Farm Finance

Net Farm Income To Decline but Remain Near 1990-98 Average

USDA's financial outlook for U.S. agriculture remains generally favorable, despite the recent price collapse for many commodities. With additional government support payments and with prospects of lower production expenses, net farm income for 1999 should remain near the 1990-98 average.

The financial soundness of the overall U.S. farm balance sheet reinforces the USDA outlook. Farmers' equity in agricultural assets should increase for the 10th straight year, reflecting the combination of relatively small increases in assets and a modest decline in farm debt. Nonetheless, specific segments of the industry and areas of the country will continue to struggle with cash flow problems.

Net farm income in 1998 and 1999 is receiving a significant boost from approximately $5.6 billion in government support as part of the 1999 Appropriations Act, which is in addition to support provided under the 1996 Farm Act. These additional payments provided under the legislation will boost 1998 net farm income, while disaster payments, coupled with stable to declining production expenses and improved receipts for some commodities (notably livestock, cotton, fruit, and nursery and greenhouse products), will reduce the adverse impact of low grain prices on 1999 income.

Net farm income, which accounts for changes in farm inventories and noncash income and expenses, is forecast at $44.6 billion in 1999. This is down from the revised 1998 preliminary estimate of $48 billion, which would be the fourth highest on record, trailing only 1996 and 1997 by any significant amount. The 1999 forecast is only slightly below the decade's $45.5-billion average.

Net cash income, the return to farm operators from sales and other cash income minus out-of-pocket expenses, is estimated at $59.1 billion for 1998, the second highest on record. The 1999 forecast is $55.5 billion—above the 1990-98 average.

Production Value & Expenses To Be Unchanged

The value of crop and livestock production is forecast to be $197.4 billion in 1999, virtually unchanged from 1998. Production of many agricultural commodities is expected to remain high, barring adverse weather in major producing states. Consequently, crop receipts will continue to be pressured by low market prices as in 1998. Prices for many commodities fell to new lows in 1998, and there is little reason to expect significant changes in 1999. Commodity Credit Corporation loan rates are supporting revenues from major crops to some extent.

In 1999, lower farm prices are expected to be partly offset by lower expenses, due mainly to lower input prices and interest rates. Farmers will likely continue to modify their financial strategies and production measures to achieve additional cost savings. For example, some businesses will refinance existing debt into longer term obligations, reducing interest expenses. Adoption of new technologies such as Bt corn should help lower production costs.

The value of commodity production in 1999 is expected to exceed the 1990-98 average by almost $11 billion because of high production, with crop value up 5.5 percent and livestock value up 4.9 percent. The values of production in 1998 and in 1999 are exceeded only by 1996 and 1997 when higher crop values pushed up the total. In those 2 years, farmers benefited from an unusual combination of large harvests and high prices, resulting in part from strong export demand.

In 1999, total farm expenses are forecast to be $186.1 billion, up 0.5 percent from the revised forecast for 1998. Expenses decreased in 1998, the first significant drop since 6-percent declines in 1985 and 1986.

Interest rates and fuel prices are at the lowest levels seen in recent years, which will help farmers hold down production costs in 1999 if low levels are maintained as expected. The average interest rate on outstanding debt will fall, although exact movements in interest rates and their effect on debt structure are not known. Low oil prices, in addition to keeping a lid on fuel prices, should also translate into stable to lower fertilizer prices. Farm wage rates will probably rise less than in the previous 3 years, which were characterized by tight labor markets and increases in production of labor-intensive crops. The only significant jump in input prices will be cattle and calves for feeding operations, expected up 10-20 percent as supplies tighten.

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U.S. Farm Income To Stabilize in 1999

	Average 1990-98	1995	1996	1997	1998	1999	Change 1998-99
				$ billion			
Crop receipts	96.1	95.8	115.6	112.5	104.6	102.2	-2.4
Food grains	9.1	10.4	10.7	10.6	8.8	8.3	-0.5
Feed crops	22.4	24.6	27.3	27.6	23.8	21.9	-1.9
Cotton	6.0	6.9	7.0	6.5	5.6	6.1	0.5
Oil crops	15.1	15.5	16.4	19.9	17.6	16.3	-1.3
Livestock receipts	90.5	87.6	92.2	96.2	92.9	95.2	2.4
Meat animals	47.7	44.8	44.4	49.9	43.1	47.7	4.6
Dairy products	20.5	19.9	22.8	21.0	23.9	22.5	-1.4
Poultry and eggs	18.7	19.1	22.3	22.2	22.8	22.4	-0.5
Services and forestry	18.3	19.4	20.7	22.1	22.6	23.0	0.3
Total value of production	204.9	202.8	228.4	230.8	220.1	220.4	0.3
Direct government payments	9.2	7.3	7.3	7.5	12.9	10.2	-2.7
Net farm income	45.5	36.0	53.4	49.8	48.0	44.6	-3.4
Net cash income	54.6	51.8	56.4	60.8	59.1	55.5	-3.6

1998 preliminary; 1999 forecast.
Economic Research Service, USDA

In response to low crop prices, farmers may seek lower rental rates from landlords as rental arrangements are finalized in the first quarter. Some analysts are predicting a significant drop in cash rent rates. Operators may also moderate the amount of crop production inputs.

