Agricultural Economy

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Outlook for the Farm Economy In 1999

The outlook for U.S. agriculture changed abruptly during 1998. At home, inclement weather devastated California, Florida, and many regions in between. Rising world commodity supplies and fallout from the Asian financial crisis reduced farm prices and the value of farm exports. The U.S. government reacted with legislation to increase assistance to farmers. Totaling nearly $6 billion, these funds are helping maintain farm income and tempering financial hardship for many producers. With exports and prices likely to be lower in 1999, farm financial stress will intensify, particularly in the Corn Belt.

Global events have been and will continue to be a major factor in the U.S. agricultural economy. While strong world economic growth and lower trade barriers in 1996 and 1997 helped push U.S. agricultural exports to a record-high $60 billion in fiscal 1996, expanding world production and weakening world demand have hurt U.S. exports since then. Grain, cotton, beef, and poultry exports have all been seriously affected. In 1998, the U.S. economy was strong, but the foundation of world demand deteriorated as Japan, South Korea, Malaysia, Philippines, Thailand, Indonesia, Russia, Saudi Arabia, and Brazil all saw recessions. In the boom period of 1996 and 1997, the world economy grew 3.4 percent per year. In 1998, growth fell to 1.9 percent, and in 1999, a further slide to just 1.7 percent is expected.

Brazil's problems are a particular concern given the fall of the *real* during January. For now, the currency has stabilized following the decision to allow it to float (*AO* March 1999). But the underlying large government deficit remains, and until this is addressed, Brazil faces high interest rates and slow growth. Because Brazil is the largest economy in South America, its performance will affect the entire continent. At this point, indications are not optimistic for 1999.

Anemic world economic growth and lower prices are expected to lower U.S. farm exports to $49 billion this year, down nearly $11 billion from the 1996 peak. Exports to Asia account for over 80 percent of the decline in total export value.

The drop in exports has given rise to several questions: Could more aggressive use of credit guarantees boost exports? Would elimination of trade sanctions help solve the problem? Would full use of the Export Enhancement Program restore lost trade? But the answer to these questions is no. Credit guarantees are being pushed to the limit, trade sanctions are having only a minor effect on U.S. exports, and the Export Enhancement Program, which is available primarily for wheat, would drive down world wheat prices, making it a waste of taxpayers' money given the ample competitive supplies on the world market.

Many uncertainties could affect agricultural markets and the well-being of market participants over the next 1 to 2 years. Weather is always a key and could work to make prospects better or worse. Another major factor will be the world economy. If the Asian economies fail to stabilize or if the economic problems in Brazil spread, U.S. agricultural exports could drop further. Right now, the engines of growth in the world economy are the U.S. and the European Union (EU), and both are slowing. Should either of these two regions fall into recession, there would be a global recession that would further erode world food and fiber demand and U.S. farm exports.

Higher Farm Stress Expected in 1999

Given this somewhat pessimistic outlook regarding demand for farm products, what are the implications for the overall health of the U.S. farm economy? Starting with aggregate cash flow, declining prices caused farm market receipts to fall by $10 billion down to $198 billion during 1998. Prices are likely to hold at that reduced level this year, with crop receipts projected to drop again and livestock receipts to rise with some improvement in cattle prices.

The projections and discussions in this article are drawn from a presentation at USDA's 1999 Agricultural Outlook Forum in Arlington, VA, February 22-23. Near-term numbers reflect official USDA data as of February 22, 1999. Long-term numbers were prepared in October-December 1998 and are published in *USDA's Agricultural Baseline Projections to 2008*, released in February 1999. USDA's complete 1999 baseline estimates are accessible via the Internet at www.econ.ag.gov/briefing/baseline/

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Helping to offset the decline in cash receipts in 1998, and so far this year, have been declines in interest rates, fuel prices, and feed costs. In fact, total production expenses decreased 2 percent from 1997 to 1998, the first significant drop in more than a decade. And expenses are likely to change little in 1999.

