PERFECT STORM…

…the situation in Michigan Agriculture

- **The Impact of World Demand for Commodities**
  - **Population Growth**
  - **Dietary Changes – Starch to Protein**
- **The Impact of the Value of the Dollar**
- **The Impact of Non-Traditional Involvement in the Commodity Market**
- **Bio-Fuels**

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PERFECT STORM

The agriculture industry is facing a perfect storm.

U.S. agricultural exports are at record highs. Domestic demand for grain and oil seed for bio-fuels is soaring. We have an extraordinary global demand for fertilizer and other crop production inputs. And investor speculation has shifted from stock markets to commodities.

On many levels, many sectors of the economy have benefitted and profited thanks to these fast-moving, astounding and confounding developments: Farmers, fertilizer companies, petroleum suppliers and Wall Street.

At the same time, we must recognize that many, many others are also reeling from the speed and impact these developments have delivered to the ag economy.

Certainly high commodity prices are good, but the corresponding increase in the cost of production inputs, along with those market prices moving at light speed compared to past experience, many are scrambling to stay current, or even catch up.

This document is intended to provide a glimpse at what has happened, what is happening and what may occur in the future, and both the intended and unintended consequences of all these events.

FARMERS

According to the USDA's Economic Research Service (ERS), 2008 net farm income is forecast to be $92.3 billion, up 4.1 percent from the $88.7 billion farmers are projected to have earned in 2007, and 51 percent above the 10-year average of $61.1 billion.

This increase is driven by three factors, expanded and increasing per acre production (yields), more efficient production practices that help to maximize those yields and the most important factor, commodity prices that have increased over the past two years at a pace not seen in modern American agriculture.

These price increases have not been limited to a handful of commodities, but include virtually all annual (planted every year) agricultural crops. The 2008 value of crop production, $175.5 billion, is forecast to exceed the 2007 record by $25.9 billion, a 17 percent increase.

In the past three years, market prices for corn and soybeans have increased between 200% and 400%. For example, corn has jumped from $1.90 per bushel in 2005 to more than $5.00 per bushel today, and soybeans from $5.00 per bushel to more than $13.00 per bushel in the same period

Even specialty crops have joined the upward spiral. Dry beans are now trading in excess of $40 per hundredweight, while just two years ago the same beans were being sold at closer to $15-$20 per hundredweight.

These rapidly moving prices and the promise of unseen market opportunities have pushed farmers to forward contract their production with local elevators and end users at very high levels.

For decades farmers have had the opportunity to forward sell their production with local market makers. In the case of grain (corn, wheat, oats, barley, etc.), oilseeds (soybeans) and many other annual crops, they sign contracts with local grain elevators that receive their production at harvest promising to deliver a certain amount – bushels – of the contracted commodity at a set price. For example, a farmer may agree to deliver 10,000 bushels of corn to the local elevator at $3.00 per bushel when they harvest their crop that year.

Usually farmers only contract a relatively small percentage of their local production in recognition that farming is an inherently risky venture; extraordinarily dependent on weather, pest pressure and other factors.

The practice of a farmer contracting production for more than one year has always been available, but in the case of general commodities has been somewhat rare. In the case of dry beans however, multi-year contract opportunities date back 35 years, and have become common for many companies.

In the case of corn, soybeans or wheat however, farmers often contract production for the coming season. And have sometimes contracted another year in advance, but rarely more than that.

With the rapid price increases last year however, many farmers were tempted to break with their past practices and contract production as long as two or three years (or more) in the future, committing their production for not just 2007, but also 2008, 2009 and some even as far out as 2010.

The challenge for those that did so is that commodity prices have continued to increase, often double the level where many contracts were signed during the summer and fall of 2007.

Even as 2008 approached, many farmers contracted production for this coming season at levels they found extremely attractive.

Many in the industry suggest that as much as 30% of the 2008 Michigan wheat production may be contracted in the range of $4.50 to $5.50 per bushel; a third of the soybean crop between $7.00 and $9.00 per bushel and 40% of the projected 2008 Michigan corn production between $3.00 and $3.50 per bushel.

Current farmer prices (as I write this) for 2008 production are quoted at $8.84 per bushel of wheat, $13.10 per bushel of soybeans and $5.10 per bushel of corn.

This situation has caused farmers to question whether they should contract more of their production at these higher prices, or wait until harvest to see what happens to the markets. The challenge for many farmers is that they have been contracting as the markets continued to increase, so every decision to sell their production in advance has been at levels less than current prices.

