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Events in Asia Lower Prospects For U.S. Farm & Rural Economy

A 15-percent depreciation of Thailand's baht on July 2, 1997, has cascaded into a series of declines in currencies and stock prices in Asia. The fall of the Thai baht followed a policy decision to let the country's currency float, as the Thai central bank had nearly depleted its financial resources to hold up the currency's value. The foreign exchange reserve drain was also caused by international investors pulling out their short-term loans, because of concerns about excessive lending to some industries and in real estate.

The devaluations spread to other countries in Southeast Asia whose banking sectors, like Thailand's, have systemic problems, and whose economies also relied heavily on short-term foreign loans. The currency dives spotlighted weak regulation of financial and other enterprises in Malaysia, Indonesia, South Korea, and the Philippines, as well as Thailand. Currencies of Japan and Taiwan have lost value as well, but to a lesser extent than in Southeast Asia and Korea.

As investors pulled their money out of the problem countries in Asia and from other potentially shaky emerging markets, they turned to U.S. government bonds for safe investments. So the value of the dollar rose against the currencies of other major U.S. customers and competitors, including Australia and Canada. The contagion has been reflected in some declines in stock markets around the globe, as investors anticipated lower profits for some multinational corporations.

The current financial crisis in Asia inevitably raises questions about its impact on the U.S. economy in general, and on the farm and rural economy in particular. Economic forecasters have moved from an assumption of "minimal effect" to concern that the crisis might dampen the economic performance for some U.S. businesses beginning in the final quarter of 1997. Business forecasters have all lowered their expectations for global economic growth in 1998.

But until the situation stabilizes, economic forecasts can only reflect a best guess as to how the markets will "bottom out." While currencies in Asia continue to lose value, while the potential remains high for banking crises to spread to other emerging economies, and while the outlook for economic growth in Japan continues to sour, forecasters will not settle on a consensus regarding the severity of the situation.

The Asian countries most directly affected by the crisis—Thailand, Indonesia, Malaysia, the Philippines, and South Korea— accounted for about 12 percent of U.S. agricultural exports in 1997. Taiwan and Japan, where the problems are somewhat different, accounted for nearly 25 percent of U.S. agricultural exports in 1997. Steep currency devaluations in Southeast Asia and South Korea will result in a sharp cut in their demand for imports, and in profits of firms operating in the region. The region's welfare will suffer from its financial downturn, experiencing higher import prices, losses in stock markets, weak domestic demand, and credit constraints.

Most international analysts agree that these problems will persist until banking systems are reformed, and until other commercial operations that are effectively bankrupt are allowed to fail. In Thailand, as in the rest of Southeast Asia, South Korea and to a lesser extent Japan, excessive lending had led to overbuilding in real estate and many industrial sectors. With the devaluations, higher priced imports are feeding inflation, while domestic demand plummets and loans denominated in foreign currencies become harder to repay. Even with the required banking and institutional reforms complete, the affected countries will have to sharply boost exports to restore economic growth.

The speed with which governments are able to implement the needed reforms will vary, and the reforms will take some time to return the economies to their previous growth rates. In some countries, such as Thailand, many analysts believe the IMF will speed the reforms, while in other countries, such as Japan, the needed reforms are not yet on the horizon. The pace of institutional reform will determine the duration of the economic turmoil.

Current thinking has some Southeast Asian countries and Korea resuming trend growth within 3 years; recovery for some others in the region likely will take longer. In contrast, Mexico's post-devaluation rebound took just 1 year from the 1994-95 peso crisis. But there is a key difference between the Mexican and Asian situations: there is no large market to absorb an increase in Asian exports, as the U.S. did for Mexico.

Since exports account for over 45 percent of Southeast Asia's gross domestic product (GDP), the region's recovery requires a dramatic increase in exports. However, over 40 percent of developing Asia's exports have been intraregional, as have much of its transborder investments. As demand throughout the region plunges, exports will have to expand rapidly outside the region, and investment funds will also have to come from outside. Japan's ongoing financial crisis and lackluster economic growth rule it out as a prime market for Asia's exports. Instead, the developed economies—primarily the U.S. and the European Union—will face more and cheaper Asian imports. And at the same time that the steep decline in Asia's growth rates means it is no longer the

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most important U.S. export market outside the North American Free Trade Area, the region's currency depreciations raise competitive pressures on U.S. exports in other markets as well.

