

November 2007 Economic Analysis Team Market Update



Fertilizer Outlook

By Bob Young, Chief Economist

Introduction

The Fertilizer Institute held their annual outlook conference recently. In keeping with their policy and advice from council, analysts at that meeting no longer talk about price projections for the coming year. Making those projections sure would have made it easier for the rest of us, but would also open them up for collusion or price-fixing charges.

So what's someone to do as they think about input costs for the coming year? About the best one can do at this point is to go back through the fundamentals and consider what major shifts in supply and demand for the fertilizers might be doing over the next several months and determine where the forces might be that would move things one way or the other. Based on a variety of presentations made at the Institute's meetings, there may be a few tidbits one can gather.

Before moving to the specific fertilizer components, the Fertilizer Institute's conference used 88 million acres of corn for their expectations for 2008, with 64.8 and 67.6 million acres of wheat and soybeans respectively.

Nitrogen

The United States used 17.4 million metric tons (MMT) in FY2006/07. Of that, 11.3 MMT were used as fertilizer, 1.7 MMT were exported and 4.4 MMT went for industrial use. With export and industrial usage expected to be relatively constant, the major demand changes will obviously derive mainly from shifts in plantings. The anticipated shift away from corn next year is expected to lower the overall fertilizer usage from 11.7 MMT to 11.4 MMT – a drop of only 2.5%. However, this also assumes a constant application rate of 138 lbs/acre. These higher fertilizer prices are certainly driving producers to

consider some of the most efficient application methods possible, so some decline in that number will also serve to lower demand.

On the supply side, the picture has been undergoing a steady transformation over the last several years. In the 1999/00 season, the United States imported only 31% of its nitrogen needs, producing 69% from domestic sources. For last year, the United States imported 57% to only 43% produced here at home. Expectations are that this trend of greater reliance on imported sources will continue for some time to come as natural gas prices are much higher domestically than is the case in our largest external source of ammonia – Trinidad. Trinidad accounted for 56% of the ammonia imports for the United States and is expected to continue to be the largest supplier for some time to come. There has been a major shift underway between Russia and the Ukraine as Russia has significantly boosted natural gas prices to the Ukraine, taking over ammonia market share from the former member of the Soviet Union.

With only slight declines in nitrogen demand and essentially no growth in supply, prices for nitrogen in the coming year are going to look very similar to those observed in last year's planting season. One reason for weakness is that the infrastructure needed to move such large volumes was thoroughly tested last year, and should be ready to handle the demand with most of the kinks worked through the system.

Phosphates

The International Fertilizer Association expects world phosphate use to rise to just over 40 MMT in the 2007/08 season. Growth in demand should continue around the 3% per year mark throughout much of the rest of the decade due to

strong demand in Asia and Latin America. India has emerged as a major importer of phosphate imports, and given the financial picture of their agricultural sector, is expected to continue to import near record levels. Brazil is also expected to remain a strong importer. Their phosphate imports grew by more than 50% in 2007 and will likely rise a further 5% in 2008.

The United States is a major exporter of phosphates and, due to the import needs of several countries, is expected to see trade continue at a fairly strong pace. Exports moved up 6% in 2006/07 and will likely bounce up even further in the 2007/08 campaign – hitting close to a new record. In the first quarter of this year's cycle, shipments were running 45% higher than at the same time last year. This has led to a significant reduction in phosphate stocks. In September 2006, phosphate stocks were over 1 million short tons. In September 2007 the figure was closer to 800,000 short tons, well below the bottom end of the range observed in the last seven years.

In the United States, higher application rates and additional corn acreage lifted demand in the 2006/07 marketing year by 9%, compared to year earlier levels. Expectations are that use will stay near that level for the 2007/08 cycle.

Like nitrogen, the demand picture if anything will remain in close balance with supplies. In the United States in particular, with stocks well below what has been considered normal over the last several years and exports very strong, prices for phosphate products like nitrogen will probably stay near levels observed last year. If anything, one might expect most of the risk to be on the upside for phosphate prices, particularly if Chinese domestic demand should jump, limiting their export capabilities.