Because of this, there has been a resistance by farmers in recent weeks to do much more forward contracting. Growers fear that they will lose out in the face of future price increases, which has been the trend in recent months.

This has created a serious problem for annual specialty crops in Michigan and across the country. As prices of traditional commodities have increased, specialty crop prices have struggled to keep up. The problem for these crops – such as green beans, cucumbers, peas, sweet corn, dry beans and others - is that the return or profit farmers need from those crops must actually exceed their profit potential from corn, soybeans or wheat. Specialty crops present more risk to the farmer in terms of market availability, production problems, etc.

These crops are mostly all contracted in advance of planting, and few acres of specialty crops are planted without a contract. Therefore, the reluctance of growers to contract, coupled with production and marketing risk considerations have those seeking specialty crop acres in a bind.

This means that many canners and other food processors are having great difficulty finding acres for the crops to produce what they need to meet their customer demand. Even if they do find acres, they are often coming at a cost close to double that of last year.

The additional challenge for farmers is that their overall cost of production has continued to increase as seed, fertilizer, land rent, pesticides and fuel prices have also soared, but more on that later.

GRAIN ELEVATORS

Grain elevators provide several services for farmers. They offer production contract opportunities (as previously discussed), additional marketing instruments, receive grain from farmers at harvest, and process and sell that production to end users or other buyers.

When grain elevators receive grain, they must dry, condition (clean) and store the grain until they can ship the product to customers during the year, either by rail or truck.

In the context of contracts, grain elevators serve as the farmer's "broker," or point of access to the broader global market, much as a stock broker serves as the access point for people to invest in stocks on the Dow or NASDAQ exchanges. Grain elevators are the access point for farmers to the Chicago Board of Trade (CBOT), and other grain exchanges across the country.

The difference from stock trades is that these transactions, farmers selling their production to elevators before they harvest it, are marketing and risk management tools. Elevators protect the speculative positions that they accept by contracting with farmers by also contracting – or hedging – their position of future deliveries promised by farmers by selling that production on the CBOT or other exchanges.

This system has worked for decades, and provides security for farmers, grain elevators and those that use grain either domestically or around the world.

One of the challenges to this system is that grain elevators – not their farmer customers - have the exposure to the broader market.

Usually this works fine, but when markets exceed the price at which elevators have sold grain on the exchange, as is also the case with speculative puts or calls in the stock market, they face margin calls.

A margin call, in an ascending market (prices moving higher) is the difference between what an elevator has sold at, and the new price.

In the most simplistic example, if a grain elevator sold corn (through a contract on the CBOT at $3.00 per bushel, and the CBOT market price moved to $5.00 per bushel, the grain elevator would face a margin call of $2.00 per bushel as soon as that price moves higher.

For perspective, if an elevator has 200,000 bushels of corn sold on the CBOT at $3.00, and the market increases $.50 in one day, after the market closes for the day the elevator will receive a notice that they must send the market $100,000 the following morning by electronic transfer.

Failure by the elevator to do so will result in the CBOT liquidating the "position," or contracts the elevator has with the Board. This could mean economic failure for the elevator.

With current market conditions, and the farmer contracting patterns previously described, it is not uncommon for a Michigan grain elevator to have 1,000,000 bushels of corn, 1,000,000 bushels of soybeans and 1,000,000 bushels of wheat sold on the CBOT to hedge their contract positions with farmers. The following table describes their current margin situation:

Commodity	**Amount**	**Contract Price***	**Current Price***	**Margin Volume**
Corn	1,000,000	$ 3.50	$ 5.70	$ 2,200,000
Soybeans	1,000,000	8.00	15.50	7,500,000
Wheat	1,000,000	5.00	10.00	5,000,000
			Total Margin Calls	$14,700,000

* Price per bushel

This means that this "hypothetical" grain elevator has had to send the CBOT just shy of $15,000,000 in margin call money since they executed the hedge, or entered the contract to sell the particular commodity, based on their farmer contracting and delivery commitments in the past nine to twelve months.

Grain elevators generally have to borrow these funds, and the annual interest cost of this money would be $600,000, or about $.02 per bushel per month, a significant piece of the overall margin that elevators hope to capture on these back to back agreements with farmers and the CBOT.

In addition, the exposure for elevators on multi year contracts with farmers becomes a multiplier, based on how many years of production the farmer committed so in some cases these commitments could be doubled or even tripled.