U.S. Economic Growth To Reflect Asia Downturn

Analysts agree that the reverberations of the economic crisis in Asia on the U.S. economy will be mixed. With a stronger U.S. dollar and lower incomes in Asian countries, the effect is for U.S. export growth to slow markedly and imports to rise. Imports to the U.S. become cheaper—a plus for consumers and for industries that import their inputs. And as more capital is diverted into investments in the U.S., interest rates decline—a plus for businesses and consumers wishing to borrow. But the trade balance effect will dominate: the U.S. trade deficit will rise as total exports grow much more slowly and imports rise, pulling down U.S. economic growth, albeit by a modest amount, as demand for U.S. products slows.

U.S. merchandise exports to Asia account for about 30 percent of total U.S. exports and 3.4 percent of GDP. A 10-percent decline in total U.S. exports to Asia would translate into a drop in U.S. GDP growth of about half a percent.

Any impact of the Asian currency devaluations is smaller on U.S. agricultural exports than on some other sectors—forestry and fishing, textiles and apparel, and durable manufactures, for example. Foreign demand for most U.S. agricultural products is less sensitive to drops in foreign incomes and increases in domestic prices than is foreign demand for products from other sectors. On the import side, the U.S. will buy more products than it would have otherwise.

Because manufactured goods will account for much of the slowdown in U.S. export growth and the increase in imports, any resulting declines in income and employment growth will affect the rural economy more than urban areas. Manufacturing accounts for a larger share of the rural than the urban economy, where services have become increasingly important. Further, raw materials prices will be under downward pressure, curbing growth in mining, another sector important for the rural economy. As a result, the rural economy will see slower job growth compared with the rest of the Nation in 1998. This will also dampen employment prospects for many farm families who increasingly rely on off-farm income.

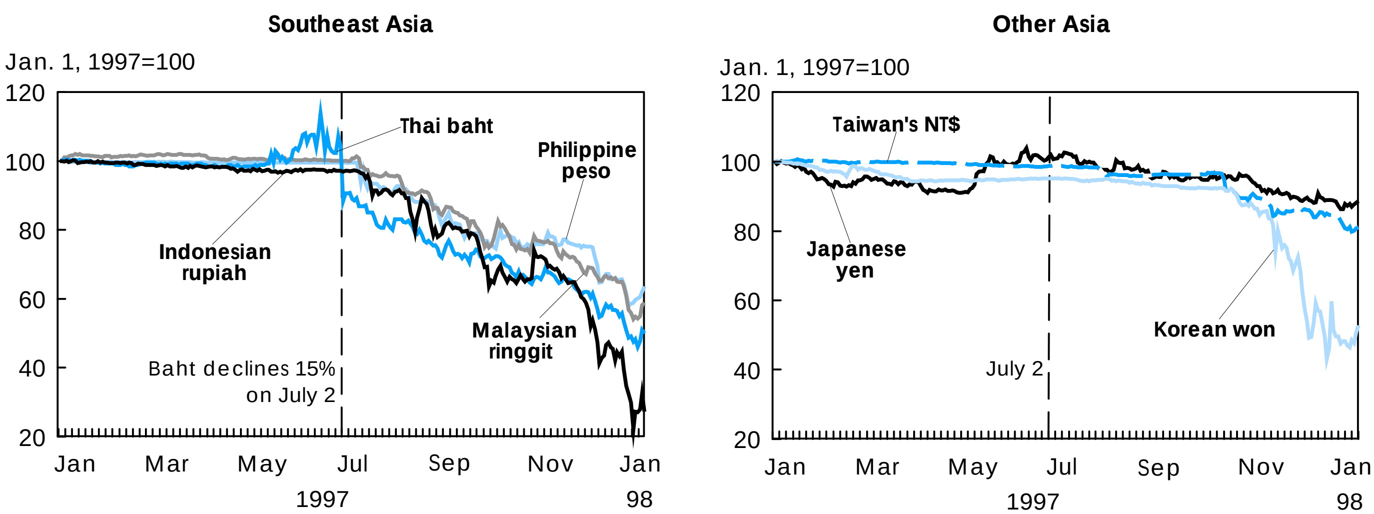
Downward Pressure on U.S. Ag Exports & Income

The slowdown in world economic growth due to events in Asia will affect the U.S. agricultural sector through two channels. One is the resulting slowdown in *U.S. economic growth*; the other is the reduction in international *demand for U.S. agricultural exports*.