Potash

Since last fall, potash prices have risen \$50 to \$75 per ton. Most potash suppliers are also operating at near to effective capacity rates, limiting the short-term expectations of additional product coming to market. Several new operations are under discussion over the next

three to four years, but for the next year's growing cycle there will need to be a reliance on current plants. Given some recent plant flooding issues, it is even possible one might see some major global supply disruptions that could also lead to some spot market price spikes. Like phosphates, the stocks of potash are also coming into the new growing season at fairly low levels – levels similar to those observed at the end of the 2005 growing season. Chinese, Indian and Brazilian demand is also expected to help support prices near those observed this fall.

The Longer Term Picture

If one looks around the world at where additional fertilizer supplies might be produced, it looks as though markets will remain tight through 2008, possibly into 2009. Additional nitrogen production may come on line in 2009, with 2010 a more likely target. This market will likely remain under pressure until 2010. Phosphate supplies should also be very close to balance between now and the end of the decade, as the expectations for potash. In the case of these last two nutrients, it will probably not be until early in the next decade before additional production capacity comes on line and eases the supply side of the equation.

Crop Outlook

By Terry Francl, Senior Economist

The November WASDE report produced only one major surprise, interpreted on the surface as a bearish development for cotton. The report increased estimated U.S. cotton production by 708,000 bales to 18.86 million bales and reduced estimated demand by 500,000 bales. The production increase reflected a much higher yield estimate, 859 pounds per acre versus 826 pound in October. Most of the gain was in Texas where estimated production was increased by 600,000 bales. The bulk of the gains were in the Southwest, whereas the Southeast experienced a prolonged drought that reduced the North Carolina and Alabama cotton crops to 17 and 14 year lows, respectively. Nevertheless, the total Southeastern production estimate was raised 105,000 bales from October to November.

On the demand side, estimated cotton exports were reduced 500,000 bales. This may have been the only change, but the net impact was a 1.2 million bale increase in estimated U.S. carryover stocks to 7.6 million bales.

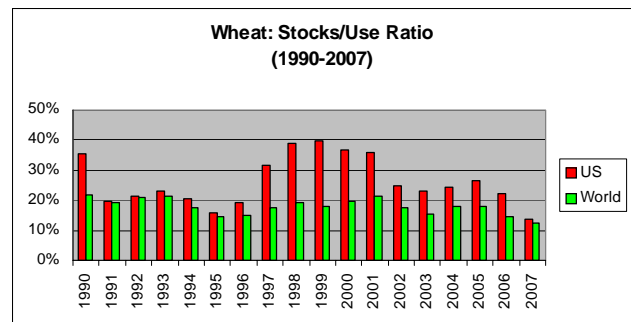
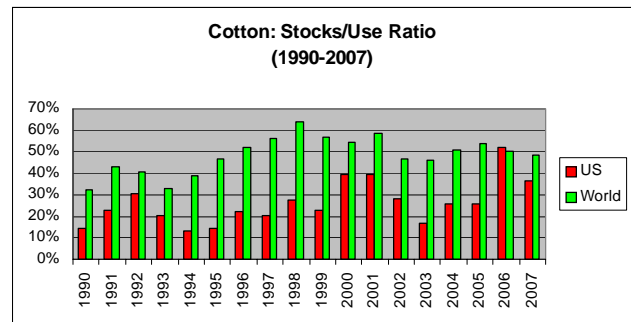
Consequently, the carryover stocks-to-use ratio was increased to 36.5% in November, up significantly from the 27.6% level estimated in the July report, the low number thus far for the 2007/08 crop. As would be expected the price response since the report has been a 2-3 cent drop in cotton futures prices. The WASDE report can be found at this link:

<http://www.usda.gov/oce/commodity/wasde/index.htm>

The graph of domestic and world cotton stocks-to-use ratio indicates that although stocks will tighten marginally this year, cotton supplies are more than adequate both in the United States and throughout the world. About the only thing that would rally U.S. cotton prices is another dramatic drop in planted acres in 2008. The outlook for 2008 planted crop acreage will be the topic for the December Market Update.