Farm Balance Sheet To Remain Strong

The viability of the farm economy derives in large part from the financial soundness of the balance sheet. Assets should continue to increase, though at a slower rate than in recent years. Farmers' equity in agricultural assets is projected to increase for the 10th straight year, totaling more than $900 billion at yearend 1999.

Farm real estate values, which represent the largest component of farm assets, are expected to increase in 1999 (although more modestly than in previous years), reflecting relatively low inflation and borrowing costs. The national rise in farm real estate values reflects the counterbalancing of lower prices in areas where agricultural uses dominate, and rising land prices in areas subject to urban pressure.

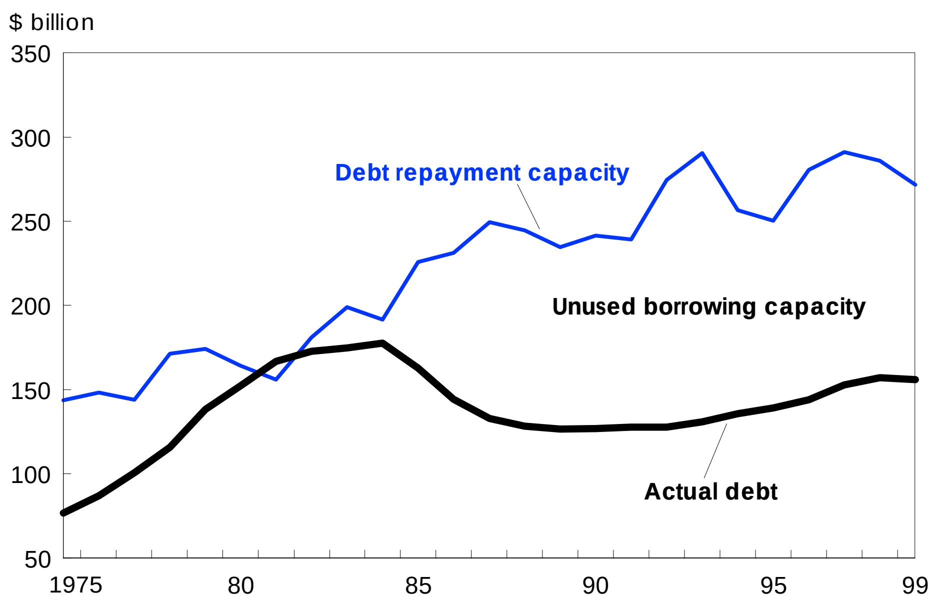
Meanwhile, farm debt is expected to decline slightly to $169.1 billion in 1999, ending 6 years of increases in farm sector debt. The forecast decline reflects fewer new capital investments financed by debt and a relatively low incidence of farms borrowing their way out of cash flow problems. Adequate levels of working capital and additional government support are also helping to hold down borrowing. Farm debt remains about $24 billion below its 1984 peak.

Farmers may choose to save a substantial portion of the payments they receive under the recent emergency assistance package in the 1999 Appropriations Act in anticipation of more limited credit availability in the spring. While ample funds are available for lending to creditworthy borrowers, bankers in some regions of the country have indicated that, given the commodity prices that are likely to be used in projecting next season's receipts, some borrowers may have difficulty showing that their operations have a positive cash flow—a requirement for production loans.

Any credit availability gaps may be filled by the increasing number of machinery, seed, and chemical suppliers that have ventured into the lending business. Besides expanding their traditional use of financing as a means to boost product sales, these input suppliers are offering financing to meet farmers' full production credit needs.

In 1999, farmers are expected to use their available credit lines more fully than in recent years. Farmers are expected to use a larger proportion of their debt repayment capacity—the level of debt that could be supported by their current

Unused Borrowing Capacity Remains Substantial For U.S. Farm Operators



1999 forecast.
Economic Research Service, USDA

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incomes, based on current bank interest rates and a 7-year repayment period. The proportion used by farmers rose from 45 percent in 1993 to 56 percent in 1995. In 1996, high net cash incomes and lower interest rates reduced debt repayment capacity use to 51 percent, despite a rise in farm business debt. Expected favorable interest rates and reduced debt in 1999 will not be sufficient to offset the effect of lower net cash income; debt repayment capacity use is expected to rise to 55 percent in 1998 and 57 percent in 1999.