Direct government payments to farmers reached nearly $13 billion in calendar 1998 and will probably total at least $11 billion in 1999, again providing strong support. For the 1990's, government payments exceeded these levels only once—in 1993.

All these figures reflect an industry still performing adequately financially as it entered 1999, thanks to higher government payments and lower production costs, which helped push total net cash farm income for agriculture in 1998 to the second highest ever. The farm balance sheet was fairly sound, as farm equity steadily increased through the 1990's and as the overall debt-to-asset ratio remained steady at about 15 percent, down from over 20 percent in the mid-1980's.

For long-term agricultural prospects

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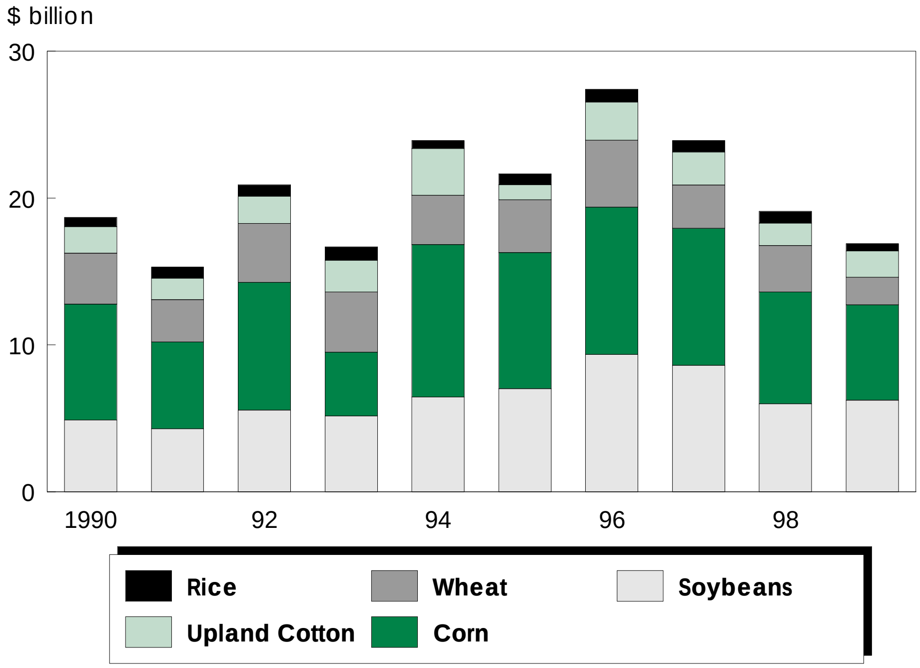
But these aggregate figures mask a marked erosion in market income in many regions and commodity sectors, and all signs now point to higher farm financial stress in 1999. Net cash farm income is projected at $55.5 billion in 1999, down $3.6 billion. While U.S. farm real estate values may rise slightly, land values began declining in a number of Midwestern states during the last half of 1998. The drop in income, coupled with declining asset values for many producers, means many will have difficulty obtaining credit. Those who do obtain credit will use it for variable cash expenses rather than investment, and will find themselves squeezed as they try to repay debt out of current income. Many producers who struggled with cash flow in 1998 resulting from low prices and adverse weather will likely see their problems worsen in 1999.

Net Income of Field Crop Operations to Again Reflect Financial Strain



Value of production and government payments minus total cash production expenses. 1998 preliminary; 1999 forecast.
Source: Office of the Chief Economist, USDA.
Economic Research Service, USDA

Aggregate farm income estimates include a large, stable, and growing core of commodities that include fruit, vegetables, nursery and greenhouse products, and broilers. Farm sales of these commodities—which exceed the total value of food grain, feed grain, and oilseed sales—will trend up again in 1999. So, looking beneath aggregate U.S. farm income reveals that the greatest financial strain in 1999 will be on field crops. For the 1998 wheat, corn, soybean, upland cotton, and rice crops, net income will be 17 percent below the previous 5-year average, and for 1999 crops, current projections show income 27 percent below the previous 5-year average.