There was only a minimal change in the November domestic wheat balance sheet; imports were raised 5 million bushels, which marginally raised the carryover stocks number to 277 million bushels versus 272 million in October. However, world wheat production was raised 2.8 million tonnes. China, Argentina and Ethiopia account for the increase while Australian estimated wheat production was reduced 0.5 million metric (MM) tonnes to 13.0 MM tonnes. However, this is about 1.0 MM above the current ABARE's (official Australian) estimate and some private estimates are even another 1.0 MM tonnes +/- below the ABARE estimate.

The graph of wheat stocks-to-use ratios reflects the extremely tight situation for wheat throughout the world. It should also be noted, most obviously in the domestic number, that the stocks-to-use ratio has been slowly but surely tightening over the past eight years. In other words, use has been outpacing production.



Contrary to what is often been repeated in the media, it has been wheat that has lead the price increase in crops for most of the past year, not corn. And the past couple of years the reduced wheat production was almost totally weather induced, both here in the United States and in several other major wheat producing countries like Australia.

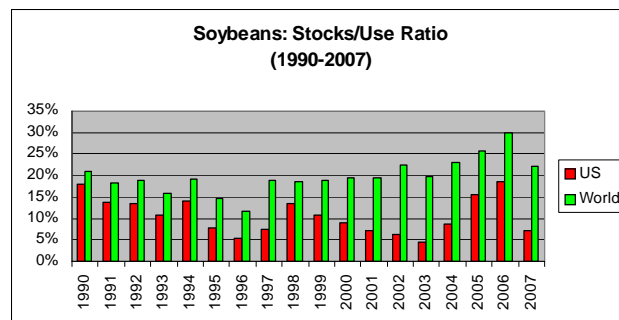
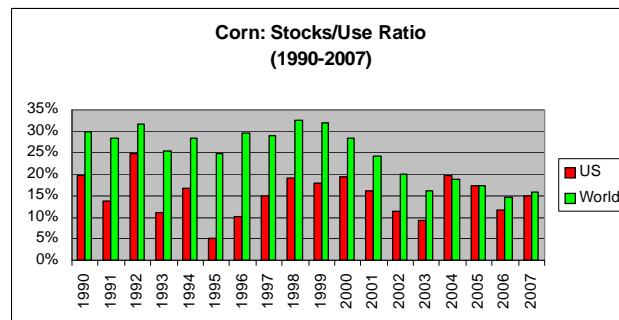
As had been expected, the yield for corn was reduced in the November report. The 1.7 bushel per acre reduction to 153.0 bushels per acre was near the mid-point number offered analysts predicted prior to the report. This reduced production 150 million bushels to 13.17 billion bushels, still up a healthy 25% from the previous crop. It should be noted that in the group of ten years, out of the past 40, when yields declined for three consecutive months, they declined further when the annual (January) number was calculated seven times. The yield reduction from November to January averaged 1.1 bushels per acre and ranged from 0.2 to 2.4 bushels per acre. Yields increased the other three years an average of 0.5 bushels per acre ranging from 0.2 to 0.9 bushels per acre. Consequently, historical experience would indicate it is likely that the January number (there is no crop production estimate in December) will be further reduced, around one (+/-) bushel per acre.

On the demand side of the corn balance sheet the only adjustment was a 50 million bushel downward revision in feed demand. A number of analysts were looking for another downward adjustment in the amount of corn utilized for ethanol, but the USDA left that number unchanged at 3.2 billion bushels. So the overall carryover stock number was reduced to 1.9 billion bushels, resulting in a 15% stocks-to-use ratio versus an 11.6% ratio for the previous crop year. Corn futures prices had traded as high as \$3.90 per bushel prior to the report and backed off about 15 cents before rallying back about half that amount.

Like wheat, the stocks-to-use graph for corn shows tightening stocks over an extended period of time, particularly on a world level. That trend has also been more pronounced in the United States the past couple of years; however, with the large increase in corn acreage in 2007 the trend has been reversed to some degree this crop year. Whether or not that continues the next crop year will be largely dependent on 2008 planted acreage.

Also like wheat, there was not much change in the soybean balance sheet. Yields were reduced slightly, 0.1 bushels per acre, which lowered estimated production 6 million bushel. The demand side was essentially unchanged. Consequently, carryover stocks were lowered by 5 million bushels to 210 million bushels. This left the stocks-to-use ratio at 7.1%, down significantly from the previous year's number of 18.6% and, as the graph shows, the lowest since 2003/04.

