



**Commodity Markets Continue To Soar As Production Drops And
Feds Infuse Money to Stimulate Economy
High Market Prices and the Changing Political Climate May Influence Farm Bill Negotiations**
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Commodity prices continue to soar as USDA further reduced corn, soybean and cotton production estimates while, at the same time, the Federal Reserve announced that it plans to buy \$600 billion of U.S. government bonds over the next eight months. This action by the Fed has the potential to put an additional \$600 billion into circulation by expanding the monetary base (a narrowly defined measure of the money supply consisting of deposits held at the Federal Reserve by depository financial institutions plus coin and currency) from a current \$2 trillion to near \$3 trillion. Long-term, the monetary policy of the Fed is designed to encourage more borrowing and stimulate economic growth; near-term the policy keeps interest rates low and the dollar weak, providing underlying support to dollar denominated commodities.

Additional commodity price support is coming from speculators attracted to commodity investments due to up trending commodity prices and low investment returns from low risk alternative investments like bonds. Prices for nearby corn and soybean contracts reached life-of-contract highs recently at about \$5.90/bu. and \$13.20/bu., respectively. Cotton futures contracts were trading at record highs with December 2010 trading over \$1.50 per pound.

Improving commodity market prices are always welcome news. While the potential impact of the change in the political climate in Washington has yet to be determined, the surge in prices and the change in the leadership in Congress may have a significant impact on Farm Bill 2012 negotiations which should start in 2011.

Opinion of potential changes to agriculture policy vary widely: from maintaining the status quo to

some reductions in subsidy payments to putting pressure on federal agencies to reduce regulations (such as putting pressure on the EPA to not tighten regulations on farmers and agricultural businesses). Although changes are not expected to be immediate, many are hopeful heavy regulations will be relaxed.

The mood in the new Congress, which will take over in January is to cut spending, reduce the deficit, reduce the role of government and extend all the tax cuts which are scheduled to expire in 2010, at best a very difficult task.

With commodity prices high and a strong new objective in Congress to cut costs, some contend Congress may negotiate a farm bill which would focus more on the market place, probably similar to the Freedom to Farm Act of 1996. This sentiment was recently expressed by the outgoing House Agriculture Committee Chairman, Colin Peterson. As commodity market prices have increased significantly, it may be very tempting for Congress to end or dramatically reduce price-triggered payments on the theory that they will no longer be needed because world crop prices remain high. Only peanuts and cotton received counter-cyclical payments in 2009 and early estimates indicate that counter-cyclical payments will not be made for the 2010 crop year. The 1996 Farm Bill was negotiated under a similar market situation. It was designed to phase out some farm payments over a transition period as farmers managed financial risk from the market. The program was abandoned as commodity prices weakened and the farm sector was left with substantial financial risk without a market price safety net in place.

\$3.0 Billion Ag Cuts Recommended

A recent report by the Deficit Reduction Commission, challenged to reduce the U.S. deficit by \$3.8 trillion over 10 years, includes recommendations to reduce farm spending by \$3.0 billion a year. Not counting federally subsidized crop insurance programs, government payments to farmers and landowners have been running at about \$12 billion a year during the last four years. Reducing payments by \$3.0 billion a year would significantly reduce the government financed market safety net.

Current high commodity prices will stimulate increased agricultural production in the U.S. and the world, especially in countries in the southern hemisphere such as Brazil and Argentina. Markets react to changing supply and demand conditions and current high prices are vulnerable to sizeable downward adjustments. A significant reduction in farm program payments would require the farm sector to rely on other market-based tools to manage financial risk.

Government Funding Cuts

With a current U.S. national debt of about \$13.7 trillion, the Deficit Reduction Commission recommended plan would hold down the growth of the federal debt by roughly \$3.8 trillion by 2020, or about half of the \$7.7 trillion by which the debt would have otherwise grown by that year. While the Deficit Reduction Commission report is just a recommendation, their discussion of budget cuts that includes social security benefits and defense spending will not leave agricultural untouched.

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