrums:

Domestic production, U.S. dollar, disease potential and consumer behavior drive markets in 2016

AgriThought

AgriBank Farm Credit Bank provides financial solutions to meet the needs of production agriculture in America's heartland. We feature our research and analysis in AgriBank Insights as part of our AgriThought initiative to help inform the financial decisions among those we serve.

Livestock and dairy margins continue to adjust downward from their record levels set in late 2014, as production increases and export demand declines due to the increasing value of the U.S. dollar. After declining $26.5 billion in 2015, the USDA projects that total U.S. livestock and product receipts will decline another $9.6 billion (-2.5 percent) in 2016.

Contents

Highlights

- **TURKEYS ARE THE EXCEPTION.** Receipts are projected to be down in all of the major categories with the exception of turkeys, where the rebuilding of flock numbers and prices remaining near historic highs are expected to grow cash receipts by $300 million (+5.3 percent).
- **EGGS: THE BIGGEST LOSER.** The largest percentage loser is projected to be eggs (-16.1 percent), as the industry comes off record growth in 2015 due to the shortage caused by bird flu and record high prices.
- **MANY FACTORS AT PLAY IN 2016.** Major themes affecting the livestock and dairy sector in 2016 include domestic production cycles and price response, the increasing dollar's negative impact on exports, the potential for additional disease events and their disruption of supplies and exports, and domestic consumer behavior with respect to saving and consumption.

Livestock and Dairy: Still Declining from Record Margins in 2014

After a strong finish to 2014 with record profit margins for many livestock and dairy producers across the board, 2015 was, for the most part, a transition year to the reality of lower margins. This assessment reflects the occasional supply disruption due to disease outbreaks such as the high path avian influenza (HPAI, or bird flu), which devastated a significant portion of U.S. turkey and egg production in the upper Midwest and had a serious negative impact on exports of U.S. poultry products across the board.

According to the USDA Economic Research Service (ERS)*, total cash receipts for animal agriculture and products fell by slightly over $26.5 billion in 2015, down 12.5 percent. Among the major product categories, dairy products and milk had the largest decline at slightly over $13.9 billion (-28.2 percent) followed by hogs with a decline of almost $6.9 billion (-26.0 percent), beef cattle with a decline of slightly over $4.6 billion (-5.7 percent), and broilers with a decline of slightly over $4.1 billion (-12.6 percent). Egg producers saw an increase of $2.45 billion (+24.1 percent), and turkeys saw an increase of $370 million (+6.9 percent) due to reduced supplies and sharply higher prices because of the bird-flu outbreak.

Figure 1 illustrates a margin over feed cost (MOFC) profitability index that AgriBank calculates on a monthly basis using USDA-NASS *Agricultural Prices* monthly data for the livestock profitability ratios. Each MOFC series is normalized to a 0-100 scale with 0 being the minimum value since January 1991 and 100 being the maximum value. Then the geometric average of the normalized values is plotted on the graph. So, for example, the minimum value in August 2008 of 0.8 would strongly indicate that all of the livestock and dairy categories were at or very close to their all-time minimums since January 1991. This is also the month where corn and soybean prices were at their record-high values after the summer drought of 2012, so the feed-cost component of MOFC across the board was extremely high for all livestock categories. Likewise, the October 2014 value of 99.1 indicates that most margins were near their all-time highs, as livestock and milk prices were at all-time highs across the board, and feed costs had retreated significantly from the August 2012 highs. As 2015 ended, the index had dropped to near the 60th percentile, which is still above the long-term average (50) but down considerably from the start of the year.

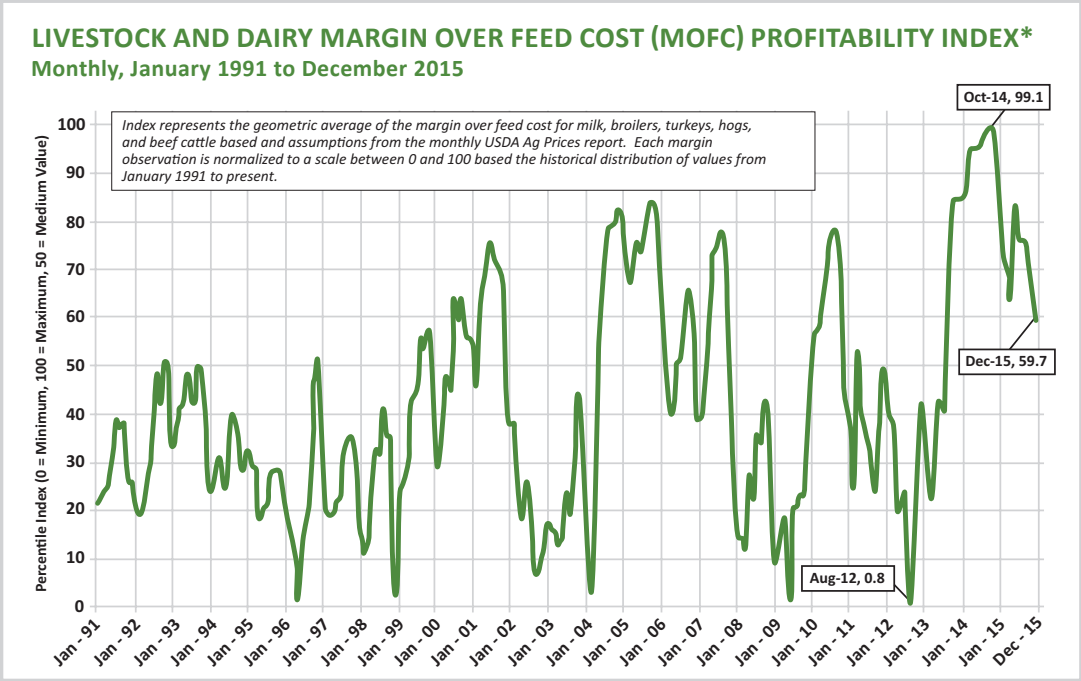

Figure 1

*USDA-ERS, U.S. and State Farm Income and Wealth Statistics, Feb. 9, 2016

In 2016, the dominant themes will be the impact of several major categories entering or continuing their expansion phases of the production cycle, the increasing dollar's negative impact on exports, the potential for additional disease events and their disruption of supplies and exports, and domestic consumer behavior with respect to saving and consumption. Additionally, the continuing theme of the reorientation of the global developing economies to a slower future growth path will also have an influence on the U.S. livestock and dairy sectors. As always, weather will be a wildcard in the outlook picture with the potential for a follow-on La Niña to the current historically strong El Niño. These weather patterns could portend major drought conditions across the Corn Belt region in late summer.

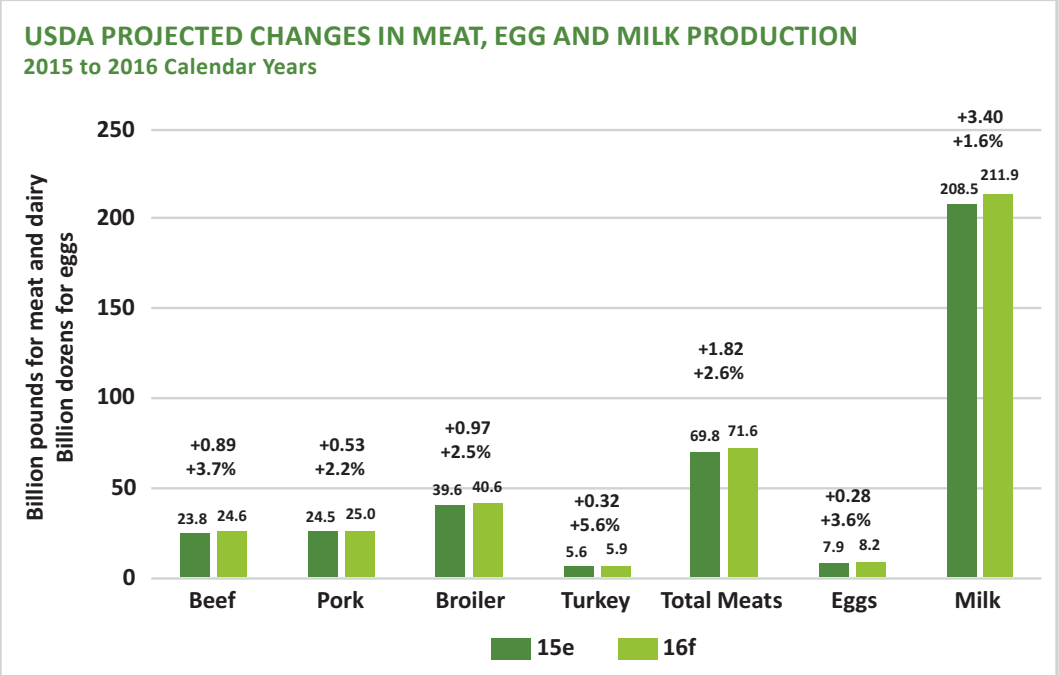

Figure 2

Figure 2 shows the USDA's latest projections for meat, egg, and dairy production for 2015 and 2016 from the February 2016 *World Agricultural Supply and Demand Estimates* (WASDE) report. The absolute (in billion pounds for meats and dairy, in billion dozens for eggs) and percent changes from 2015 to 2016 are shown above the bars. All of the categories are projected to have significant production increases for the coming year. For beef, it would represent the largest increase in 10 years. For pork, broilers and dairy, it would build on the strong increases from 2015. For turkeys and eggs, it would represent a recovery from the bird-flu impacted production losses from last year.