Three components of the Asian financial crisis will influence the *demand for U.S. agricultural exports*. First is the significant loss in the value of Asian currencies relative to the U.S. dollar, and also the strengthening of the U.S. dollar relative to the currencies of major customers and competitors in the region, such as Australia and Canada. Second is the response of producers and of consumers globally for the next several years to the new set of exchange rates and changed pattern of world growth. Third is the decline in economic growth in the region and the resulting slowdown in the region's consumer spending.

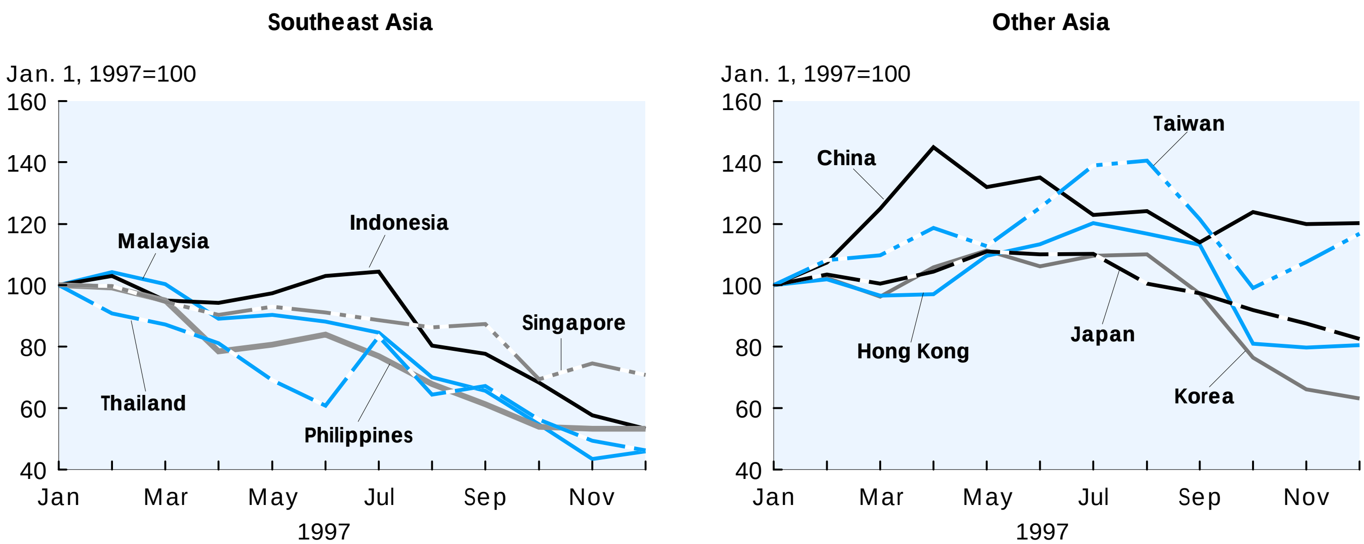
In world markets, most agricultural commodities are priced and traded in U.S. dollars. A loss in a currency's value relative to the U.S. dollar has the effect of raising the price of imported food and agricultural products. For example, the

Currency Depreciation Spread From Thailand to Other Asian Countries



Nominal currency movements against U.S. dollar, January 1, 1997, to January 15, 1998.
Source: Pacific Exchange Rate Service.
Economic Research Service, USDA

Stock Prices Have Declined Most in Southeast Asia and South Korea



Economic Research Service, USDA

price of meat products on the international market (denominated in U.S. dollars) has weakened somewhat over the past 6 months. However, the depreciation in the Indonesian currency relative to the dollar means that the domestic price of imported U.S. beef to Indonesian consumers increased by roughly 200 percent. The much higher price to Indonesian consumers will result in a fall in demand for the imported product.