Couple this situation with the fact that many grain elevators don't just handle grain, but also sell crop production inputs such as seed, fertilizer and pesticides. The much higher cost of those materials, and the cash requirements for these companies to inventory these products skyrocket to levels they have never seen before.

One of the most serious problems facing the agricultural commodity market has been the flight from the Dow and NASDAQ stock markets to commodity markets as prices have stagnated and volatility has increased there. The cause of problems in the stock markets is largely blamed on the sagging real estate market, and accompanying mortgage crises.

Hedge funds have been targeted as part of the problem in this situation, and it seems that they are now focused on ag commodities.

Current estimates suggest that more than 90% of the money involved in the CBOT ag complex is from outside of agriculture. Many individuals and institutions are very concerned that agricultural commodities have become the new preferred investment for hedge and other funds.

Many believe that this may explain the rapid, often unrealistic and unprecedented price fluctuations and increases in ag commodity prices.

ETHANOL

Many blame ethanol for the commodity price increases of the past two years, and while corn demand for ethanol production is certainly a piece of the equation that is driving this phenomenon, it is not the only factor.

Ethanol demand for corn nationally was 1.093 billion bushels in 2002 (10% of U.S. production), and hit just over 3 billion bushels in 2007 (21% of production). By 2015, ethanol will claim about 4.7 billion bushels annually from the U.S. corn crop (about 27%). Consider that even though the noise and news about ethanol has been almost hysterical in nature, out of a total corn production last year of 13.1 billion bushels, less than 25% was used for ethanol.

At the same time, corn used for feed is about 44% of total U.S. corn production, and exports claim just under 17% of that total.

It should be noted that the profitability of ethanol producers has suffered in recent months as ethanol prices were depressed (though they have improved in the past few months), and the higher price of corn is also putting additional pressure on margins in the ethanol business.

Arguably more pressing than corn as a driver of commodity prices has been wheat for the past eighteen months. Severe shortages of wheat drove significant increases in wheat acreage across the country, and prices are moving at a ridiculous pace. Monday, February 25, 2008, prices for dark spring wheat (primarily produced in the Pacific Northwest) jumped $4.75 per bushel in just one day.

In light of these confounding developments, those who blame ethanol for a whole host of price, supply and demand problems in agriculture – from food and fuel to beans and meat – should recognize that planted corn acreage across the country is projected to actually decrease in 2008.

Logic suggests that if these markets and prices were all about corn, acreage would increase. The largest price increases for any annual ag commodity have been for wheat, followed by soybeans, which many claim is a direct result of low stocks and high demand for both crops.

In Michigan, the situation is the same. While about 300,000 acres shifted last year (the 2007 production year) from soybeans to corn, this year the Michigan Agri-Business Association projects that situation to reverse with those 300,000 acres going back to soybeans at the expense of corn acres.

In addition, wheat acreage in Michigan jumped this past fall (wheat is a fall planted crop) about 30% to 700,000 acres, and that acreage move was a direct result of price and the potential for farmer profits. Most still agree, interestingly enough that even today wheat still offers a better profit option for farmers than any other commodity crop.

INTERNATIONAL

Commodity price escalation is being driven by several factors, but one of the most notable is the rapidly developing international market.

Economies in China, India, Brazil, Eastern Europe, Russia and other countries are expanding at rates no one saw coming as recently as five years ago. Along with the economic boom comes cash and wealth, and the desire for new things and products, from cell phones to cars and style to different foods.

The impact on the food industry – and agriculture – is primarily felt by the move from starch based diets to those featuring protein, specifically meat. The move in China away from rice, Russia and Eastern Europe away from root vegetables and Mexico away from beans is creating unprecedented international demand for feed grains – corn, soybeans, etc. – to feed beef cattle, hogs and poultry to meet the new meat demand.

China's gross domestic production per capita has more than doubled since 2004, from $1,000 per person to more than $2,200 per capita, and with 1.1 billion people that is a tremendous amount of capital!

The world's average daily calorie consumption today is about 2,600 per person. Experts predict that by 2030, the amount of daily caloric intake will jump about 15% to 3,000 calories. Coupled with world population growth predicted to grow from the current 6.6 billion people to 8.2 billion souls, the world's total caloric consumption will increase 30% from 17.1 trillion calories to 24.6 trillion per day.