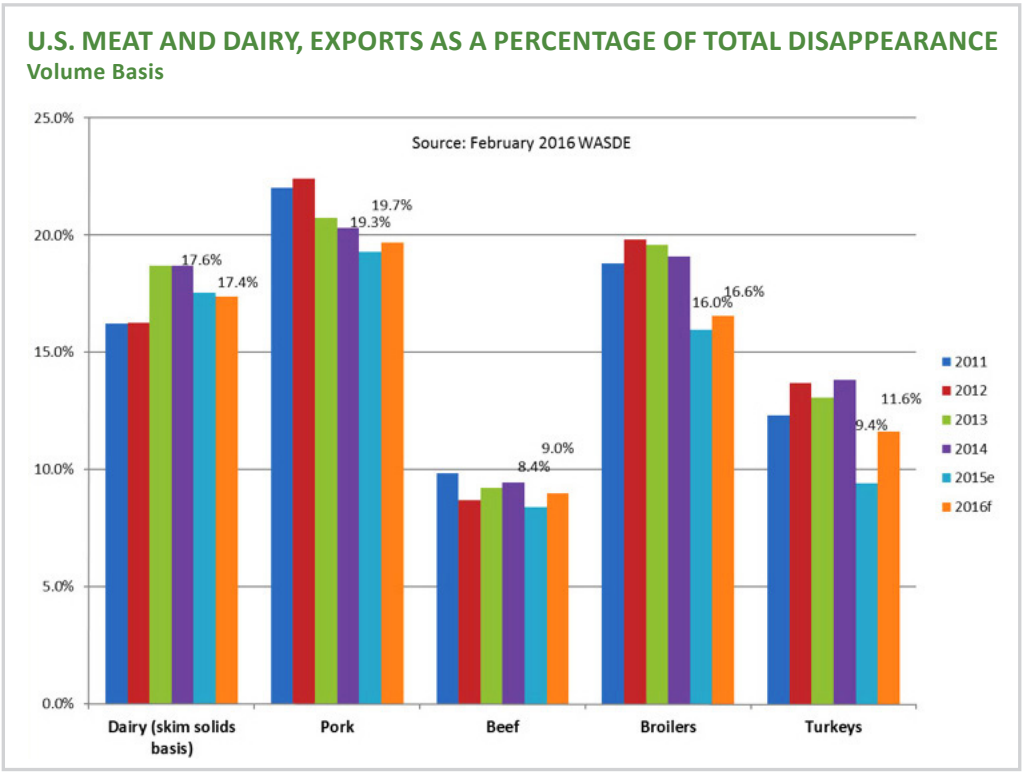

Figure 3

The increasing U.S. dollar has a negative impact on agricultural exports, and the importance of the export sector to U.S. livestock and dairy markets varies. Figure 3 shows exports as a percentage of total disappearance for the past five calendar years and the projected percentage for 2016. Pork, dairy and broilers are the most dependent on exports, while beef and turkeys are less dependent. However, the percentages are projected to increase for all categories except dairy.

Despite the U.S. economy continuing its slow recovery from the Great Recession, consumer wages and spending remain stagnant. Figure 4 illustrates the annualized monthly growth rate in personal spending for 2015. Two of the three months in the fourth quarter had no growth at all.

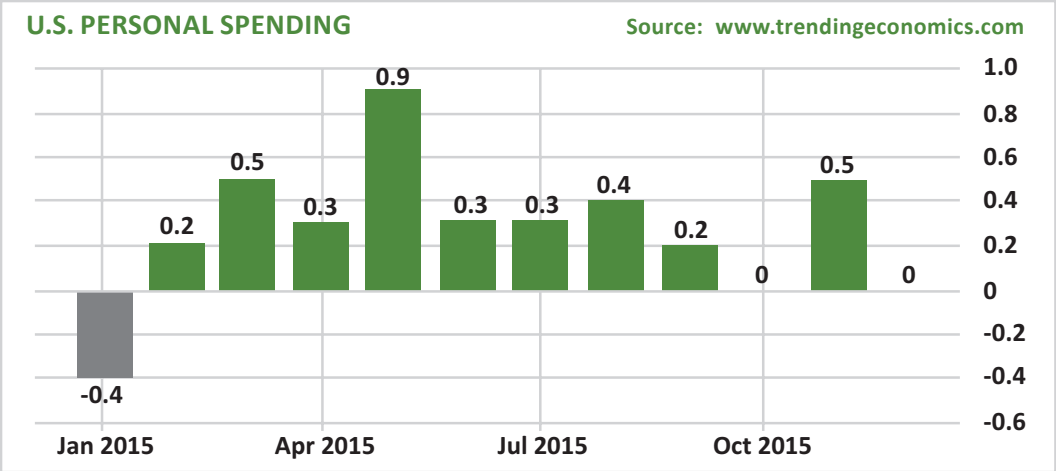

Figure 4

In terms of the impact on the food industry, Figure 5 plots the Restaurant Performance Index (RPI), which is published monthly by the National Restaurant Association. Values above 100 indicate industry expansion, while values below 100 indicate contraction. In December, the value fell below 100 for the first time since February 2013.

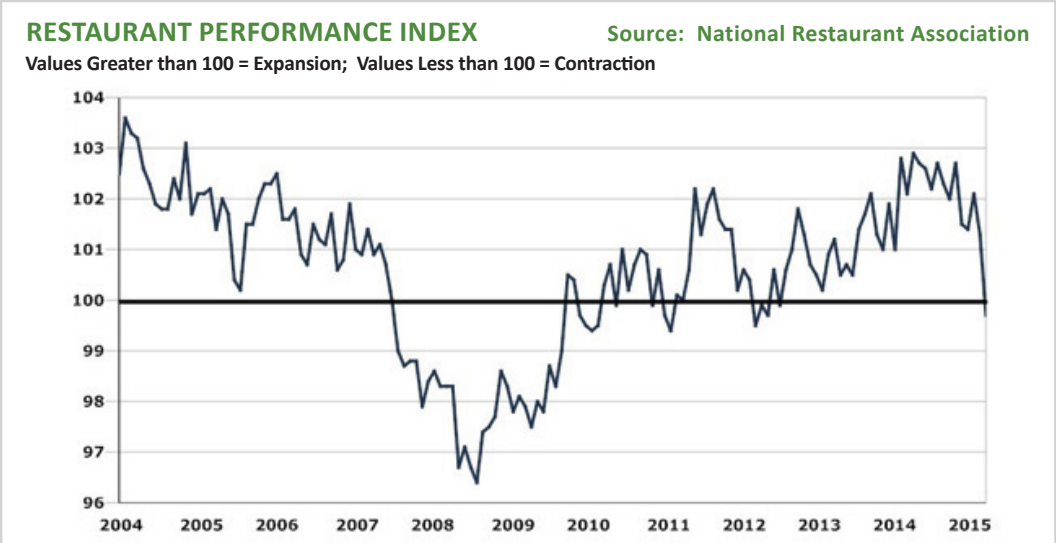

Figure 5

With the onset of the recession, savings rates spiked significantly higher as consumers started setting aside reserves to weather whatever uncertainty lay ahead. Rates came down sharply in 2013 to mid-2014 as the signs of an economic recovery and lower crude oil prices elevated consumer confidence. However, as economic growth has cooled, particularly overseas, the rate of savings has started to creep higher again. Also, the impact of global terrorism and other negative global events has likely shaped consumer attitudes since the end of 2015.

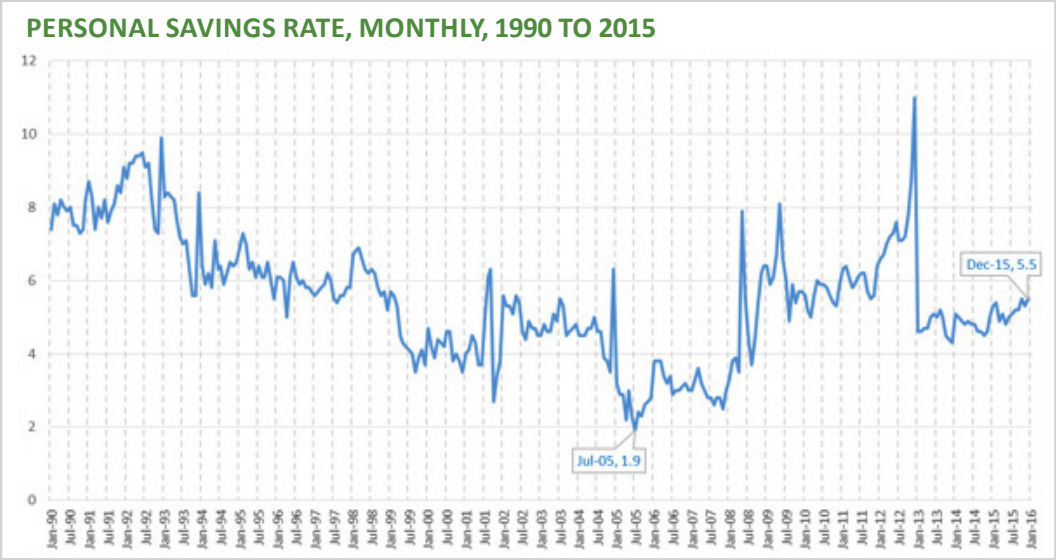

Figure 6

Each of the following sections provides a review and outlook for each of the major categories of meat and dairy. The price forecasts come from the most recent February 2016 WASDE release. Aggregate receipts data comes from the February 2016 *U.S. and State Farm Income and Wealth Statistics* release.