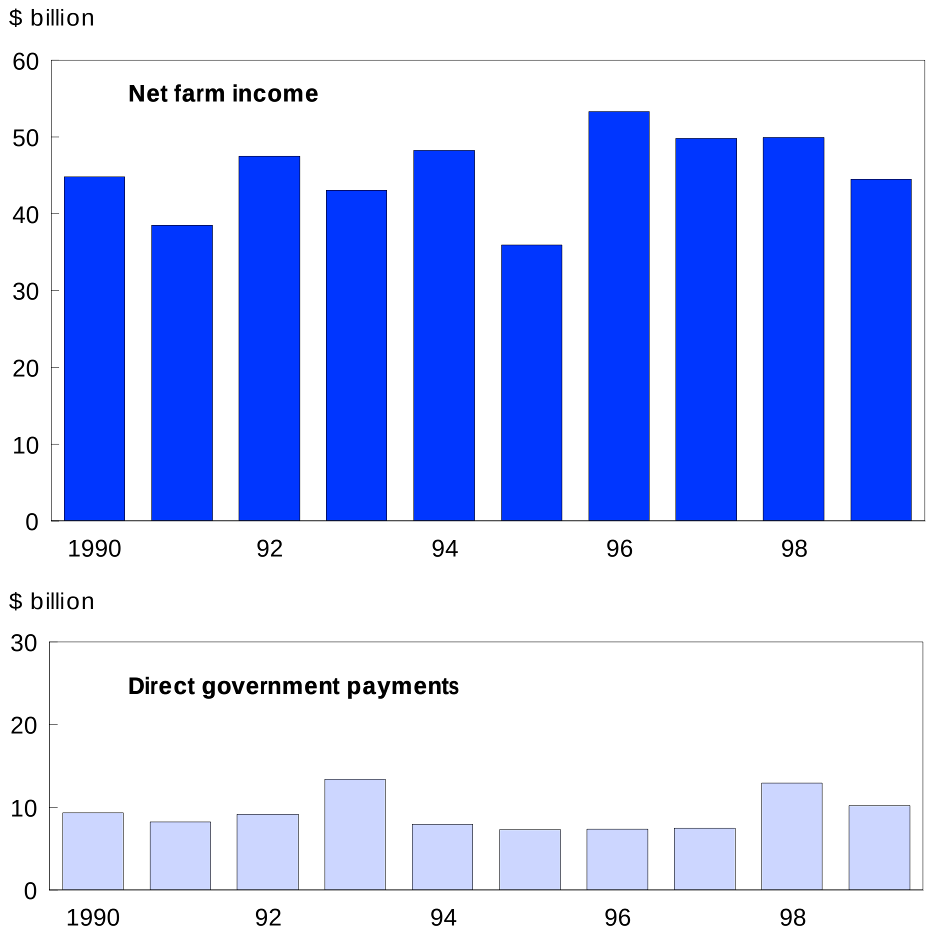
Income Changes, Farm Debt Distributed Unevenly

Most, but not all, financial problems faced by producers in 1999 will be cash flow-related. These cash flow difficulties, however, will reflect different conditions from those in the early 1980's when falling asset values and excessive debt in the farm sector, together with high inflation and interest rates in a fragile general economy, triggered a widespread farm financial crisis. During the farm financial crisis in 1981, 38 percent of available income was used for interest expense, compared with only about 17 percent in both 1998 and 1999.

In 1999, the reduction in debt, coupled with favorable interest rates, is expected to ease the impact of lower income. Total interest expenses are anticipated to decline about 3 percent in 1999. However, it appears that as a group, farm operators will have less income available to meet 1999 principal and interest payments on their loans, and those operators experiencing the greatest reduction in income may experience additional difficulty in meeting debt service requirements in 1999.

In 1998, many farms struggled with cash flow as some regions experienced poor weather and as abundant U.S. and foreign supplies squeezed commodity prices. With supplies projected to continue large, these farms may get little relief in the form of higher commodity prices in 1999.

Government Payments To Bolster Farm Income in 1998 and 1999



1998 preliminary; 1999 forecast.
Economic Research Service, USDA

Farm operators in the Lake States, Corn Belt, and Northern Plains accounted for almost 48 percent of all farm operator debt at the end of 1997. Almost 28 percent of the debt in these regions was owed by operators reporting sales between $50,000 and $250,000, a group consisting mainly of smaller family farm operations. While operations in these size classes tend to produce commodities currently experiencing low prices (e.g., wheat, corn, and soybeans), they are benefiting from additional government payments authorized in the recent emergency assistance package.

Overall, many farms will enter 1999 with more optimistic prospects than a year earlier. Beef cattle farms and ranches should see increased earnings based on higher prices and a likely drop in expenses. The hog sector, after enduring low prices and industry restructuring, should see some recovery in income. The economic outlook is also favorable for other commodity subsectors such as vegetables, fruits, and cotton.