And we are moving well along that path. U.S. agricultural exports are predicted to increase next year to $110 billion, up 19% from 2007. About half of the increase is due to higher commodity prices, but the rest is a result of increasing demand. Despite higher commodity prices, wheat exports are up 32% compared to last year, 33% of the U.S. soybean crop will be exported and corn exports this year may break the 2.4 billion bushel record set more than a decade ago

One of the other major factors driving U.S. exports is the depressed value of the Dollar. The world knows that the U.S. generally has the best quality of any ag product exporter, and with all of their currencies worth more against the Dollar, they now can afford to buy our goods.

The Euro is worth about 40% more today than a couple years back, and that means that the Euro can buy 40% more “stuff” from the U. S. than before. An example of this suggests that even though U.S. soybean prices may be $15 per bushel, that equates to only $9 per bushel in “real” cost if a buyer is paying with Euros, simply because the currency is worth 40% more.

This example shows why the world’s appetite for U.S. ag products will not wane. The increase in the value of other world currencies is absorbing our commodity price increases.

Another interesting side development is that some countries had avoided the purchase of U.S. ag commodities because U.S. farmers use genetically enhanced seed. Whether a social argument or simply an artificial trade barrier, we are now seeing countries begin to accept genetically enhanced corn and other grains and oilseeds. South Korea bought their first cargo of genetically enhanced corn recently and indications are that Japan may soon follow suit. Though the European Union continues to resist, there are experts in the U.K. that predict there will be shortages of livestock feed this year unless the governments relax their opposition to genetic advances.

In addition to the demand for more food - for the reasons mentioned above - fewer and fewer citizens in these developing economies are willing to farm just for themselves. Subsistence farming where farmers produce just enough for their families and any livestock or poultry they happen to own is evaporating in countries where economic development is occurring, just as it did in the United States 60 years ago.

So as is the case in the United States where one farmer produces enough food for 144 people (compared to 1947 when a farmer produced food for only 19 people) world-wide agricultural production efficiency is growing, along with the consolidation of farms and farmers.

As a further example of this situation, the USDA says that the wheat stockpile – estimated to be about 272 million bushels - will be the lowest in six decades when harvest begins in late spring, and by late summer U.S. soybean stocks will be just 160 million bushels, little more than a three week supply.

Food production has to increase, and food security is a major concern for these developing countries. Because of this, grain exports from many countries have been suspended as countries try to build their own domestic food stocks.

With all this, farmers in developing countries have figured out that they need to use improved technology and fertilizer to increase production.

FERTILIZER AND CROP PRODUCTION INPUTS

The old adage ‘that they aren’t making any more land’ is driving farmers all over the world, but especially in developing countries to try and maximize their production per acre. An estimated 90% of the world’s farmland is already being farmed.

Improved seed (advanced genetics), fertilizer and pest control have resulted in improved yields and increased production wherever they are used.

Strong global demand for high-yielding seed corn has driven companies like Pioneer, a DuPont Company and Monsanto to both significantly increase the number of acres they grow for seed. Pioneer for example plans a 30 percent increase in the number of acres it needs for seed corn production in 2008. That follows a significant increase in acreage in 2007, as compared to 2006, and Monsanto is on the same path.

Much of this is being driven by international demand for seed with new, improved technology.

In terms of pest management, there is an international shortage of the world’s two most widely used herbicide products. Both atrazine (primarily a Syngenta product), which has been on the market for about 40 years and glyphosate (brand name Roundup®) which has been sold for more than 25 years are both in short supply, and prices are increasing.

The primary reason for these shortages is simply strong international demand. Price increases are justified by higher oil and transportation prices (because of fuel prices), along with heavy demand for the products. China and India, along with other countries are making use of U.S. production technologies to increase their crop yields.

Farmers world-wide are taking advantage of technology in order to meet the growing food demand for a wealthier world population.

One of the most important factors in increased crop production is fertilizer. The prescription for improved yields includes seed and pest control, but without fertility, the other two can't deliver optimum benefits.

There are three primary nutrients necessary for plants and crops to grow; nitrogen, phosphorus and potassium. The absence of any one of these three nutrients in a plant "diet," means that crops will wither. There are also several micronutrients that help crops and plants grow, but these three are by far the most important.

The growth in world-wide fertilizer demand over the past five years is equal to the total current annual U.S. fertilizer consumption of over 55 million tons.

China, India and Brazil are leading that increased fertilizer consumption trend. Today, the three largest users of fertilizer in the world are China, India and the United States, in that order.