Beef Cattle

The Jan. 1, 2016 USDA Cattle report left little doubt that the U.S. beef herd has entered an expansion phase. Total beef cows and heifers that had calved were up for the second straight year at 30.3 million head, a 4 percent increase over the Jan. 1, 2015 inventory (see Figure 7). Heifers that were 500 pounds and over and retained for beef cow replacement were up 3 percent over last year. The number of steers 500 pounds and over was up 4 percent, while the number of bulls was up 2 percent. The total number of cattle on feed was up 1 percent compared to a year earlier.

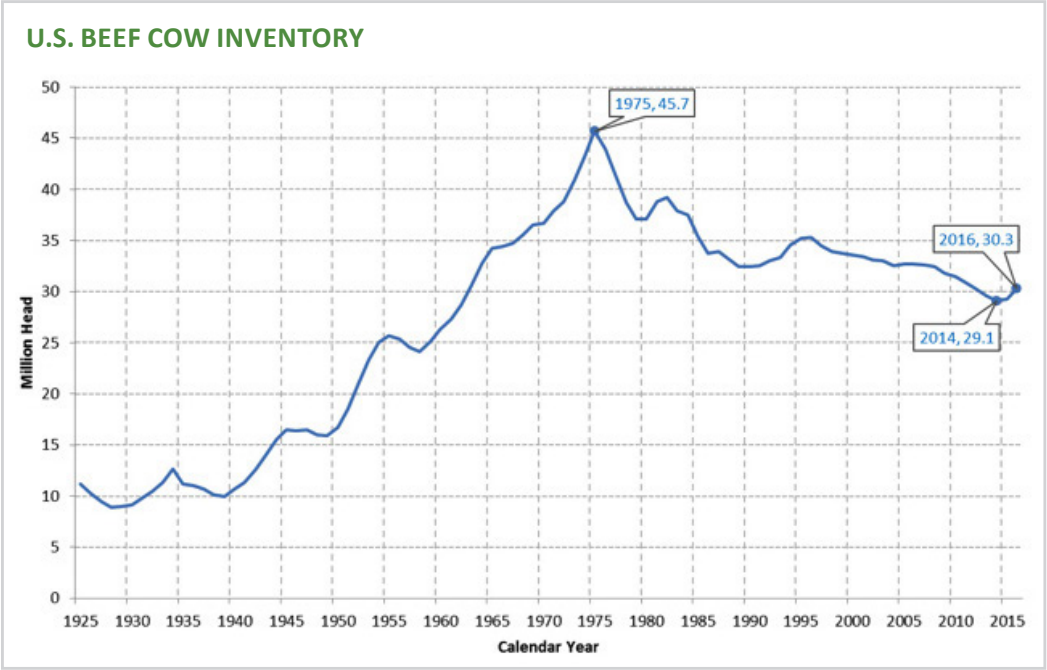

Figure 7

Cold storage stocks of beef began 2016 at the second-largest level in the past 15 years at 513.9 million pounds, surpassed only by the 524.6 billion pounds at the start of 2003. This is 15.6 percent larger than the beginning stocks for 2015. This increase in stocks occurred although commercial beef production was down in 2015 for the fifth-consecutive year, declining 2.2 percent to 23.7 billion pounds. Commercial slaughter of cattle greater than 500 pounds was down 4.7 percent; however, most of this was due to retained heifers. Heifer slaughter was down 12.3 percent (following 8.2 percent decline in 2015), while steer slaughter was down only 0.3 percent. To make up for the reduced slaughter numbers (as in the previous year), average slaughter weights increased by 30 pounds per head (or 2.2 percent) from 1,331 pounds to 1,361 pounds.

For 2016, the USDA projects a reversal in the five-year declining trend in beef production (Figure 8) with an increase of 3.7 percent for the year. This represents an additional 889 million pounds of beef for the market to absorb over what was estimated to have been produced in 2015.

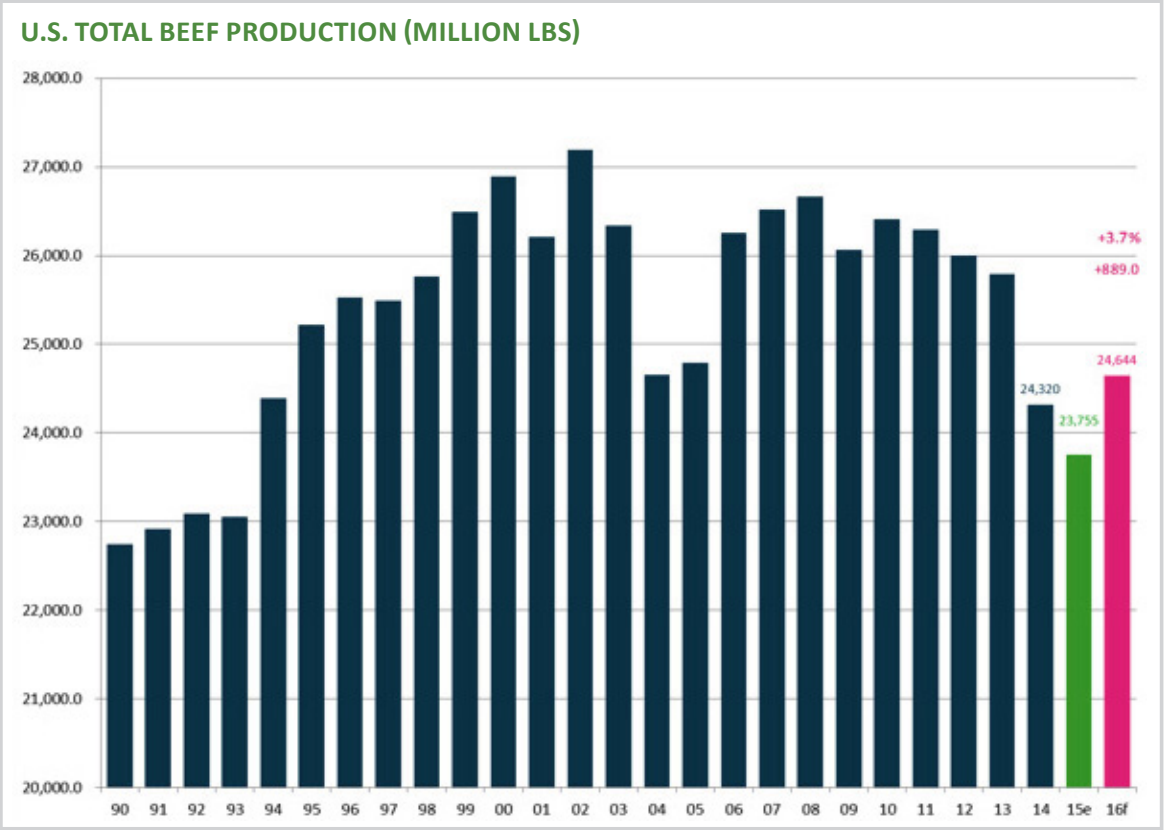

Figure 8

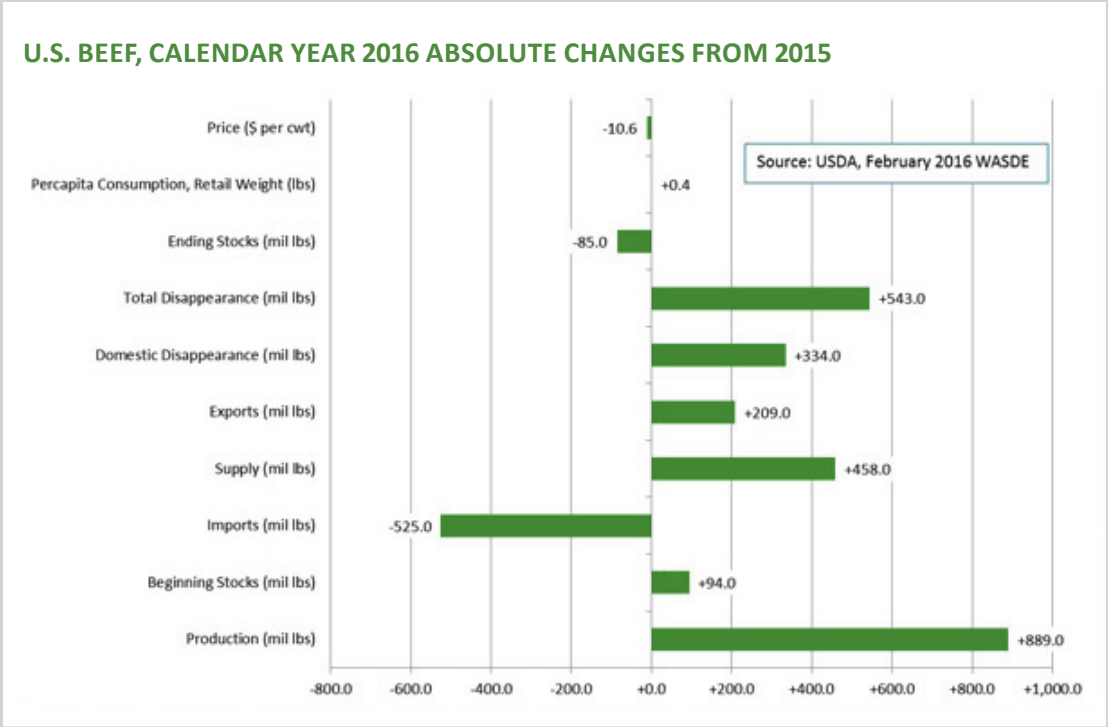

Figure 9

Figure 9 shows how the USDA anticipates the market will absorb this extra production in 2016. A big portion (525 million pounds) will be offset by reduced imports. This is due to decreased demand for lean processing beef from Australia and the overall higher domestic beef production. Exports are projected to increase by 209 million pounds due to higher global beef demand and lower prices. Domestic disappearance is also projected to increase by 334 million pounds on higher per capita consumption due to lower prices on the domestic market.

