

The Agriculture Letter®

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Dear Client:

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Our annual longer-term outlook & predictions issue... What to expect in the year ahead. Volatility will rise not only from Trump unknowns but from geopolitical concerns worldwide.

2016 IN REVIEW

First, a look back at '16... Story of year: November U.S. election. Balloting ended most uncivil and unexpected election

in our lifetimes. It proved “conventional” thinking wasn’t so conventional. Proved the old electoral map is no longer realistic. GOP made inroads into Rust Belt that could continue if they are successful in “putting America first.”

D.C. dethroned. Election captured a true distaste and disgust for the way Washington has worked, or not worked.

Should force both political parties to major reform as voters rejected the status quo. Yet the Democrats maintained Rep. Nancy Pelosi (D-Calif.) as minority leader.

Focus now: Filling key positions as people drive policy... selected by a President-elect that does not owe the political establishment a thing. Many choices thus far signal major upheaval ahead... a wholesale reworking of executive branch.

“It’s got to be a straight-out war on federal bureaucracy,” former Rep. Newt Gingrich (R-Ga.) said during a *Washington Post Live* interview. He said the Veterans Administration has a bullseye because Gingrich considers it the “archetype of — disaster.” Unless you change civil service laws, he said, “you can’t change the civil service within the normal framework of Washington.”

Trump has been telling his new Cabinet he wants bold changes... not just incremental shifts.

Other big ag-related stories of '16...

Corn & soybean production. Record crops for both as national-average yields surpassed expectations, in some cases by a long shot. A near-perfect finish for most areas of the country also reminds that while assuming “normal” weather is still a “requirement” for assessing yield potential... “actual” weather and conditions can make or break things. And it is a reminder of just how productive the U.S. agricultural sector can be.

Food prices. For the first time in at least 49 years, consumers will pay LESS for groceries. A triple-edged sword of sorts as it gives consumers more spending money... or saving money. A plus since some other things will cost more. One downside: The restaurant sector is clearly struggling with costs beyond food and the “restaurant recession” appears underway as traffic is in decline. Another downside: Food retailers. Yes, consumers have a smaller grocery bill but food company costs outside of grocery items are still there and retailer margins on those food items may be razor thin. Meat prices are a key driver for those lower food costs.

More key 2016 topics, and a look ahead to '17 on pages two through four...

AVG. GOV'T PAYMENT PER PROGRAM RECIPIENT 2010 vs. 2015 (DOLLARS)

TYPE	2010	2015
All Gov't. Payments	\$11,294	\$14,946
Conservation	\$3,278	\$4,683
Retirement Lands	\$2,314	\$2,719
Working Lands	\$963	\$1,964
Commodity Crop	\$6,372	\$2,522
Direct	\$5,314	\$0.00
Counter Cyclical	\$854	\$2,426
Mktg. Loan	\$204	\$196
Other gov't.	\$2,274	\$7,641

Source: USDA's Agricultural Resource Management Survey (ARMS)

More top topics of '16...

2016 IN
REVIEW

Resilience of the U.S. livestock industry. Despite the challenges of avian influenza for poultry and porcine epidemic diarrhea virus (PEDV) for hogs in '15, both sectors posted strong output recoveries in '16. Egg prices plummeted as layer flocks were rebuilt, providing consumers major savings at the breakfast table. But it has put pressure on some areas of the poultry industry. The hog industry also got back on track with records on efficiency... the number of pigs saved per litter resumed setting records again in '16 and is poised to continue the trend in the new year.

Weather outlook uncertain. Global gov't weather forecasters are not on the same page regarding whether or not La Niña is in place. U.S. and Japanese forecasters say "yes," Australian and others say "no." But even the U.S. Climate Prediction Center (CPC) says neutral conditions are coming by spring. La Niña-like impacts can't be ruled out... we saw lingering El-Niño-like impacts even though the event was declared "over." Eventual outcome will in part help determine yields and production levels not only in the U.S. but also other key growing areas worldwide.

2017
OUTLOOK

Now a look at key topics for '17...