As demand has grown, so have prices for fertilizer, as shown below:

Year*1	**Nitrogen***2	**Phosphate**	**Potash**
1999	$199	$201	$155
2000	227	233	165
2003	373	243	165
2007	523	418	280
2008	800	950	550

*1 Prices are expressed on a "per ton" basis
*2 Nitrogen prices are anhydrous ammonia prices

One additional factor that must be considered is that nitrogen fertilizer is made from natural gas as the raw material. The three-fold increase in prices of natural gas over the past three or four years has been reflected in the price of nitrogen.

As the price of fertilizer has soared, so has the cost of production for all farmers, including those in the U.S. and Michigan.

Beyond the price of fertilizer, availability may be an issue for some farmers this coming season.

As prices of fertilizer have increased, those that sell fertilizer to farmers have been reluctant to sell product unless they physically have it in inventory.

While the vast majority of fertilizer dealers are working to supply their traditional customers, it is not certain if they will be able to access all the product – or specific type – a farmer wants. For example, it may be difficult to secure enough 28% liquid nitrogen, so a farmer may have to switch to urea or anhydrous ammonia as their nitrogen fertilizer source for their crops.

One factor that may ease some supply issues this spring is that there will be fewer corn acres which should reduce the demand for nitrogen fertilizer somewhat as soybeans use less nitrogen than corn, though the increase in wheat acreage will use some of that supply.

Another major factor that impacts a farmers cost of production is the price of fuel. Fuel prices impact every step of the food production chain from the transportation of crop production inputs like fertilizer to farming and food delivery.

Diesel fuel prices from 2000 to 2003 were about $1.03 per gallon, and today that price is closer to $3.20 per gallon. While modern farm equipment is much more fuel efficient, fuel cost is a major part of a farmer's cost of production, and the overall cost of food at both the wholesale and retail levels.

The following shows the cost of production and yields of Michigan crops in 2008, versus 2000. These increases are driven primarily by land rent/cost and higher fertilizer prices:

Crop	Cost of Production Per Acre		Average Yields*	
	2000	2008	2000	2008
Wheat	$140	$270	72	80
Corn	220	420	124	150
Soybeans	150	260	36	45
Dry Beans	165	290	15	18

* Yields are expressed in bushels and except for dry beans where yield is expressed as hundredweight

FOOD

Food prices are high and going higher.

As commodity prices have increased, food products that use wheat, corn or soybeans, or other annual agricultural crops have also increased in price. Even though many of those price increases of prepared and processed foods have exceeded the actual impact of the specific commodity, agriculture is the primary target for much of the blame for price increases.

During the USDA's recent Outlook Forum, William Lapp of Advanced Economic Solutions told a luncheon, "I hope you enjoy your meal. It's the cheapest one you are going to have…for a while." His point clearly suggests that food prices are only headed higher.

It should be noted that there really are several stages of impact that the higher commodity prices will have on food prices. Those products closest to the commodity have seen the most rapid price increases.

In the past year, consumer prices of eggs have increased about 35%, bread 6% and milk close to 18%. Those are just the beginning.

Most vegetables are purchased from farmers during the fall of the year, and then canned or frozen, so the most significant price increases for those products will be felt in about nine months.

Livestock is where there is a real lag in price increases. Feeding a calf or hog to a mature animal ready for slaughter takes several months. While the cost of feed (corn and soybean products) has increased dramatically, usually farmers are locked into contracts for the sale of their animals that unfortunately may be less than the cost of production because of the higher feed costs.

This means that many farmers who raise livestock are locked in to feeding their livestock to gain a guaranteed, predetermined loss on every animal they take to market.

Another factor is that as feed costs increase, some farmers decide that they do not want to feed their animals to maturity, and simply sell their animals to eliminate the need to feed them. This has been happening for months, which has depressed near term livestock prices, placing even more stress on livestock producers. The pork industry for example is forecasting that 2008 may be their worst year in several decades.

This greater lag in livestock production and pricing mean that wholesale and retail price increases for many meat products are still in the wings.

Another factor to consider is that as farmers sell livestock, and do not replace livestock inventory, there will be less meat production in the future, and when that happens, prices will increase even more dramatically.

As an aside, it should also be noted that the decision by Meijer, Kroger and Wal-Mart to demand that producers stop using Rbst in dairy production, will also lead to an increase in milk prices that has nothing to do with feed costs, etc. Halting the use of Rbst will reduce milk production per cow by between 10-15%. This drastic action will mean higher milk prices and tighter supplies.

Fruit crops are primarily perennial crops, so while their cost of production for fertilizer and pesticides may increase, they are not traded on the CBOT, so therefore, those prices have not moved as much as other ag goods.