Access the full Economic Research Service Report on *Agricultural Income and Finance*, including more details on individual commodities.

http://usda.mannlib.cornell.edu/reports/erssor/economics/ais-bb/1998/
Adobe acrobat version available soon at *www.econ.ag.gov*
(click on "Outlook reports")

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Government Farm Payments for 1998 To Be Decade's Second Highest

New legislation has prompted a substantial increase in expected government payments for 1998 and 1999 over the 1997 level. This includes supplemental support from the Omnibus Consolidated and Emergency Supplemental Appropriations Act for Fiscal Year 1999 signed in October. It also includes the offer to provide farmers 100 percent of their fiscal year 1999 production flexibility contract (PFC) payments before January 1, 1999 under legislation signed into law in August 1998.

USDA projects that these legislative packages combined with payments under the 1996 Farm Act will amount to direct payments of $12.9 billion to farmers by the end of calendar 1998 and $10.2 billion in 1999, up from $7.5 billion in 1997. For the 1990's, government payments exceeded these forecasts only in 1993, when payments totaled $13.4 billion.

Under the 1996 Farm Act, participants received PFC payments of $5.7 billion in fiscal year 1998 and will receive $5.5 billion in fiscal 1999. To estimate calendar year payments, the conventional assumption is that 20 percent of the fiscal year payment is taken before December 31.

The legislation signed in August changed the rules so that farmers could take all of their fiscal 1999 PFC payments in the remaining months of 1998 rather than receiving half in mid-December or mid-January and the rest by September 1999 as provided under the 1996 Farm Act. Some farmers, particularly those in areas affected most by climatic disasters and lower prices for grains and soybeans, are expected to take their entire fiscal 1999 payments in 1998. It is too early to know exactly how much of the fiscal 1999 payment will be requested before yearend, so the analysis assumes that an additional 10-12 percent could be added in 1998. This would increase PFC payments in calendar 1998 by about $600 million and reduce calendar 1999 PFC payments by the same amount.

Under the October Appropriations Act, almost $6 billion of new funding will be injected into the agricultural sector, with about $5.6 billion expected to be disbursed as direct government payments in 1998 and 1999. Nearly $2.9 billion will be disbursed as additional payments to farmers based on fiscal 1998 PFC payments before the end of calendar 1998. The bulk of the remaining funding is intended for disaster payments, with most of the disaster component likely to be disbursed in calendar 1999. Assuming that no more than 10 percent of the disaster funds will be disbursed before the end of calendar 1998, about $3 billion in additional government payments for 1998 and $2.5 billion for 1999 will be distributed to farmers from this legislation.

Following sharp declines in major crop prices, loan deficiency payments emerged as a significant portion of direct government payments in 1998 (*AO* October 1998). Farmers can receive the difference between the loan rate ($1.89 per bushel for corn in 1998, for example) adjusted to local market, and the daily market price, also adjusted to the local market. Once they have taken a loan deficiency payment for an eligible commodity, farmers can no longer place this same crop under a nonrecourse loan. Total loan deficiency payments for 1998 crops were $1.4 billion as of mid-December.

For more information, see the Farm Service Agency's Background Information: Non-Recourse Marketing Assistance Loans and Loan Deficiency Payments, March 1998, available at http://www.fsa.usda.gov/pas/publications/facts/nonrec98.pdf.

Farm Household Income To Rise

In recent years, prosperity in the nonfarm economy has been key in maintaining average farm household income. This year will be no exception to this trend. Despite expected lower income from farming, farm household income should increase in 1999 with a significant contribution from off-farm earnings.

Farm operator household income has averaged about the same as U.S. household income during the past three decades. Farm operator household income averaged $52,300 in 1997 and is forecast to be about the same—$51,000 and $52,000—in 1998 and 1999.

Forecasts of average operator household income are not highly sensitive to forecasts of farm income because farm earnings make up only a small share of total operator household income (only 10-17 percent since 1988). In 1977, off-farm wages made up 54 percent of operator household income. Off-farm income can make up such a large portion of farm household income because an establishment qualifies as a farm with only $1,000 of sales.

For households operating farms with sales of at least $100,000, earnings from farming make an important contribution to household income. Households operating these farms are affected the most by changes in farm sector income. These larger farms, however, account for only about 15 percent of all family farms.

The remaining 85 percent of family farms fall in the limited-resource, retirement, residential, or lower sales categories and depend on off-farm sources for practically all of their household income. Households operating residential or lower sales small farms rely on off-farm wages or self-employment earnings for most of their income. Operators of limited-resource and retirement farms rely heavily on Social Security and other public programs. (In 1997, about 42 percent of limited-resource farmers reported they were retired.) None of these farm households are affected greatly by changes in farm sector income.

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