Regulatory pendulum poised to swing back to the "less" side. A common view in U.S. farm country and with BOTH Republicans and Democrats in Washington has been the current Environmental Protection Agency (EPA) went too far with its regulatory bent. That is about to be reversed... either via regulatory or legislative actions. That could bring court challenges to a close, particularly those on the controversial waters of the U.S. (WOTUS) rule. Other areas are poised to see reduced regulation, including relative to climate change and energy. The scope and volume of the reduction will not match the desire of many in favor of less regulation but will be greater for those fearing environmental damage under a Trump administration.

Get ready for major tax reform... likely in '17 but assuredly by end of '18.

The "Trump bump" in financial markets (stocks, bonds, etc.) is due partly to escalating odds for tax reform, perhaps besting the last major reform in '86.

Lower tax rates, fewer deductions and credits are the likely outcome. Individual rates will be consolidated to three: 12%, 22% and 33%.

Business rates (also C corps) could see top rate of 25%, with some pushing for a 20% mark.

Estate tax changes... Another push for repeal; if not, some relief. Trump wants repeal, but also wants to tax predeath appreciation of large estates, subject to a \$10-million-per-couple exemption. That could occur by limiting step-up in basis for those inheriting capital assets from estates. House GOP plan echoes call for repealing estate tax... but is mum on any limits using date-of-death value as heir's tax basis.

Tax incentives for individuals and businesses... some, like the biodiesel tax incentive, will lapse Dec. 31. Others in '15 were extended permanently... including Section 179 and research and development tax incentives.

All will be under review via tax reform debate.

Timeline for tax debate: After midyear '17, which means fate of lapsed biodiesel incentive will not be known until new-crop marketing year.

From ObamaCare to TrumpCare in several not-so-easy steps. Costs and availability of health care remain key concerns. While Trump and GOP lawmakers say they will repeal ObamaCare... it will be a wholesale reform. Both parties know changes are not easy... but they are coming... likely in several steps rather than one package. Most popular parts of ObamaCare will remain to avoid moves that could cause millions of Americans to lose coverage.



Past issues of this newsletter are available at theagricultureletter.com

^{'16/'17}
OUTLOOK

U.S. economy poised for stronger '17. We expect the U.S. economy will expand by at least 2.6% in '17... well above the tepid '16 performance of 1.6%... even higher if businesses respond to tax and other likely reforms ahead. Plus, the Trump administration plans for infrastructure spending could be a key to convincing businesses '17 is the time to act.

Other expectations:

Inflation will also pick up, though it is still not responding as it should at this stage of the recovery. Consumers are facing higher costs for housing and assorted other areas... but food is not one of them.

While costs will rise, consumers will have higher wages. Expect incomes to gain around 3% in '17... could continue into '18, especially if infrastructure plans take off.

Higher interest costs ahead. The Fed is now signaling three hikes in '17... it anticipated just two in September. But that would still leave the Fed funds rate range at a very accommodative level. Operating loans will be pricier in '17... but farmer borrowers will still be in good shape since key financial indicators remain solid. Savers will be happier... but not ecstatic... after years of less-than-single-digit returns on CDs and savings accounts.

MARKETS

U.S. stock markets will have another positive year... returning 5% to 7%, including dividends... as measured by the Standard & Poor's 500 Index. As usual, there will be ups and downs, even a healthy correction. The Dow has posted its largest post-election rally in history. Room for a pullback, but markets see positives in potential Trump policies... until proven otherwise.

U.S. agriculture sector will face increased cash-flow problems for some producers if commodity prices in general don't rally from spring forward. Equipment dealers will need another year or two to turn the sector around, while used equipment remains hot. Seed companies will continue to battle for market share in a more cost-conscious environment. Recent declines in fertilizer and other input prices may be tempered if energy costs rise as some expect. Land values are likely to ebb further in '17, but won't fall out of bed. Rental rates will continue to lag the land-value decline, but may gather a little steam eventually in '17.

Corn markets will be faced with more-than-adequate supplies, a rebound expected in Brazil's corn output and stagnant corn demand linked to biofuels. Exports are a plus, but a stronger U.S. dollar and more foreign competition will prove a challenge.