FUTURE

FARMERS

The one thing that is always true is that if farmers have money, they will spend it. Land rents this coming season have at least doubled, and in some cases, rents are three times what they were only two years ago. Land sale prices are also between 250-300% higher than those of three years ago.

Farm equipment dealers have had a great twenty-four months as farmers buy new equipment, and there is no end in sight.

There are several challenges farmers are facing though as they head toward planting and the 2008 production season.

The most pressing issue is making sure that they have sufficient fertilizer to get their crops planted. An accompanying issue is the price of that fertilizer.

Farmers with production contracts that were entered into at levels substantially below current levels face some serious challenges. If farmers did not have their production inputs, especially fertilizer purchased or at least agreed to with their supplier before the increases, they could be in trouble. The chart below outlines this issue:

Crop	Cost/Acre	Yield*1	Price*2	Revenue*3	Profit*3
Wheat	$270	80	$5.00	$400	$130
Corn	420	150	3.50	525	105
Soybeans	260	43	8.00	344	84

*1 Bushels per acre
*2 Dollars per bushel
*3 Value are expressed on a per acre basis

While there is still a profit per acre – if all goes well – the profit that some producers will realize per acre is far below where they would like to be. Also, in the cost of production numbers used in the chart, there are certain assumptions that may not be replicated by individual farmers, and their actual costs may be higher or lower.

We are concerned that there may actually be some farmers that are locked in a negative situation, whereby they will not realize any profit per acre at the prices they have accepted.

It is fortunate that farmers do not contract all their production, so they can average these lower prices with higher prices that they will likely receive at harvest.

The second issue involves weather and the fact that there has been little consideration of a drought or other production problem, as existed in much of the Michigan last year. If a producer cannot deliver the quantity they have contracted, elevators may require the producer to buy commodity on the open market to fill that contract.

GRAIN ELEVATORS

There are several issues grain elevators are focused on as we near the 2008 crop production season.

First is the prospect of commodity prices continuing to increase at the pace they have been in the past six to eight weeks. If that happens, and grain elevators continue to be faced with more margin calls, some operations may not be able to access additional credit. If that happens, These elevators will fail, and that would be devastating for the industry.

Ultimately producer contracts will “converge” with the grain elevator hedge contracts when farmers harvest their crops this fall. Many things can happen however in the next eight or nine months before farmers complete their harvest.

Many elevators have taken steps to minimize their cash and risk exposure by no longer offering producer contracts beyond the 2008 growing season. This is a prudent move as neither producers or elevators are certain what the years beyond 2008 may hold, either for commodity or crop production prices. For grain elevators not to offer contracts beyond the upcoming growing season seems to make sense.

Some other elevators have also stopped buying cash grain (grain from last year’s production that farmers may still own) unless they can merchandise (sell) that grain in the current market. This is because there have been market price fluctuations of between $.50 and $.80 per bushel during a single trading day. Grain elevators need to make sure that they have the grain sold at a profit before they can accept a farmer sale.

Farmers delivering commodities on their contracts with grain elevators this coming growing season is critical. In past situations where current prices are considerably higher than contracted prices (though we have never seen anything quite like this), 99% of farmers live up to the obligations and deliver grain as they agreed. The challenge this year is that the price is so much higher than the level where many contracted, the temptation for some farmers to skip delivery on low priced contracts may be too great to ignore.

Elevators will have to aggressively enforce their contracts and make sure they watch farmers closely as they harvest.

There have been suggestions that some farmers may try to deliver grain below contract quality specifications to avoid delivery, or even simply ignore the contract.

Questions have already been asked by producers about what would happen with their contracts – especially the lower priced contracts that they really do not want – if there is an elevator failure. The best guess is that a failure would result in a bankruptcy, and the federal court with jurisdiction would certainly want to optimize the position of creditors, and require farmers to deliver on all their contracts.

The next challenge for grain elevators is that as harvest approaches most believe that farmers will sell all their grain as soon as it is delivered to the grain elevator. The challenge for elevators beyond the cash requirements to buy all the grain at harvest, is that they will need the rest of the year to market the grain, and again be caught paying interest on the cash paid out to producers.

This issue is a special concern because of the quantities of soybeans that will be produced this coming season. Soybeans generally take more time for grain elevators to merchandise than corn, so they will be faced with even more exposure as soybeans – that are usually harvested before corn – may clog their own facilities, and even the destination elevators or end users.