While slow world economic growth and abundant world food and fiber supplies converge in 1999 to reduce the economic performance of U.S. agriculture, Americans will continue to benefit from ample high-quality food choices, with food prices rising only 2 percent this year.

Field Crop Prices To Remain Low . . .

Wheat, corn, and soybeans saw sharply lower prices in 1998/99, with carryover stocks expected up. Farm prices for *wheat* in 1998/99 are expected to average $2.70 per bushel, the lowest season-average price in 8 years. USDA estimates carryover stocks on June 1 at nearly 1 billion bushels, the highest since 1988. Since wheat was the first major commodity to sink after the mid-1990's runup, it will likely be the first to start reviving. The 1996 Farm Act envisioned that planting flexibility would help reduce surpluses by causing a cutback in planted acreage when prices were low. This year is the first big test, and wheat is passing the test. For the 1999 crop year, the world wheat situation will be tighter, with lower U.S. and EU production. U.S. wheat prices should rise, but with weak global demand and trade, the increase may be limited to a range of 10 percent.

For *corn*, total supplies in this marketing year are up sharply, and carryover stocks on September 1 are likely to be at their

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Low Prices for Field Crops: How Did We Get Here?

The recent Asian financial crisis and subsequent economic problems in many other countries are contributing to weak commodity prices, but the roots go back further. In 1995, record-high prices provided strong incentives to grain producers to expand production, which they did, both in the U.S. and abroad. In 1996, global production of wheat increased 44 million tons to a record 583 million, reflecting higher acreage and good yields. Output rose another 27 million tons in 1997. Similarly, global coarse grain output soared in 1996, jumping more than 100 million tons to a record 907 million. Although production slipped slightly in 1997, it was still the second largest on record.

Oilseeds experienced a similar supply response triggered by high prices, although lagging by a year. Led by gains in soybeans, global oilseed production in 1997 increased 24 million tons to a record 286 million. Again, there was a striking increase in area, and favorable weather boosted yields. This was followed by a smaller production increase in 1998.

Against this backdrop, world trade in coarse grains declined in 1997/98, and is increasing only modestly in 1998/99. The volume of world wheat trade held up in 1997/98 but is forecast down sharply in 1998/99 to the lowest since the mid-1980's.

Even before world imports began to falter, U.S. grain exports started to weaken as the U.S. lost market share in 1996/97 in the face of strong competition from other suppliers. While U.S. exports and market share for corn have increased in 1998/99, they remain relatively low by historical standards. For wheat, the volume of U.S. exports and market share has improved only marginally.

Oilseed trade has been stronger, which helps explain why soybean prices have showed less weakness relative to the grains despite large supplies. Record high in 1997/98, world trade in the major oilseeds has remained strong in 1998/99 despite a decline in soybean trade volume. Global trade in the major protein meals, including soybean meal, has risen for the last several years, and will be record large again in 1998/99.

Likewise, vegetable oil trade, including soybean oil, is expected to be record high in 1998/99, although its growth rate has slowed. U.S. exports of soybeans and products have been comparatively strong, even with some loss of market share to South America. However, in 1998/99 U.S. exports are contracting, a large factor behind recent price weakness.

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highest level since 1993. USDA's corn price forecast is the lowest in more than a decade. For the 1999 crop, trend yields would push U.S. supplies up again even with a little less acreage. Total use should expand by about the same amount, leaving U.S. corn carryover stocks near this season's high levels and setting the 1999/2000 price outlook for feed grains about unchanged from this year.

For *soybeans*, U.S. supplies this season are record high, and U.S. producers face strong competition from Brazil and Argentina. Carryover stocks on September 1 are expected to exceed more than 400 million bushels, the highest carryover in more than a decade. Soybean prices will probably average just over $5 per bushel this season, the lowest since 1986/87.

