Agricultural Economy

Jack Harrison

U.S. Economy To Cool in 1998

GDP growth in the U.S. is expected to slow in 1998 to 2.5 percent, following 3.8-percent growth estimated for 1997. With the labor market expected to remain tight, slightly higher wages and high capacity utilization rates in 1998 will bump inflation up. We expect the GDP deflator—a measure of overall inflation in the economy—to move up 2.3 percent in 1998, from a very low 2.1 percent in 1997.

Interest rates are expected to be relatively stable in 1998. Short-term interest rates are expected to be stable in part due to the expected stability of monetary policy. Long-term interest rates, which began 1998 at near-30-year lows, are expected to remain relatively unchanged in 1998. The dollar, which before the financial crises in Asia had been expected to depreciate in 1998, is now expected to appreciate sharply relative to 1997.

Robust growth in consumer, business equipment, and inventory spending led the strong GDP growth in 1997. Substantial gains in disposable income and record-high consumer confidence pushed consumer spending in 1997 to its fastest increase in the past 7 years of economic expansion. The strong consumer spending growth over the last 2 years stimulated inventory buildup in 1997. Business equipment spending has also increased, driven by strong profit growth, new technology, the need to economize on increasingly scarce and expensive labor, and vigorous export growth.

In 1997, more jobs were added to the economy and real compensation rose more rapidly than in any previous year of the current expansion. The shortage of qualified job seekers, however, constrained job growth in late 1997. These hiring bottlenecks likely will persist in 1998 because the economy, most analysts believe, has reached full employment.

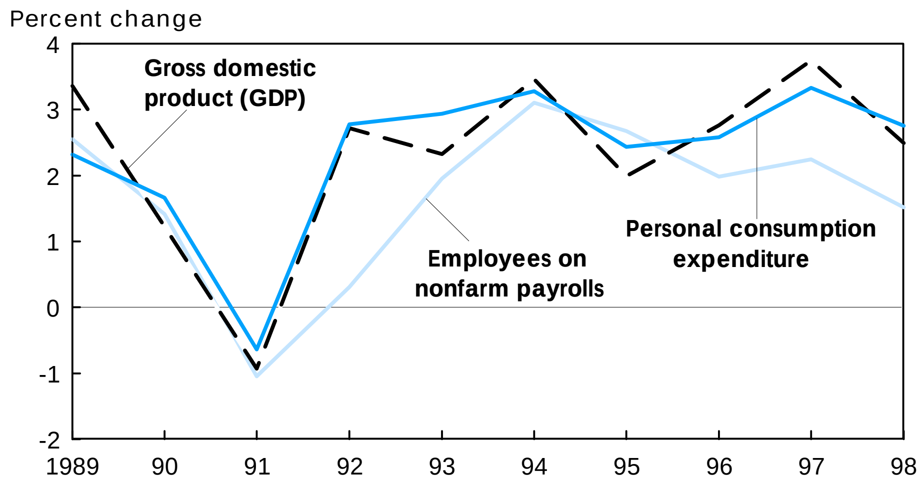
The rural unemployment rate, which has been about the same as the urban rate for the last 4 years, was a low 5.2 percent in 1997. During 1997, employment growth in rural areas trailed urban areas—rural areas added jobs at more than a full percentage point below the rate for urban areas. Wage and salary growth, however, has been stronger in rural areas—4.3 percent over the 12 months ending September 1997, compared with 3.5 percent in urban areas over the same period. Rural earnings growth has been greater than urban over this expansion, and rural areas have seen income inequality decline slightly in the 1990's.

The continued shortage of qualified workers will limit job growth, slowing growth of disposable income and, ultimately, growth of consumer spending in 1998. As growth in spending on consumer goods slows with more sluggish job growth in 1998, the desired inventory buildup is expected to slow. The serious slowdown in Asia's growth and the dollar's gain relative to the depreciating Asian currencies and the currencies of other U.S. trading partners will substantially slow export growth and accelerate imports in 1998. Business, in turn, is expected to curtail growth in equipment spending. This combination of events will lead to a slowing of GDP growth for 1998 to 2.5 percent.