Many believe that the basis, the difference between the CBOT price and that actually offered by local grain elevators may expand. That would mean that while soybeans may be $13 per bushel on the CBOT, the price offered by local grain elevators will be considerably less. It is anticipated that the basis will widen through rest of the spring and summer as fall approaches to encourage farmers not to sell at harvest, and wait to price their grain until the market signals it wants ownership. The market would send that signal by increasing the local price and probably narrowing the basis (bring the local elevator price closer to the CBOT price.

ETHANOL

The most important issue regarding the ethanol industry is the fact that ethanol production using corn as a feed stock will not go away.

The Michigan plants that are operating will continue to do so, and the Liberty Renewable Fuels plant will likely be completed after they resolve their equity issues.

The prospect of additional ethanol plants in Michigan is still questionable as corn acreage seems to have hit the high level, and it seems unlikely that there will be much more corn production in Michigan, except for that available from yield increases per acre.

It has become abundantly clear that other major crops won't be replaced by corn acreage, and in fact the Michigan Agri-Business Association predicts that soybean acreage will increase next year and corn acreage will fall, as demonstrated in the chart below.

Crop	**2007 Planted Acres**	**2008 Estimated Acreage**
Corn	2,650,000	2,330,000
Soybeans	1,750,000	2,000,000
Wheat	560,000	700,000
Dry Beans	200,000	185,000
Sugar Beets	150,000	145,000
	5,310,000	5,430,000

INTERNATIONAL

As long as the dollar stays at these low levels compared to other currencies, international demand for U.S. commodities will continue and even expand.
Population growth around the world will also continue to drive market expansion, and the shift from starch based diets to protein will move the demand for feed grains and oilseeds even higher.

The pace at which developing countries are adopting U.S. style technology in their crop production systems will continue and increase. Seed, fertilizer and pesticide demand will continue to grow around the world, especially if commodity prices stay high.

The question is how fast seed, pesticide and fertilizer producers can expand their production to meet this demand.

The most significant concern about production agriculture and prices this coming year revolve around the potential for a crop failure because of drought or other calamity somewhere in the world.

Production problems of the magnitude of the Australian drought last year, and their severely reduced wheat production, or even the drought in the High Plaines of the United States last year that reduced our own wheat crop could have serious effects on supply, and cause commodity prices to move even higher than where they are currently.

FERTILIZER AND CROP PRODUCTION INPUTS

World fertilizer demand will only increase in the coming years as developing countries and others attempt to meet food demand in their own countries, and elsewhere.

Fertilizer companies face some special challenges in expanding production to meet exploding demand, though. Opening new phosphate and potash mines is a very expensive and time consuming process. This may cause prices for these nutrients to stay high – and supplies to continue to be tight – in the foreseeable future.

There have been estimates that potash prices may increase as much as another 50% in the next several months, depending on the result of ongoing negotiations between the Saskatchewan (Canada) potash producers and the Chinese government. These producers are the world's largest suppliers of potash, and this agreement may substantially alter supply and pricing of potash in the foreseeable future.

Domestic phosphate fertilizer supplies are being exhausted, and the development of new mines is very difficult because of where they are located, mostly in Florida.

Nitrogen prices, and again the production of all nitrogen products use natural gas as a raw material, will continue to be driven by the cost of gas, as well as world-wide demand. Natural Gas availability and pricing will determine the future availability and pricing of nitrogen fertilizer products.

More and more fertilizer products are coming from international sources, and those products require a special level of management as the products can vary in terms of both available crop nutrients and their adaptability to blends, etc.

Bottom line is that while there may be some price adjustments from time to time, overall fertilizer demand and prices will stay strong.

FOOD

"Food consumers worldwide are going to have to pay more," says Chris Hurt, an Agricultural Economist from Purdue. "We ended 2007 with the monthly inflation rate on food nearly 5 percent higher. I think we'll see times in 2008 where the food inflation rate might be as much as 6 percent."

There are those that believe that as food prices escalate in the United States that consumers will virtually rebel, and demand what may be perceived as "solutions." Ethanol will be identified by many as the primary cause of higher food prices, and there may be pressure on Congress to rescind the subsidies for ethanol.

As has been outlined previously, while corn demand for ethanol is a piece of the puzzle, world-wide demand, the low value of the U.S. dollar and rapidly changing diets around the world are likely greater causes of commodity price increases, and subsequently food price escalation than ethanol.

There may also be discussion about export controls on ag commodities. The last time that happened in the United States was after the Russians entered the U.S. market in 1972 and the U.S. virtually ran out of soybeans. It seems highly unlikely that an embargo could ever happen again, though.