Asian consumers are thought to be more sensitive to price changes for higher-valued products such as meats, horticultural products, and processed food products than for staples such as wheat products and rice. That is, a significant price increase for the higher-valued imported products would spur Asian consumers to halt consumption of the product, or to look for lower cost alternatives, such as domestically produced chicken. The currency/price effect is expected to have a more significant effect on the higher-valued U.S. agricultural exports.

There is a secondary longer term effect associated with the appreciation of the U.S. dollar. With some lag in timing, the higher price in local currency terms stimulates increased production in the importing country. A stronger effect likely will come from competitor countries, like Australia, whose dollar is also depreciating against the U.S. dollar. For example, Australia might become more competitive in the wheat and barley markets and in the beef and cotton markets. Thailand is likely to offer increased competition in the Asian market for poultry parts, as it now does in sugar.

Separating the Asia fallout from other events occurring in world agricultural commodity markets is difficult. This fiscal year, large coarse grain crops in China, Eastern Europe, and Ukraine are displacing U.S. exports. And Canada and Australia's large wheat crops, as well as their more competitive currencies, are exerting large impacts on the wheat trade.

Empirically based theoretical models can control for some of these other factors, to arrive at a picture "with other things being equal." With such a tool, tempered by analysts' judgment, USDA's Economic Research Service (ERS) found, for example, that U.S. exports of red meat and poultry are likely to drop 5-6 percent in fiscal 1998 and 1999, with more impact on red meats as Australia's beef gains market share. These estimates are relative to what U.S. exports would have been had the Asian economies maintained their fast-paced growth.

U.S. exports of horticultural products will be down about 4 percent. The decline in grain exports is likely to be about 2 percent in fiscal 1998, as consumer demand for these commodities is less sensitive to changes in price or incomes. However, the effect on grains and other bulk commodities likely will be greater than 2 percent in future years, when producers and consumers globally have time to adjust to the new price and economic growth patterns that result from the Asia situation.

Overall, the Asia situation likely means that U.S. agricultural exports will be down about 3-6 percent in fiscal 1998 and 1999 from what the level would have been without the Asia crisis. All these estimates incorporate ERS's "best guess" as to when the Asian economies will turn around, based on events through late December.

Lower GDP growth in Asia implies lower global demand for U.S. products and services. So *U.S. economic growth*, disposable income, and consumer expenditures will be less than otherwise expected. As a result, U.S. business demand for labor will soften, and wages will rise more slowly than expected earlier. Among agricultural products at the domestic retail level, this downward pressure on U.S.

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incomes primarily affects livestock and poultry products. Consumer demand for these products will be lower in 1998 than had been expected.

Slower-paced retail demand for meat products leads to lower retail prices, which in turn lead to lower farm prices. Farm prices for livestock and poultry will be lower than otherwise as a result. But international factors will reduce the price of feed, so the profit picture is not going to change much for livestock producers. As a result, livestock and poultry producers will leave their output close to what it would have been without the events in Asia.

Slower growth in demand for U.S. agricultural products in general leads to downward pressure on U.S. net farm income. USDA forecasts that net cash income in 1998 will be about the same as in 1997, at $54.5 billion, down 2-3 percent, adjusted for inflation. The “Asian financial flu” is among the factors affecting farm income prospects this year.

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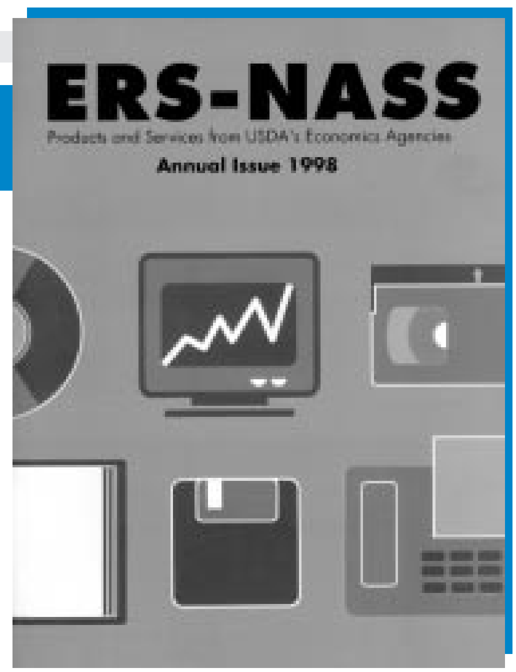

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