Overall, fed cattle prices are projected to decline moderately in 2016, losing on average a little over a dime per pound, but will remain at what can be considered a historically high level at around $135 to $140 per hundredweight.

In the cow-calf/backgrounding sector, producers saw feeder cattle prices come down sharply from the record highs during the second half of 2015 (Figure 10). Prices peaked mid-summer at slightly over $230 per hundredweight on the CME par spot value but gave up over $80 by year-end before bouncing back to consolidate in the current $155 to $165 range. The two main reasons for the collapse were the unsustainable negative feedlot margins that reduced demand and the bottoming of the contraction phase in the cattle cycle with calf numbers starting to increase.

Most analysts still project positive margins for a majority of cow-calf producers in 2016.

Despite the decline in feeder cattle prices, most analysts still project positive margins for a majority of cow-calf producers in 2016, as pasture and forage conditions remain good across most of the Plains and Corn Belt region. As of the final pasture and range condition report issued on Oct. 25, 2015, the USDA-NASS reported 40 percent of the acreage in good to very good condition versus 25 percent in poor to very poor condition. As of Feb. 9, 2016, the U.S. Drought Monitor shows abnormally dry to moderate drought conditions across portions of Wyoming, Montana and North Dakota with sparse patches of abnormally dry conditions in Texas, Colorado and Kansas.

With the decline in feeder cattle prices and continued lower feed costs, most predictions are for improved cattle feedlot margins in 2016. The Iowa State University Cattle Crush Margin model (http://www2.econ.iastate.edu/margins/cattlecrush.htm) for finishing 750 pound yearling calves to 1,250 pounds finished weight forecasts positive margins for cattle coming to market in May 2016 and continuing through the end of the year. Professor Glynn Tonsor of Kansas State University (http://www.agmanager.info/livestock/marketing/outlook/newsletters/Figure1.asp) is not quite as optimistic but projects feedlot margins returning close to breakeven by the middle of the year.

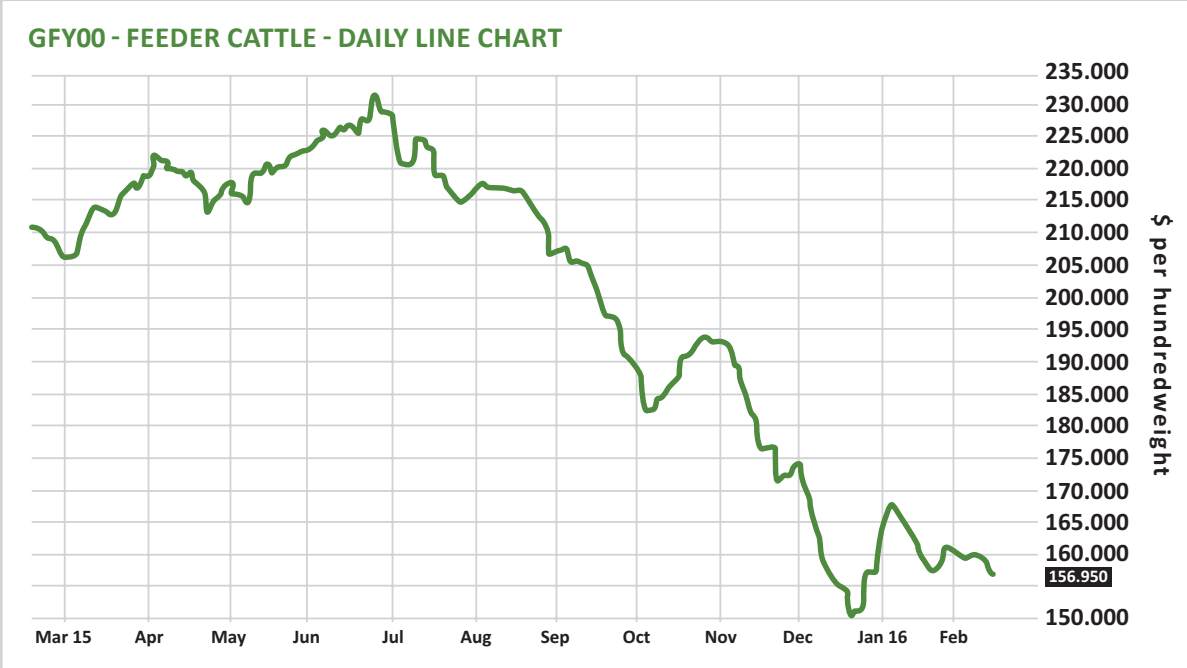

Figure 10

Pork

Calendar-year 2015 saw hog prices fall to their lowest levels since 2010 as hog numbers recovered from the PED virus (PEDv) outbreak of 2014. However, average weights did not come down proportionally, resulting in an oversupply of pork on the market. A higher dollar also resulted in a lackluster growth in export demand, which did not recover to its pre-PEDv level in 2015. Domestic disappearance was the lone bright spot, jumping sharply to a record 20.7 billion pounds as per capita disappearance rose from 46.4 to 49.9 pounds per person after falling in 2014.

Cold storage stocks of pork at the beginning of 2016 stand at 545.6 million pound, an increase of 8.3 percent over the beginning of 2015. This level of beginning stocks is still smaller than 2009 (555.6), 2013 (551.5) and 2014 (554.3). Commercial pork production in 2015 totaled 24.5 billion pounds, up 7.3 percent from the previous year. Commercial hog slaughter numbers were up 8.0 percent in 2015 at 115.4 million head, and average slaughter weights were down 1.6 pounds per head (down 0.6 percent) from 284.8 to 283.2 pounds.

The USDA *Quarterly Hogs and Pigs* reports indicated that the Dec. 1 inventory of all hogs and pigs stood at 68.3 million head, an increase of 523,000 (up 0.77 percent) over the same period in 2015. The farrowings for the three months leading up to Dec. 1 were down almost 4.0 percent, while intentions for the first and second quarters of 2016 are down 1.9 and 0.1 percent, respectively. The pig crop for the three months leading up to Dec. 1, 2015 was down 1.2 percent at 30.3 million head, despite pigs per litter increasing by 0.3 head, or 2.9 percent from the previous year – continuing a pattern of sustained strong increases in the pigs per litter seasonal metric from year to year.

The February 2016 WASDE projected balance table changes for calendar-year 2016 are shown in Figure 11. Total supplies of pork are projected to increase a net 449 million pounds based on a 531 million pound gain in production added to the 29 million gain in beginning stocks and a 111 million decline in pork imports due to a decline in Canadian swine inventories and excess packer demand in western Canada. However, the repeal of Country of Origin (COOL) legislation could result in higher revisions to the import numbers in the future, which would be reinforced by the higher dollar.

On the demand side of the ledger, USDA expects disappearance to increase by 438 million pounds with most of the increase coming from the domestic market (up 254 million), while exports are projected to increase by 184 million pounds. Overall, ending stocks are projected to increase by 11 million pounds with prices falling by $2.70 to a calendar year average of $47.50 per hundredweight (national base barrow / gilt price, live equivalent 51-52 percent lean).

After a big increase in 2015, the USDA is projecting that per capita disappearance of pork will take a smaller sustained increase in 2016 (Figure 12) as it remains competitively priced versus other meats in the domestic market. In the export market, Mexico was the primary volume destination for U.S. pork in 2015, taking 1.555 billion pounds (31.5 percent) of U.S. exports. Japan was the No. 2 volume destination with 1.209 billion pounds (24.5 percent of 2015 exports). On a total value basis, the rankings were reversed as Japan paid a higher unit price ($1.33/pound) versus Mexico ($0.72/pound). Canada, South Korea and China-Hong Kong ranked 3rd, 4th and 5th on both a volume and value basis, respectively. Pork exports in 2015 were helped by a strong finish to the year as December totals were 9 percent higher than the year earlier.