Depending on how quickly food prices increase, with the Presidential election on tap this fall, food prices may even become an election issue, and in fact has already been mentioned as an issue in certain forums.

Bottom line, the cost of food in the United States, long the best bargain in American life will increase, but still be a great value for the American consumer.

ISSUES – THE PERFECT STORM

GRAIN MARKETS

Congress, the Michigan Legislature, farmers, agri-businesses and others will have to face several crucial issues in the next six to 12 months.

The most pressing issue is the situation in the grain markets, and the extreme volatility that has permeated those institutions. There are no complaints about high commodity prices, but the rapid and large price moves are threatening the risk management function of traditional hedge practices.

Also, substantial and unexpected margin calls that grain elevators are facing have caused the majority of their budgeted annual income to now be dedicated to interest payments to cover their much larger lines of credit. Further price moves may devastate this industry as additional cash may not be available to grain elevators to meet many more margin calls.

While many believe that this may be a one year phenomenon, fundamental changes are needed to restore confidence and liquidity to market trades and ensure that farmers continue to have the opportunity to market grain and oilseeds in an orderly manner in the future.

Absent reforms to minimize market volatility and margin calls, grain elevators will be considerably more conservative going forward, and likely employ risk management practices that may be adverse to farmers.

PRODUCTION CALAMITY

One of the greatest fears facing the grain and food industries is the potential for a drought or other production problem that might reduce production in some part of the U.S., or elsewhere in the world. Such a problem could cause markets to spin totally out of control, and even create panic in some commodity markets.

Food prices could spiral upward, and commodity stocks would plummet.

PRODUCTION INPUT SUPPLIES

Fertilizer and pesticide shortages are a reality as we head toward spring 2008 planting, and they may only get worse. Prices will be higher, but the issue is whether agriculture can get the crop production inputs necessary in future years.

Competition around the world for all inputs will continue to increase.

CONSERVATION RESERVE PROGRAM

More than 44 state and national grain, feed, livestock, poultry, grain and oilseed processing organizations (including the Michigan Agri-Business Association) have urged USDA Secretary Ed Shafer to allow certain producers to opt out of the Conservation Reserve Program (CRP) without penalty so land owners can react to market prices and help meet the extraordinary demand for U.S. crops. The 34.7 million acres currently enrolled in CRP include million of acres that could be farmed without sacrificing environmental goals. The intent is not to ask that environmentally sensitive land be allowed out of the program, only that which is good, productive farm land.

FOOD PRICES

The price of food will continue to increase. The issue is how policy makers handle the issue, and how much blame is focused on ethanol production.

It is critical that the broader issues impacting commodity and food prices are examined, and not simply seek a scapegoat.

Significant investments have been made in the ethanol industry, and Congress and state legislatures must not reduce the incentives that were made available to encourage this fledgling industry.

It is also important that food processors and suppliers be realistic about price increases they blame on higher commodity prices. In reality, the amount of wheat used to make a loaf of bread is small, so an increase in wheat price is not the total factor in a baker's increasing prices.

Transportation and fuel are all major factors for all segments of these industries, and often the container or wrapper for a product costs more than the ag products used to make the food item.

TECHNOLOGY

The technological advantages in crop, livestock and dairy production must be fully exploited to maximize that production.

For corn and soybeans those advances have primarily been manifested because of advanced genetics that increase yields, protect crops against pests and tolerate challenging growing conditions, such as drought.

One major challenge is that many of these genetic advantages have not been available to all crops. New varieties of wheat for example are only developed through lengthy conventional variety development processes that involve selection instead of genetic enhancement.

Genetic enhancement must be available to all crops in the future. If they are not, a gap between corn and soybean yields – crops that take advantage of genetic enhancement - and other crops that do not use this technology will widen each year that advanced genetics are not available to these other crops.

NICHE PRODUCTION SYSTEMS

The development of various "niche" agricultural production systems such as organic, free-range poultry production, pasture based dairy production, and others are receiving considerable attention in the United States and to some extent in other countries, particularly in Europe.

These systems certainly have allure for some, both producers and consumers, but the greatest challenge to virtually all of these systems is that they do not produce yields equal to commercial production agriculture, that still makes up about 95% of all agricultural production.

CONCLUSION

These are difficult issues, and present serious challenges to leaders, both in the private sector and government.

We must protect our ag sector, both in the trade and supply sectors.

The world is shrinking, and our opportunities are others' challenges. We must recognize the impact of decisions – and direction – elsewhere on what we do, and how we do it.