The world soybean balance sheet estimates also saw production lowered slightly, 0.9 MM tonnes, while ending stocks were lowered 1.4 MM. This also reflects one of the tightest world carryover stocks-to-use ratios in four years. However, the South American soybean crop is just now being planted and the combined Argentina and Brazil crop for the current crop year is estimated to be 109 MM tonnes. That compares to 106.2 MM tonnes the previous crop year and 97.5 MM tonnes two years ago. While current U.S. soybean prices would seem to offer an incentive



to greatly increase acreage in South America, the currency exchange rate, a weak dollar and strong Brazilian real, mute a lot of the dollar price increase. Still Brazilian soybean planting are expected to rise around 5%.

The soybeans futures price has gained nearly 40 cents a bushel since the November WASDE was issued, not so much in response to the report, as much of the need to bid in more soybean planting in the United States in 2008. As predicted for some time there is another bidding war going on between soybeans and corn for acreage next spring. While it appears to be a repeat of what happened prior to the 2007 planting season, it needs to be emphasized that wheat is involved in the fray this time around. But the primary duel in the United States will be corn versus soybeans with soybeans taking the lead this time, as opposed to corn last year. Again, potential 2008 acreage changes will be addressed in the December issue of the Market Update.

Livestock Information

By Jim Sartwelle, III, Livestock Economist

Cattle on Feed Report Analysis

U.S. Cattle on Feed (1000+ head capacity feedyards), November 1, 2006-2007

Item	Number		2007 as a % of 2006 <i>Percent</i>
	2006	2007	
	<i>1,000 head</i>	<i>1,000 head</i>	
On Feed, Oct. 1	11,385	10,967	96
Placed on Feed during October	2,430	2,716	112
Fed Cattle Marketed during October	1,765	1,876	106
Other Disappearance during October	80	47	58
On Feed, Nov. 1	11,969	11,760	98

Source: NASS, USDA

At 3 PM last Friday, the USDA released its November 1 Cattle on Feed report. Leading experts' pre-report estimates of November 1 inventory numbers and October marketings were generally right on the money. Cattle and calves on feed November 1, 2007, in the nation's 1000+ head capacity feedyards, was 11.76 million head, down 2 percent from a year ago. October placements totaled 2.716 million head, up 12 percent from a year ago. Marketings were 6 percent ahead last year, but a big chunk of that was the product of one more processing day in October 2007 than the year before.

Inventories remain down in nearly all of the major cattle feeding states: Idaho (down 18% from November 1, 2006), Colorado (down 9%), Oklahoma (down 7%), Kansas (down 5%), and Nebraska (down 3%). Texas' inventory was even with 2006, and on-feed inventories were up 12% in Iowa, 8% in South Dakota, 5% in Arizona, and 3% in California.

Cattle feeders returned to the longer-term October trend of placing around 2.7 million steers and heifers on feed. October placements numbered 2.716 million, exceeding the figure for

the same month in 2006 by 12%. Remember October 2006 for a moment: corn prices were in the midst of their skyrocketing and nervous cattle feeders didn't know what the future held. October 2007 placements were 2.5% below 2005, roughly equivalent with 2004, and were 2% below 2003. More and more, we're coming to see the fall of 2006 for the anomaly it was. Every state in the USDA reporting set saw placements increase year-to-year, save Idaho and California.

Last month we mentioned we'd be looking for signs of lighter-weight feeder cattle heading to the feedyards due to relatively scarce winter grazing opportunities. We have not seen much more wheat pasture grazing become available since last month. Comparing October 2006 and October 2007 placements by weight category, we observe a shift from under 600 pound feeders to 800 pound plus feeders. That being said, supplies of heavier-weight feeder steers and heifers are still pretty tight, evidenced by nearly 60% of placements weighing less than 700 pounds despite the crystal-clear preference for heavier calves.

Bottom line for this report: no big surprises as we tack back toward pre-ethanol-boom placement patterns. Our belief that fed cattle supplies will remain tight through the first quarter of 2008 is supported by futures market activity. We do not see any news in this report that has not already been built into the recent \$91-\$93 fed cattle trade.



American Farm Bureau Federation