Asian Events Will Curb Growth In Farm & Rural Economy

Real growth in U.S. agriculture has been more export-driven in the 1990's than most U.S. industries. Growth in U.S. agricultural exports to Asia has contributed significantly to growth in U.S. agriculture. Thus, growth in U.S. agriculture will slow as a result of the Asian crisis. The economies of South Korea, Japan, and the developing Southeast Asian countries—particularly Thailand, Malaysia, the Philippines, and Indonesia—have provided expanding markets for U.S. field crops, meats, and specialty products. Cuts in

1998 To See Slower Growth in GDP, Consumer Spending, and Employment



1997 estimate. 1998 forecast.
Source: Bureau of Economic Analysis, U.S. Dept. of Commerce; Bureau of Labor Statistics, U.S. Dept. of Labor.
Economic Research Service, USDA

their demand for U.S. agricultural products will have a strong negative effect on U.S. agricultural export sales.

U.S. exports will also grow much more slowly and imports will rise as the strong dollar increases domestic prices to Asian and other customers, at the same time world economic growth slows. In addition, the slowdown in U.S. growth attributable to the Asia crisis will soften domestic demand for animal products and put downward pressure on field crop prices. This adds to the price declines caused by a reduction in foreign demand.

The Asia downturn will also curtail growth in the U.S. rural economy in 1998, because of both weaker farm exports and the effect on the manufacturing sector. Many rural manufactured goods compete in the domestic market with exports from South Asia, and the strong dollar will make Asian manufacturing exports much cheaper relative to U.S. goods. In addition, as with farm exports, the Asian financial crisis will cut exports of U.S. manufactured products to Asia in 1998, while the impact on world growth from the Asian situation will reduce global demand growth for U.S. manufactured goods.

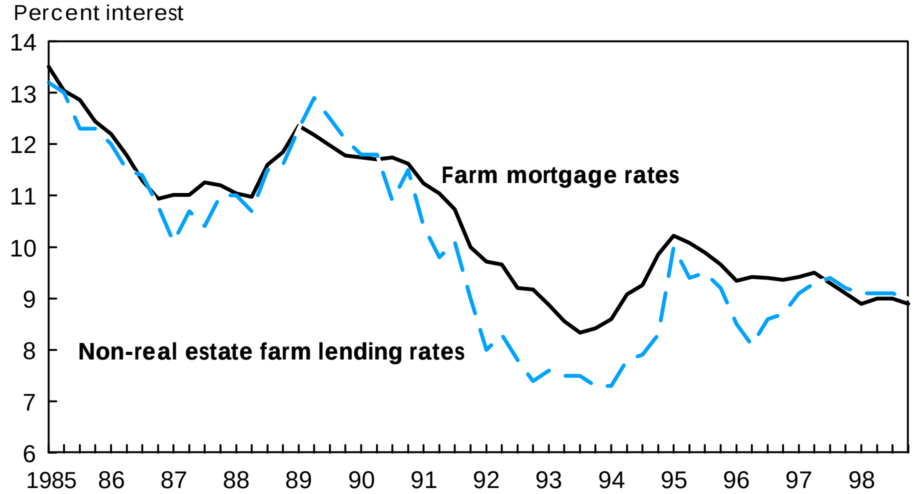
Manufacturing is a key employer in rural areas, where it provides disproportionately more jobs than in urban areas. Rural areas have been gaining manufacturing jobs during the 1990's, even in the face of declining manufacturing employment nationwide. Slowed growth in manufacturing will contribute to sluggish rural employment growth in 1998.

Low Inflation Means Slow Growth in Farm Expenses

A slight increase in inflation is expected in 1998 due to continued tight labor markets and some increases in manufacturing capacity utilization. Energy prices are expected to fall modestly in 1998, and wage increases will be small, leaving producer price inflation below 2 percent. Consumer prices are expected to rise 2.4 percent.