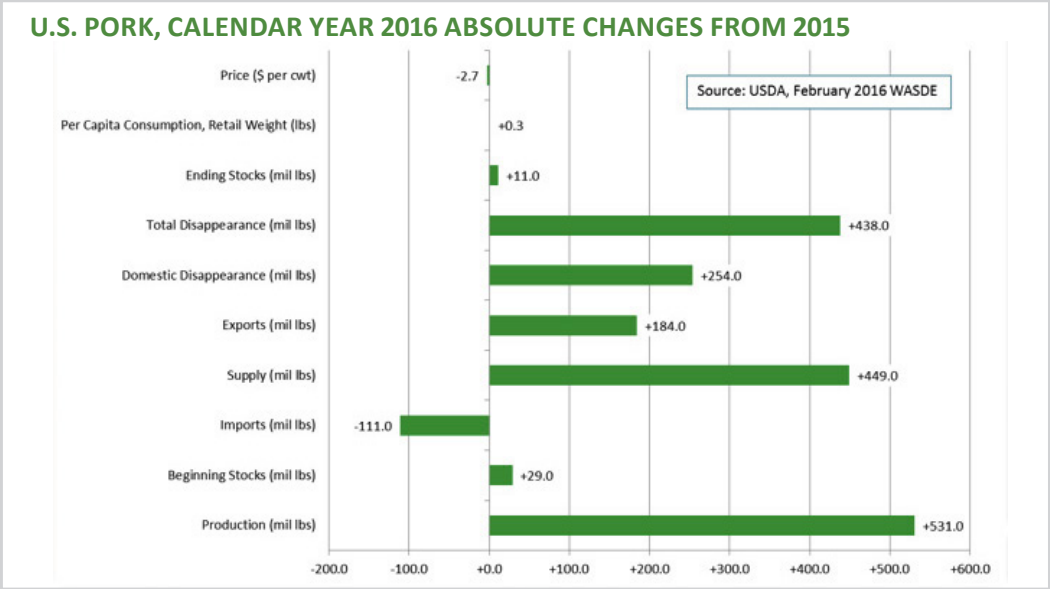

Figure 11

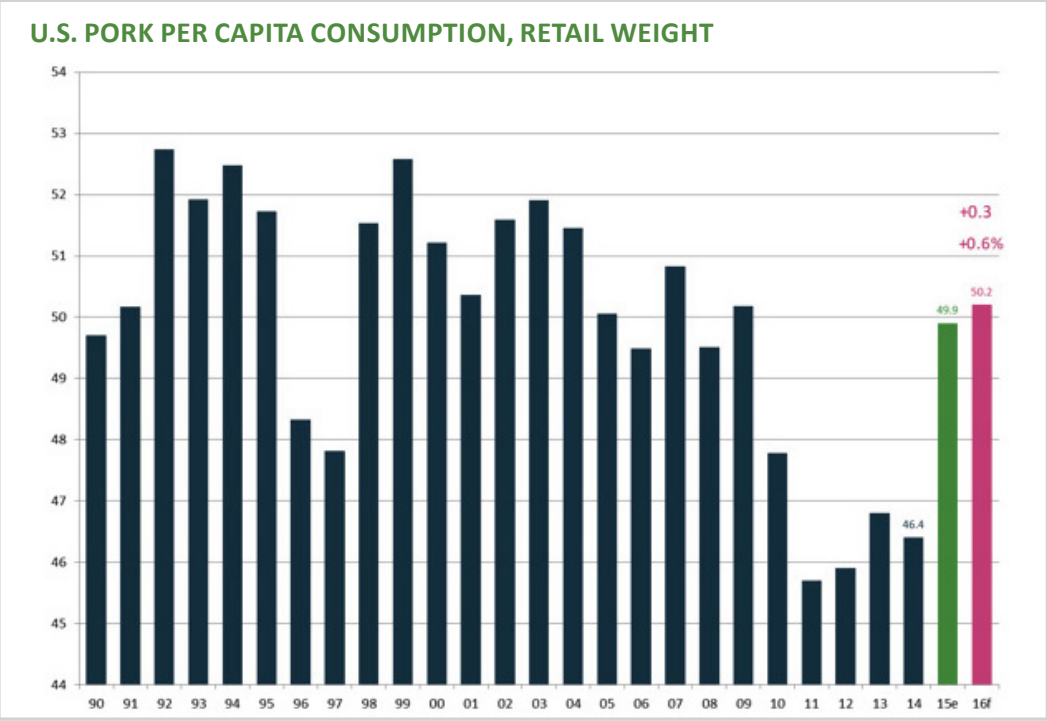

Figure 12

Export growth is expected to increase due to the rescinding of COOL along with increased demand from China, which is looking to diversify its imports. The key wildcards in 2016 will be the strength or weakness of the U.S. dollar going forward, the Chinese economy, and whether any progress is made on the Trans Pacific Partnership (TPP) trade agreement, which is viewed as very friendly to U.S. pork.

Despite the lower projected prices, projected margins still look mostly positive for hog producers through most of 2016 and into 2017. The ISU Projected Wean to Finish Crush Margin (http://www2.econ.iastate.edu/margins/swinecrush.htm), which is based on finishing feeder pigs to 200 pounds finished carcass weight, is mostly in the upper $30 to lower $60 range through December 2016. Most analysts project profits in the positive range for most of 2016, particularly as some new domestic plant capacity comes online later in the year and in the coming years.

Poultry and Eggs

The broiler industry is projected to continue expanding production for the fourth-consecutive year, while the turkey and egg industries recover from the onslaught of the bird-flu outbreak of 2015 and keep their fingers crossed that spring 2016 will not be a repeat. So far, the only cases of bird flu in the United States in 2016 have been part of an outbreak of an unrelated strain that impacted nine turkey and one egg-layer flock in Dubois County, Indiana on Jan. 15 and 16. The flocks were quickly quarantined and depopulated, and the outbreak appears to be completely contained. However, some countries did slap on export restrictions in response to this incident.

Cold storage stocks of broilers at the beginning of 2016 are at their largest level in 10 years at 832.8 million pounds, which is up 22.5 percent compared to the beginning of 2015. Add in cold storage stocks for turkey (up 3.4 percent), and cold storage stocks for all poultry is at its largest level since 2009 at 1.04 billion pounds (up 18.7 percent over 2015). Cold storage stocks of eggs, at 40.9 million dozen, are up 33.2 percent compared to a year earlier. Therefore, 2016 began with no shortage of available stocks in the poultry and eggs departments.

In 2015, hatch egg production was at its highest level since 2007 (Figure 13), according to data from the USDA *Chicken and Eggs* report, growing for the third-consecutive year to 13.34 billion eggs. Some of this growth was to replace birds lost in the layer flock due the bird-flu outbreak. However, eggs going into broiler production still grew by 3.8 percent to 12.33 billion. During the first seven weeks of 2016, broiler egg sets are 0.5 percent ahead of last year's pace, according to data from the USDA's weekly *Broiler Hatchery* report. Turkey egg placements were down 3.9 percent in 2015 at 320.8 million and through the first two months of 2016 were down 3.4 percent compared to a year earlier, according to data from the USDA's *Turkey Hatchery* report.

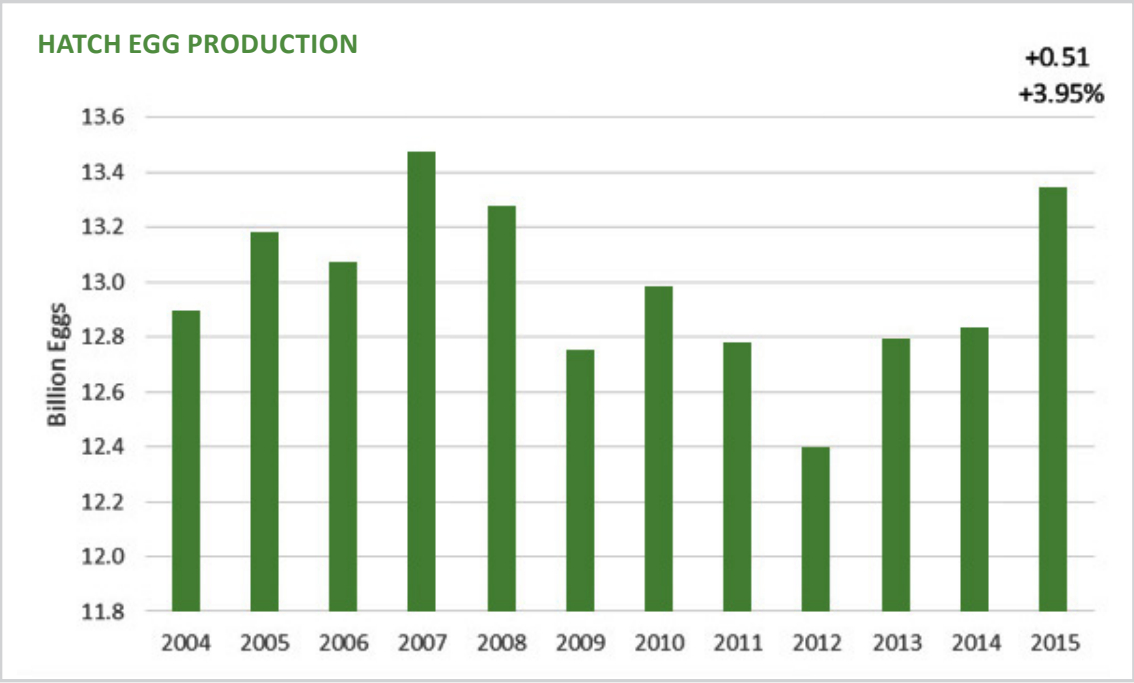

Figure 13

The February 2016 USDA WASDE projections for the balance table changes in 2016 supply and disappearance for broilers are shown in Figure 14. Total supplies are projected to increase just over 1.1 billion pounds, while disappearance is projected to more than offset the supply increase at slightly over 1.25 billion pounds, with domestic disappearance increasing 815 million pounds based on a 1.7 pounds per person increase in per capita disappearance, and exports increasing by 446 million pounds. This is projected to draw down ending stocks by over 140 million pounds. Despite the decline in stocks, average prices are still projected to decline by 3 cents to 87.5 cents per pound – mainly driven by the combination of increased per capita availability of poultry, high value of the U.S. dollar and declining prices of substitute meats in the domestic markets.