Soybeans have already defied price expectations, but the anticipated record output in South America will attract cost-conscious Chinese buyers in the weeks and months ahead. With an expected rise in U.S. acres, the rosier expectations for '17/'18 may lose luster.

U.S. has quality wheat, but there's still too much wheat around the globe. Makes wheat even more dollar-value sensitive. But supplies will come down as Kansas wheat growers already signal they'll scale back area.

Lots of optimism in cattle futures markets. Large speculative traders have remained consistent buyers, adding to net-long positions in recent weeks. And funds are said to be rebalancing their positions with an eye on tighter supplies for early '17 vs. late '16. But competition at the meat case remains a challenge.

U.S. hog industry efficiency will continue to grow. Add in plentiful feed supplies and producers will have to restrain themselves to not overload the system. As with beef, competing supplies remain a factor. Exports, however, will help temper any supply build.

Milk output will still increase in '17, but the expansion may be tempered somewhat. Exports will be important to help soak up extra supplies, but global markets will remain well supplied with milk/products ahead.



Trade issues are wild cards for '17...

Trump threatened China in several areas during presidential campaign... saying he would declare it a currency manipulator and talking about double-digit tariffs if the country continues to be an unfair trade partner. Treasury Dept. in April usually reviews whether any country is manipulating currencies. Although our crystal ball on Trump and China relations is somewhat murky, sources continue to signal the coming president wants a U.S.-China summit that could lead to agreements, rather than festering discord. If not, and trade issues turn sour, soybean traders will take note as China imports the bulk of U.S. export shipments.

U.S./Mexico sugar spat continues as will efforts to seek a revised solution from prior trade suspension agreement. If not, Mexico will lose out on a major portion of U.S. sugar market and will retaliate against U.S. farm goods, like high fructose corn syrup, hams, etc.

It's not all negative news on the trade policy front. We look for Trump and his team to start the process of new bilaterals with a host of countries, including the United Kingdom, Japan and others.

Another wild card: U.S./Russia relationship. Trump may want a rapprochement with Russia, but U.S. lawmakers in both political parties will oppose. One of Trump's first tests with the new Congress may be whether or not he vetoes possible new U.S. sanctions on Russia.

Energy prices in '17... most expect crude oil to average \$55 to \$60 a barrel... perhaps a bit higher... if efforts to curtail oil production in OPEC and non-OPEC countries succeed. Stepped-up U.S. energy production (fracking, etc.) will temper any price gains.

Trump's and the new Congress' positions on energy is all of the above... stepped-up production, open up exports, support coal and renewable fuels.

Efforts to significantly alter the Renewable Fuel Standard will fail, but Carl Icahn... a key private advisor to Trump... wants to change portions of the biofuels program, especially as it relates to RINs... Renewable Identification Numbers.

U.S. food industry will face changes... a continuation of recent mega changes.

Food policy activists will likely move to state legislatures, knowing they won't have much clout in a Trump-and-GOP-led Washington.

GMO approvals will be expedited as regulatory reforms continue in this area.

Forget about a major push for significantly boosting the minimum wage... a topic that impacts the fast-food industry. Some hikes have occurred, but the momentum for this topic faded with the November elections.

Immigration is a food industry-related topic, especially for agribusinesses who need more seasonal workers. Congress will continue to grapple with this thorny topic. Immigration has been central to the Trump campaign, with promises he will build a wall along the southern border. Border security will be the focus. It will include portions of a wall, but more likely electronic (and drone) surveillance instead. Agriculture interests will push for a stand-alone immigration reform measure that in the past had the votes but congressional leaders held it back for inclusion in a more comprehensive package, wanting farm-state votes for a complete overhaul. That won't likely change in '17.

A tumultuous year is drawing to a close yet the new year holds promise. Yes, uncertainty exists. But your *Agriculture Letter* editors will help you sort the "wheat from the chaff." May the joy of the holiday season be felt in your home, your business and your life and all the best to you and yours now and for the year ahead.

Best regards,

The Ag Letter Editors
THE AGRICULTURE LETTER EDITORS

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