Inflation was lower in 1997 than in 1996 despite a booming economy. In fact, consumer prices in 1997, minus energy and food, rose at the lowest rate in 32 years.

Farm Mortgage and Non-Real Estate Farm Lending Rates To Remain Stable in 1998



Rates for commercial bank mortgages and commercial non-real estate lending only.

Economic Research Service, USDA

The dollar was strong, pressure on raw materials prices was largely absent, and in particular, energy prices fell sharply early in the year. Producer prices dropped for 7 straight months, resulting in a likely annual rise of less than 0.5 percent for 1997. Despite growing real wages, consumer prices rose only 2.4 percent, down from 1996's modest 2.9-percent rise.

The economy set the stage for the modest growth in farm expenses seen in 1997. Manufactured input prices declined, due largely to falling energy prices and some declines in raw materials prices. Interest expenses grew less than 2 percent, and the growth was primarily from increasing farm debt, not higher interest rates. Although other operating expenses, which are strongly influenced by wage costs, outpaced the general inflation rate, these reflected real wage increases seen throughout the economy.

The expected drop in energy prices in 1998, some declines in other raw materials prices, and a strong dollar will constrain manufactured input price increases. Fertilizer prices, given a modest expected decline in natural gas prices, may actually decline. Wage-related inputs such as services and contract labor will likely see small increases. As interest rates are expected to remain flat in 1998, nonfarm input expense growth should be modest. At the same time, the slower growth of the rural economy in 1998 will likely also slow growth in farm households' off-farm employment.

Farm, Rural Interest Rates Relatively Stable for 1998

Interest rates are expected to be stable over the course of 1998. On a year-over-year basis, short- term interest rates are expected to be little changed over those of 1997. Little change is expected in 1998 due to an expected stable monetary policy and continued low default risk on most debt securities and loans. Long-term interest rates will remain about steady in 1998, near their 30-year lows seen at the beginning of the year. On a year-over-year basis, long-term interest rates should remain below 1997 levels.

Any changes in farm and rural lending rates will likely be smaller than any potential increase in interest rates in the national economy. Three main factors will hold down movements in farm and rural lending rates from commercial banks.

First, overall bank lending premiums—the difference between loan rates and cost of funds—have narrowed in recent years. This downward movement in premiums

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for business lending stems from record bank profits, competition for financial services, and lower perceived business default risk, which have made business lending more attractive to commercial banks. The trend is expected to continue in 1998. In agricultural lending, the perceived risk in farm lending has been curbed by strong growth in overall farm real estate values in 1997 and by strong farm income in recent years.

Second, many banks heavily involved in agricultural and rural lending are relatively small rural banks. These smaller banks are highly dependent on consumer-type deposits that are not very sensitive to short-term movements in open market rates. Thus, most small bank deposit rates will be only slightly affected by any potential increases in Treasury market interest rates in 1998.

Third, commercial banks, especially smaller banks in relatively isolated areas, determine their lending rates based in part on their average costs of funds. This method of pricing loans results in lower volatility for bank lending rates and bank profits. Farm operators and rural businesses have benefited from this interest rate stability, especially over the last several years.

David Torgerson (202) 694-5334, Karen Hamrick (202) 694-5426, and Paul Sundell (202) 694-5333
dtorg@econ.ag.gov
khamrick@econ.ag.gov
psundell@econ.ag.gov AO

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February

19 Livestock, Dairy, & Poultry (3 p.m.)
20 Agricultural Outlook Agricultural Income and Finance**
*23 AGRICULTURAL OUTLOOK FORUM Agricultural Exports**
24 AGRICULTURAL OUTLOOK FORUM
27 U.S. Agricultural Trade Update (3 p.m.)

**Release of summary, 3 p.m.*

Upcoming in *AGRICULTURAL OUTLOOK*:

Interest Rate Outlook

AND

Farm Credit Outlook