For turkeys, the February WASDE projects a 322 million pound increase in available supplies based on a 317 million pound increase in production, a 7 million pound in increase in beginning stocks and 2 million pound decline in imports. Total disappearance is projected to increase by 272 million pounds with exports making up the majority of the increase at 157 million pounds, and domestic disappearance up 115 million on a 0.2 pounds per person per capita consumption increase. Ending stocks are projected to build by 50 million pounds, while prices are projected to come off the historic 2015 highs by declining 2.2 cents to $1.14 per pound – still the second-highest in recent history.

For eggs, total stocks are projected to be drawn down by a little over 5 million dozen, as supplies increase by 289 million and are more than offset by disappearance of 294 million. Disappearance is mostly domestic consumption (+262 million) followed by hatching use (+20 million) and exports (+12 million). Exports typically make up a small portion of total U.S. disappearance – an average of 4.2 percent in the past five years and 3.2 percent over the past 20 years. Per capita disappearance is projected to increase by 8.2 shell egg equivalents per person; however, prices are projected to come down from last year's record levels, declining 36.3 cents to an average of $1.455 per dozen – still the second-highest price in recent history.

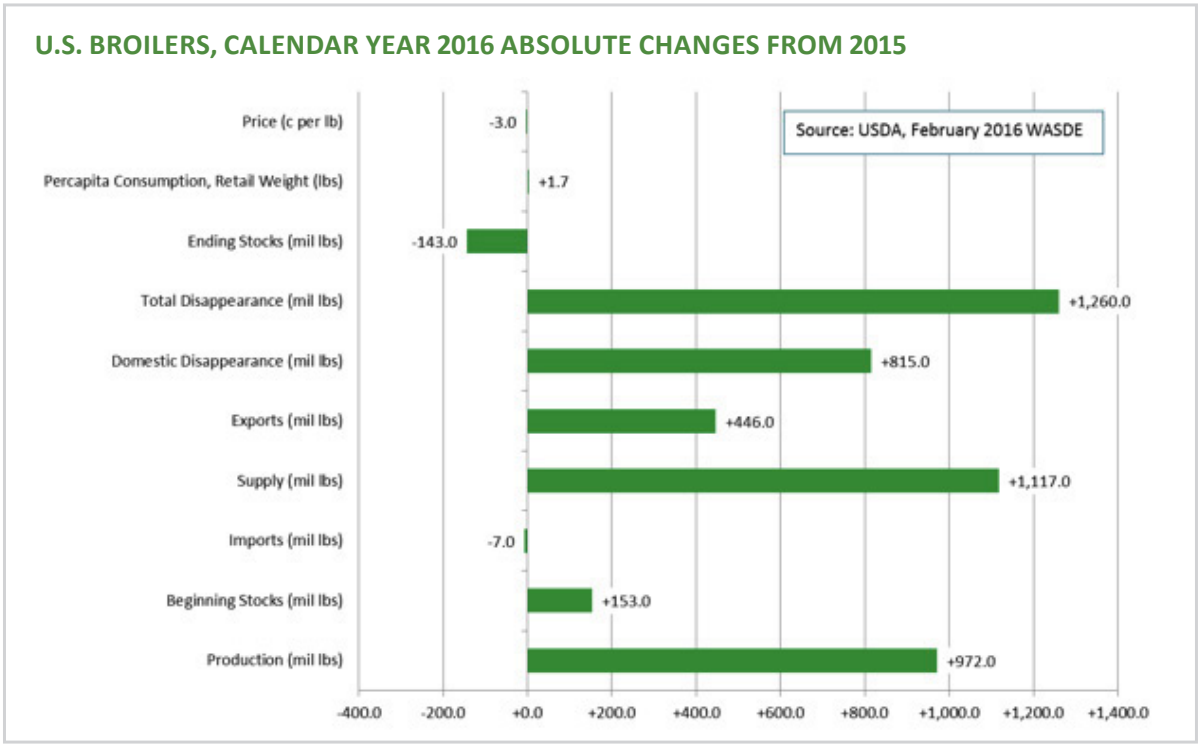

Figure 14

Removing the bird-flu scenario, the outlook for margins in the poultry industry looks mostly positive in 2016 as feed costs remain constrained.

The key downside risk to the poultry industry in 2016 would be another bird-flu outbreak that is widespread and results in significant reductions in exports. In the 2015 outbreak, broiler exports were affected even though the outbreak was almost completely confined to the turkey and egg-layer industry. The broiler industry depends more heavily on the export market for a significant share of its export demand compared to turkeys and eggs. In 2015, the turkey industry was able to successfully make up the reduced export demand through reduced supplies on the domestic market. The economic impact was essentially limited only to those operations that were directly affected by the virus. The same can be said for the egg-layer industry. A secondary threat to the market is potential oversupply on the domestic and global market given the current high stocks and production levels – particularly for broilers. However, this has not reached a critical level yet, according to most industry experts, but it is concerning to see some numbers approaching 2007 levels.

Removing the bird-flu scenario, the outlook for margins in the poultry industry looks mostly positive in 2016 as feed costs remain constrained. Exports that were curtailed in 2015 should rebound for broilers, and historically high price levels for turkey and eggs should allow plenty of cushion in producer margins.

Dairy

The price that a producer receives for milk under the U.S. federal marketing order system is basically driven by the prices of four dairy products: cheese, butter, nonfat dry milk and dry whey as determined by the USDA-NASS in its weekly surveys of production plants. A variety of miscellaneous adjustments to the formula prices are based on where the producer delivers milk, the components of the milk, etc. But the overall fundamentals are going to be driven by the supply/demand fundamentals of cheese, butter, nonfat dry milk (milk powders) and dry whey (whey powders). Increasingly, the international marketplace has become more dominant in analyzing these markets – particularly for the milk and whey powders, which have a longer shelf life and can easily be stored and transported.

Figure 15 shows the percentage of total disappearance going into exports by product type for U.S. dairy from 1990 through 2015. Cheese and butter, while increasing in recent years, have mostly been less than 10 percent, while the milk and whey powders have gone from 10-15 percent to 40-60 percent over this time period.

