

**Net Farm Income Up For 2nd Year in a Row
Outlook into 2009 Appears Dominated by Weak Economic Outlook**
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As the end of the year approaches, it is refreshing to see that early USDA-ERS' estimates of U.S. net farm income for 2008 at \$86.9 billion is up slightly from last year's record and 42 percent above the 10-year average of \$61 billion. Last year's record net farm income was attributed to high commodity prices. The year ended strong with many favorable key economic indications. In the early months of 2008, commodity prices continued to surge and remained relatively high through the first half of 2008. Prices have since backed off as the national and world economies have softened in recent months.

This coming year appears full of uncertainty as U.S. farm markets continue to be dominated by the weakening general economy. The global economic slow-down is a major concern for all business activities including agriculture as commodity prices continue to weaken. While energy costs have declined significantly from mid-summer's record highs, input costs remain relatively high and tight credit conditions make it difficult for the agri-business sector to operate smoothly. Lower energy costs will lower fuel, nitrogen and other energy-related input cost, but most other input costs, such as equipment, repairs, chemicals, labor, seed, etc. will remain high.

In terms of the livestock situation, since the price of corn has been nearly cut in half since mid-summer's highs, lower costs of gain may improve the profit opportunity for cattle placed on feed this winter/spring. Cattle markets generally appear to be caught up in a wave of uncertainty and hesitancy, largely rooted in the weak economic situation, suggesting that cattle supply/demand fundamentals have little to do with prices.

The agricultural sector is facing a significant cost/price squeeze in 2009 which will require very detailed financial planning, especially with respect to tight credit markets. In addition, the continuing drought in most of Texas and the South Central part of the U.S. will mean a lower production potential with higher input costs. So, over-all, the agricultural sector is expected to carry higher financial risk in 2009.

What's Ahead

- The financial crisis will probably dictate that agricultural lenders require more financial information and loan application documentation from borrowers, especially in terms of details of how the borrower plans to secure loans. This also means that financial institutions will increase equity requirements to finance short and intermediate loans (operating and equipment loans) and it will be more difficult to obtain financing for long term loans (land).
- In terms of **Farm Bill 2008**, while commodity loan rates and target prices were tweaked slightly, the financial risk management protection provided by these rates and prices appears to be much less relevant in relation to current commodity prices and production costs. Farm Bill 2008, however, includes two new provisions, the optional Average Crop Revenue Election (ACRE) program and the Supplemental Revenue Assistance Payments (SURE) program, which should help financial risk management planning.

The ACRE program provides a payment to producers, by crop and by farm, in the case where both state level revenue and the individual farm revenue fall below specified trigger levels. The producer must give up 20% of the direct payment and accept a 30 percent reduction in loan rates for a participating farm's production to qualify to participate in the ACRE program. It becomes important for producers to learn more about the ACRE program as soon as USDA releases implementing regulations.

The SURE program is a permanent disaster assistance program, i.e., written into Farm Bill 2008 and not an ad hoc program. The SURE program covers a person's entire operating revenue rather than a single enterprise or farm. The program requires the purchase of crop insurance and will make up 60% of difference when actual farm revenue falls below the guarantee. Essentially, a whole farm revenue guarantee is established at 115% of the implied guarantee of purchased crop insurance (using price and yield elections along with proven yields).

- Commodity prices will remain weak in relation to this past summer's record highs but the market outlook for most commodities into 2009 appears brighter than current market prices. Markets will continue to carry increased volatility however, probably until after the U.S. economy is stabilized.

- The recent rapidly escalation in farm land values will probably level-off and land prices may even weaken slightly in 2009. Biofuel production has been the driving force behind high commodity prices. As crude oil prices drop below \$50/barrel, it is difficult for biofuel production to compete in the energy market. With weaker commodity prices and the competitive future of the biofuel industry in question, the recent profit driven demand for land may weaken.
- Country-of-Origin Labeling (COOL) regulations, which went into effect in September 2008, will start being enforced.
- More food safety regulations, with trace back audit trails, will probably be implemented as a result of the recent series of E. coli-contaminated food products.
- Increased demand for organic products.
- Increased demand for source and process verified livestock.
- Increased use of Genetically Modified Organisms (GMOs) as producers attempt to reduce energy/labor intensive production costs. In addition, GMO's are adding substantial attribute enhancement features for consumers and industrial applications, such as drought resistant varieties.
- A slight improvement in the availability of Ag labor as a slow-down in home construction frees labor.
- If the economic crisis subsides, passage of immigration reform legislation may be possible towards the end of 2009.
- Increased reliance on technology, the Internet and electronic market linkages. For example, traditional open bid commodity markets for animals are fading in importance and most animals are marketed through contracts, cooperatives and a variety of arrangements that link production with processing and retailing of final products. Electronic trading of commodity futures contracts has almost replaced floor trading.