The key crop outlook question is: Can market forces stabilize or reduce stocks in 1999/2000? The answer: not likely. In fact, the 1996 Farm Act provisions are causing the pain of grain surpluses to be spread to oilseed markets. Producers are turning to soybeans because it appears to be the best of the less-than-ideal alternatives for the moment, and a further increase in carryover stocks and lower prices is likely for the 1999 crop year. Soybean acreage is likely to rise at least 1 million acres, encouraged by the high marketing assistance loan rate for soybeans relative to other crops, the benefits of herbicide-resistant soybeans, low out-of-pocket planting costs, and the crop's resilience in adverse weather. Given trend yields, prices could average well below $5 a bushel, and marketing loan payments could be in excess of $2.5 billion.

Cotton may be the commodity most vulnerable to the world economic slowdown. Lower global demand for cotton textiles and apparel has resulted in the second-lowest U.S. cotton exports in 20 years. The demise of the Step 2 cotton program has aggravated the export decline and will permit raw cotton to be imported (*AO* September 1998). With a strong dollar and with Asian textiles seeking a home, the U.S. has seen a 20-percent increase in imported cotton textiles and apparel since the start of 1997. Of the total cotton textiles and apparel Americans will buy this year, about 45 percent will be imported. Weak demand has pared farm prices, despite the drought-reduced crop in 1998. In 1999, a return to trend yields that raises U.S. production—coupled with any weakness in world demand—could push U.S. ending stocks higher, placing additional pressure on cotton prices.

. . . While Livestock & Poultry Prices to Tick Up

The meat and poultry industry is in for another year of record-high production in 1999. For *cattle*, market prices eroded further last year, and averaged the lowest in the 1990's. Continuing liquidation and record-high slaughter weights caused beef production to increase by 1 percent in 1998. A 3-percent decline in beef production is expected in 1999, but much of the year-to-year decline will not occur until the second half. For all of 1999, fed-cattle prices are expected to average $65.50 per cwt, compared with $61.50 last year.

Hog production has received attention this year as prices for all of 1998 averaged slightly below $32 per cwt, the lowest since 1972 (*AO* March 1999). What was responsible for the drop. Ten percent more production? Constrained slaughter capacity? Imports? Megafarms? A rush to avoid environmental constraints? Answer: all of the above probably had a role. But the most important factor can be expressed by paraphrasing a colorful statement of George Bernard Shaw about another farm animal. His summary opinion of New Zealand: too many sheep.

Continued large supplies will keep a lid on hog prices during the first half of 1999. But as slaughter begins to decline in the second half, prices should rise above last year's level, particularly by the fourth quarter. For all of 1999, USDA forecasts a slight decline in production and hog prices averaging $34 per cwt, 7 percent higher than last year.

As beef and pork production are cut back, *broilers* will gain increased domestic market share. Loss of the Russian market hurt broiler exports, but prices were still strong in 1998. With lower feed costs, broiler production will probably be up nearly 6 percent in 1999, pushing total meat and poultry supplies to record-high levels in 1999.

Milk production is seeing its first sustained production increases since 1995, and prices are coming down from the record-high $15.38 average in 1998. For all of 1999, farm-level milk prices will likely average about $1 per cwt below last year—about halfway between the 1997 and 1998 levels. Lower feed costs and high earnings of the past year are expected to help producers through the price decline.

Agriculture is a cyclical industry, and economic performance of the sector will improve. Over the next 2-4 years, economic recession in a number of countries should give way to economic recovery, lower prices will reduce agricultural production, weather will curb output in some areas, and demand for U.S. agricultural products will rise, bringing stronger farm prices and incomes. Unlike the rapid change in agricultural fortunes in 1998, the recovery could occur at a very gradual pace. AO

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Next month in *Agricultural Outlook* . . .

A report on farmers' 1999 planting intentions

And in future issues . . .

- The first market forecasts for field crops (1999/2000) and livestock (2000)
- Competition and concentration in U.S. agriculture