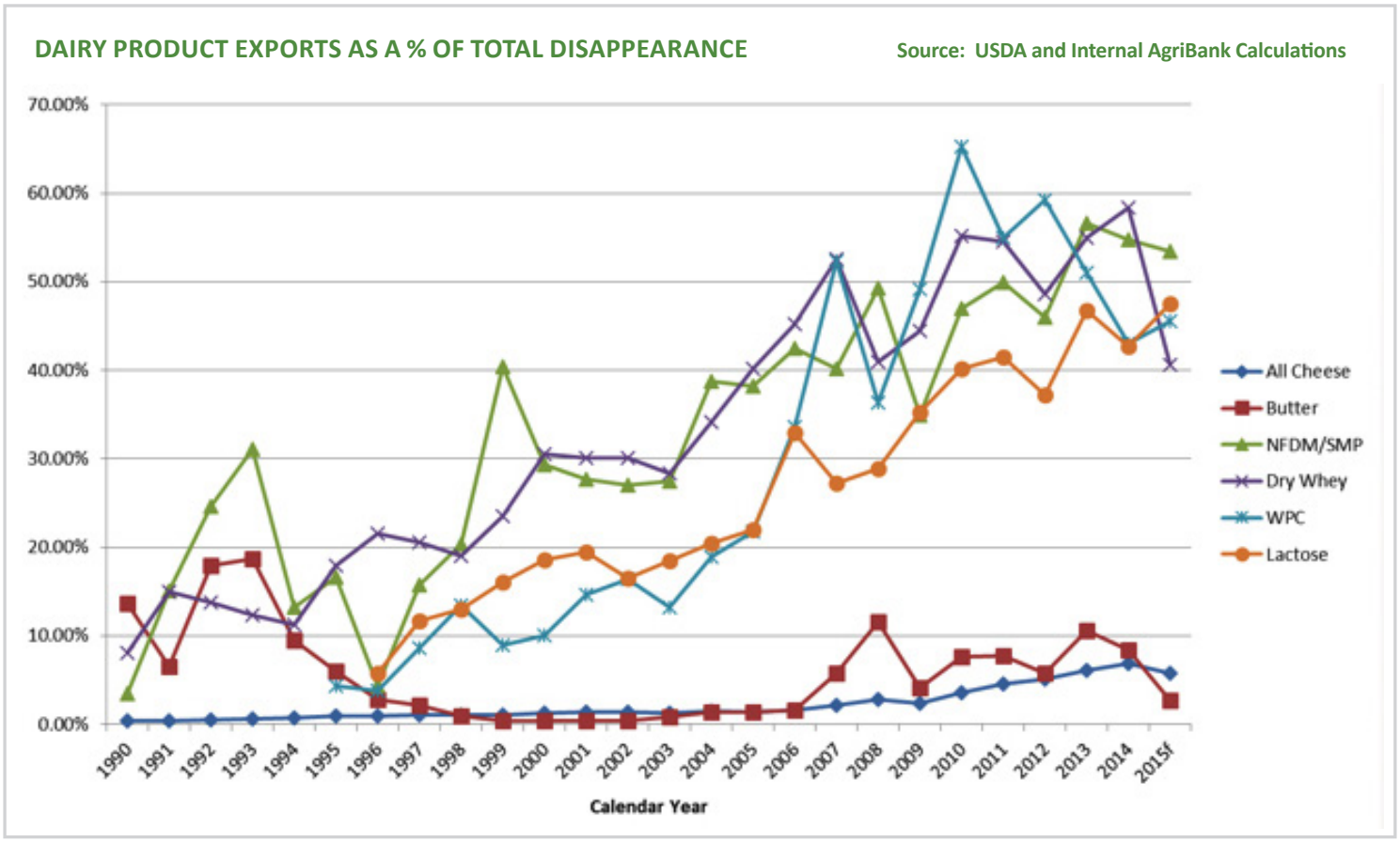

Figure 15

The NASS all milk price received by producers is primarily correlated with the Class III market order price, which is primarily driven by cheese prices. Of secondary importance in many market order territories is Class IV, which is primarily driven by butter and nonfat dry milk prices. Fluid milk (Class I) also influences some market order territories but is essentially lagged Class III or Class IV, depending on the maximum skim component. In terms of domestic per capita consumption, cheese is the primary category that has grown over the past 40 years (Figure 16). Since 1974, per capita cheese domestic disappearance in the United States has increased at an annualized rate of 2.2 percent. The only other category with positive growth has been butter, at 0.5 percent over the same time period. All of the other major categories exhibited slow but uneven negative growth over the same period, although for some (such as dried milk and whey products) this is more a function of increased export demand over time.

The preceding data support the notion that domestic demand for cheese and butter is the fundamental support to the price for milk in the United States, while additional value is generated by exports of milk and whey powders to overseas markets. The record prices in 2014 were primarily the result of heavy exports of nonfat dry milk/skim milk powder to China combined with sharp demand for cheese and butter in the domestic market. In 2015, one of the legs of the three-legged stool was knocked out in that the powder export demand went away, and the dairy market depended on the domestic cheese and butter markets for support. In the first half of 2016, the dairy market will continue to need domestic cheese and butter to carry the markets in order to maintain producer profitability. Fortunately for dairy producers, the Dairy Margin Protection Program (DMPP) offers some downside protection.

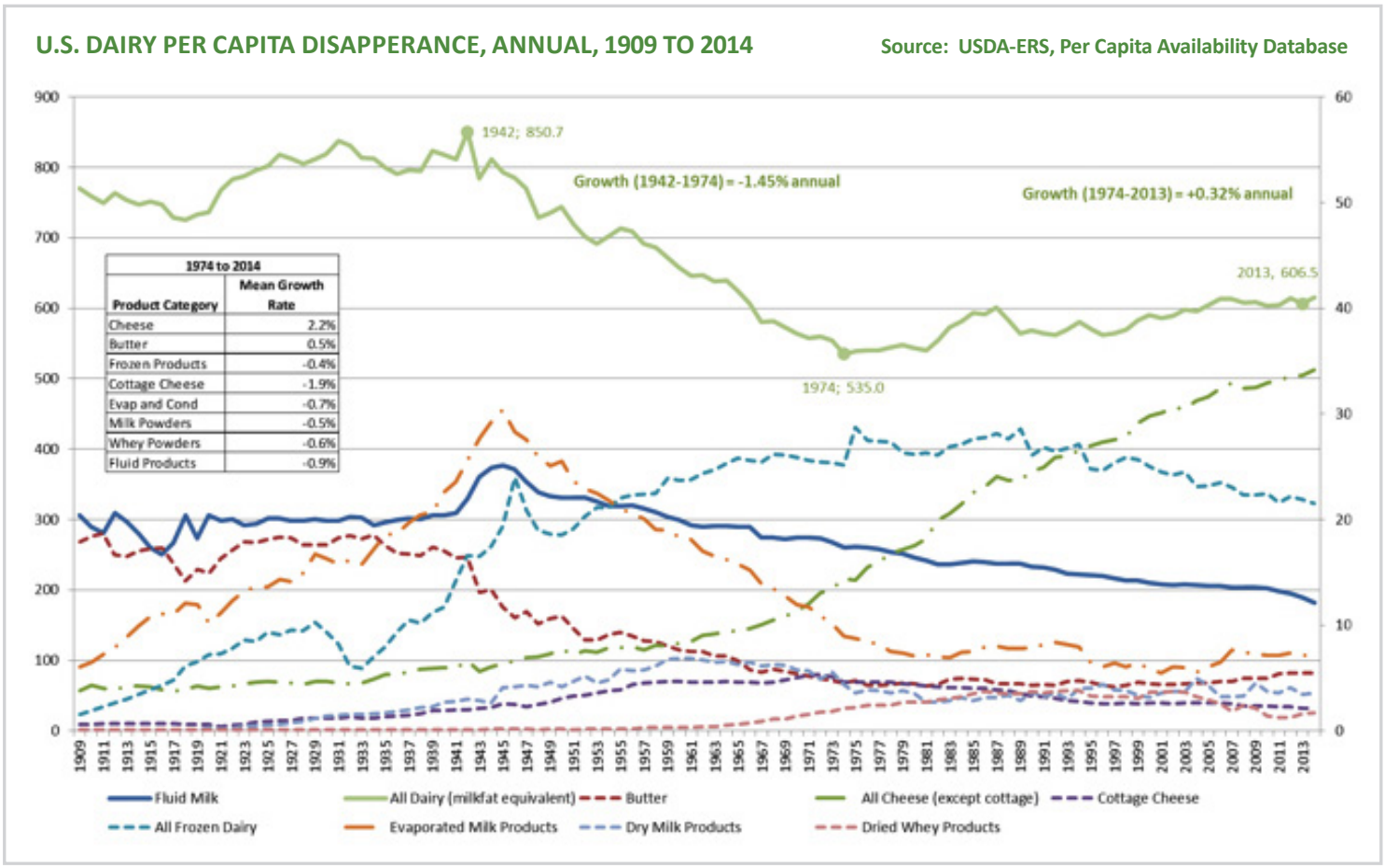

Figure 16

For 2016, the USDA predicts (in the February 2016 WASDE) the average milk cow herd to decline by 20,000 head (-0.2 percent) to 9.295 million. Production per cow is projected to increase by 1.8 percent (or 412 pounds per head) to 22,795 pounds on the year. Total milk marketed for the year is projected at 210.9 billion pounds, a 1.6 percent increase over the 207.5 billion pounds estimated to have been produced in 2015. Commercial exports are projected to decline by 5.7 percent on a milkfat basis and 0.8 percent on a skim solids basis. Domestic commercial use is projected to increase by 3.6 percent on a milkfat basis and 2.5 percent on a skim solids basis. Overall price per pound product forecasts for 2016 (percent changes in parentheses from 2015) are $1.585 (-3.6 percent) for cheddar cheese, $0.245 (-35.5 percent) for dry whey, $2.04 (-1.3 percent) for butter, and $0.805 (-10.8 percent) for nonfat dry milk. The milk price forecasts (all per hundredweight) are $14.40 (-8.9 percent) for Class III, $13.40 (-6.6 percent) for Class IV, and $15.65 (-8.4 percent) for the all milk price.

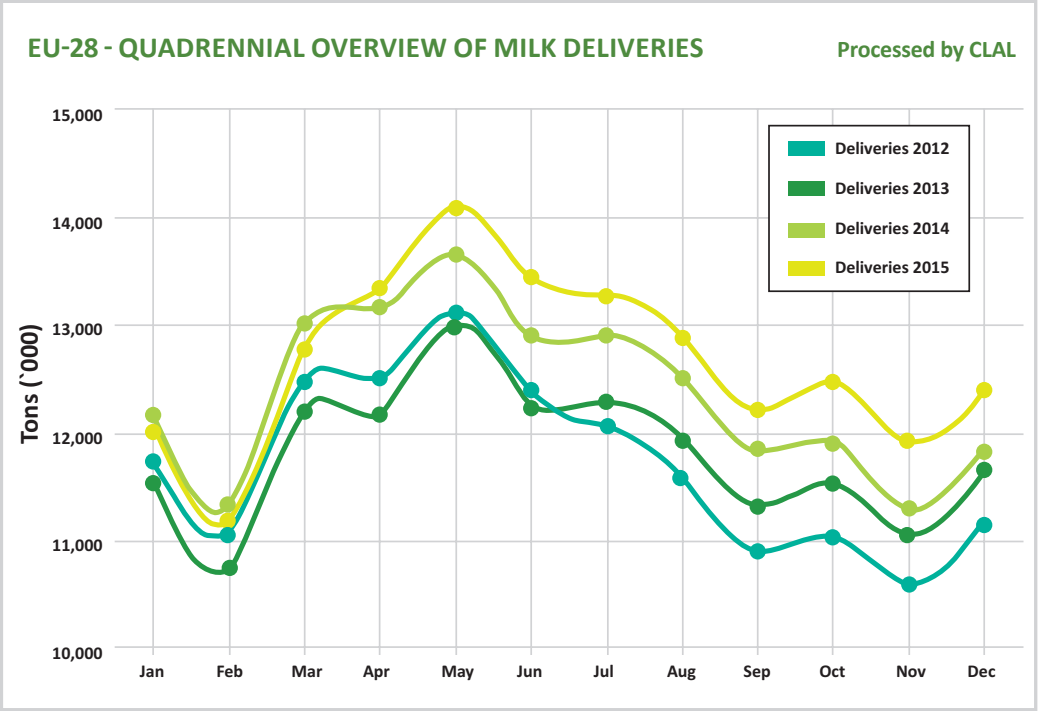

Figure 17

One of the driving factors behind the current bearish global dairy outlook has been the complete phase-out of the EU milk quota regime as of March 31, 2105 and the huge increase in EU28 milk production during the second half of the 2015 milk production season (Figure 17). As with the United States, the EU season runs from January through December, and milk deliveries for 2015 totaled 152.1 million metric tons, which was 2.5 percent larger than 2014 (which was 4.8 percent larger than 2013). Russia has traditionally been one of the primary export markets for EU dairy products; however, with the Russian embargo on EU dairy products still in place, these exports need to find a new home, which often is a traditional U.S. export market.

Most of the strong growth in recent EU milk production is due to a mild winter across northern Europe, farmgate prices that have held steady despite declining product prices and the removal of the quota. Countries with the largest growth from 2014 to 2015 are Ireland (+13.3 percent), Luxembourg (+8.8 percent), Belgium (+7.2 percent) and the Netherlands (+6.8 percent).

The New Zealand milk production season runs from June through May, so we are almost three-quarters of the way through the 2015/16 production season. The country is composed to two major islands – the North Island (approximately 62 percent of dairy production) and the South Island (remaining 38 percent of dairy production). New Zealand is the 9th-largest milk producer in the world. However, because of its small population, it exports a very high percentage (95 percent) of the milk that is produced – making it one of the leading exporters in the global marketplace.

Through the first eight months of the 2015/16 production season (June 2015 through January 2016), New Zealand milk production was down approximately 2.7 percent compared to the same period in the 2014/15 season. This is due to excessively dry conditions on the North Island sparked by this year's strong El Niño weather event, which usually results in hot, dry conditions across much of the Oceania region. Lately, both islands have been receiving good rainfall, and the trend is toward improving soil moisture conditions. Therefore, an improvement in New Zealand milk production to round out the end of the season is not out of the question.

Overall, there is little to support any level of optimism regarding a strong boost to U.S. dairy exports in 2016 with more downside risk that there is upside opportunity. EU28 production is likely to remain strong, and New Zealand has been hit by the current El Niño. However, the worst is over with minimal damage done, and the Chinese economy is slowly lurching forward with no positive spasm in dairy powder demand (as seen in 2013/14) visible on the horizon. Therefore, U.S. dairy producers cannot count on milk and whey powder prices to boost their farmgate price. In the domestic market, the saving grace for dairy is that American consumers love their cheese and butter. Class II products (ice cream, cottage cheese, yogurt, etc.) have their ups and downs but have been mostly steady in recent years. Fluid milk has been a losing battle for the industry with per capita consumption declining steadily for nearly 20 years at an alarming rate.

A major concern for domestic dairy has to be the sharp decline in the Restaurant Performance Index (RPI) at the end of 2015 (Figure 5). Cheese and butter are particularly sensitive to the away-from-home consumption market, and if this decline in restaurant performance becomes more than a temporary blip on the radar screen, then dairy could be in real trouble in 2016. That being said, USDA price projections for dairy in 2016 look reasonable as a baseline for the year with most of the risk to the downside.

Current futures-based projections indicate dairy margin over feed costs that could fall below the generally accepted $8.00 per hundredweight benchmark considered as the general breakeven level. It is also the highest margin election level that can be selected under the DMPP program. The USDA price forecast of $14.40 per hundredweight for Class III is about $0.60 below what is generally considered the breakeven equivalent benchmark level of around $15.00 per hundredweight. Of course, this assumes average feed costs, and lower than average feed costs are expected this year.

In the domestic market, the saving grace for dairy is that American consumers love their cheese and butter.

Summary

Livestock and dairy margins continue to adjust downward from their record levels set in late 2014 as production increases and export demand declines due to the increasing value of the U.S. dollar. After declining $26.5 billion in 2015, USDA projects that total U.S. livestock and product receipts will decline another $9.6 billion in 2016 (-2.5 percent).

Receipts are projected to be down in all of the major categories with the exception of turkeys, where the rebuilding of flock numbers and prices remaining near historic highs is expected to grow cash receipts by $300 million (+5.3 percent). The largest percentage loser is projected to be eggs (-16.1 percent); however, this is due to the industry coming off of record growth in 2015 due to the shortage caused by bird flu and record high prices. Dairy is projected to decline by 6.4 percent as milk prices move lower on stagnant demand and higher production. Beef cattle have entered a new expansion phase in the seven- to 10-year cattle cycle, and feeder cattle prices have come back to earth; therefore, cash receipts are projected to decline by 3.9 percent. Pork production growth will exceed decent growth in demand with prices moving below the five-year lows established last year; therefore, cash receipts are projected to decline by 5.1 percent. Finally, broilers will benefit from a recovery of lost exports due to bird-flu outbreak last year; however, a combination of heavy production growth and the high dollar will push prices lower and result in a slight decline of 0.7 percent in forecasted cash receipts.

For 2016, the major factors influencing livestock and dairy will be:

- Domestic production cycles and price response
- The increasing dollar's negative impact on exports
- The potential for additional disease events and their disruption of supplies and exports
- Domestic consumer behavior with respect to saving and consumption

Secondary themes include the reorientation of the global developing economies as they face a slower future economic growth trajectory. Weather is always a wildcard in the outlook picture with the potential for a follow-on La Niña to the current historically strong El Niño a possibility that could portend major drought conditions across the Corn Belt region late in the coming growing season.

Livestock and dairy margins continue to adjust downward from their record levels set in late 2014 as production increases and export demand declines due to the increasing value of the U.S. dollar.

For more Information

Whether farmers, ranchers or other borrowers are looking to expand operations, take advantage of new opportunities or manage day-today operations, Farm Credit can help them access needed financing. Farm Credit offers a wide range of competitive agricultural loans — including operating, equipment, real estate and home mortgage — to help meet their operation's unique needs. Offerings include multiple interest rate options and cash management solutions that can help hold down the cost of borrowing. Find a local Farm Credit Association at www.AgriBank.com.

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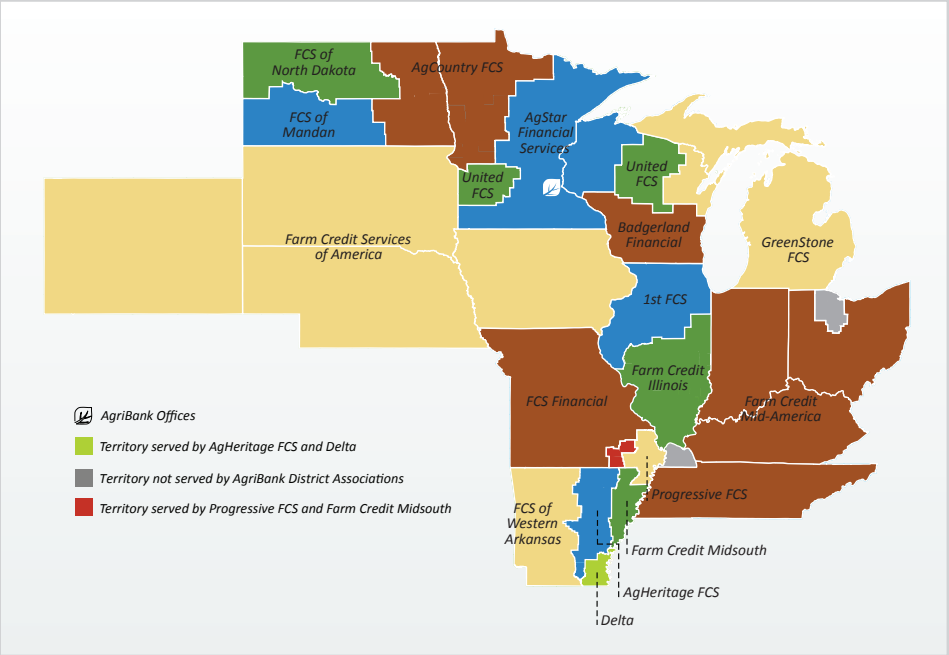
Associations in the AgriBank District



About AgriBank

AgriBank is one of the largest banks within the national Farm Credit System, with nearly $100 billion in total assets. Under the Farm Credit System's cooperative structure, AgriBank is primarily owned by 17 affiliated Farm Credit Associations. The AgriBank District covers America's Midwest, a 15-state area stretching from Wyoming to Ohio and Minnesota to Arkansas. With about half of the nation's cropland located in the AgriBank District, and nearly 100 years of experience, the Bank and its Association owners have significant expertise in providing financial products and services for rural communities and agriculture. For more information, please visit www.AgriBank.com.

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