Agricultural Economy

Jack Harrison

Continuing Strength Seen for the U.S. Economy in 2000

The U.S. economic expansion continued in 1999, undeterred by a tripling of the real trade deficit from 1997 through 1999. Despite some weakness in the goods-producing sector, U.S. economic growth in 1999 continued near the 4-percent rate of 1997 and 1998.

Strong profits, low interest rates, and profitable business opportunities brought robust growth in spending for business equipment and software. Solid consumer spending growth continued as real wages and stock market returns rose. The gains in domestic spending more than offset the effects of growth in the trade deficit.

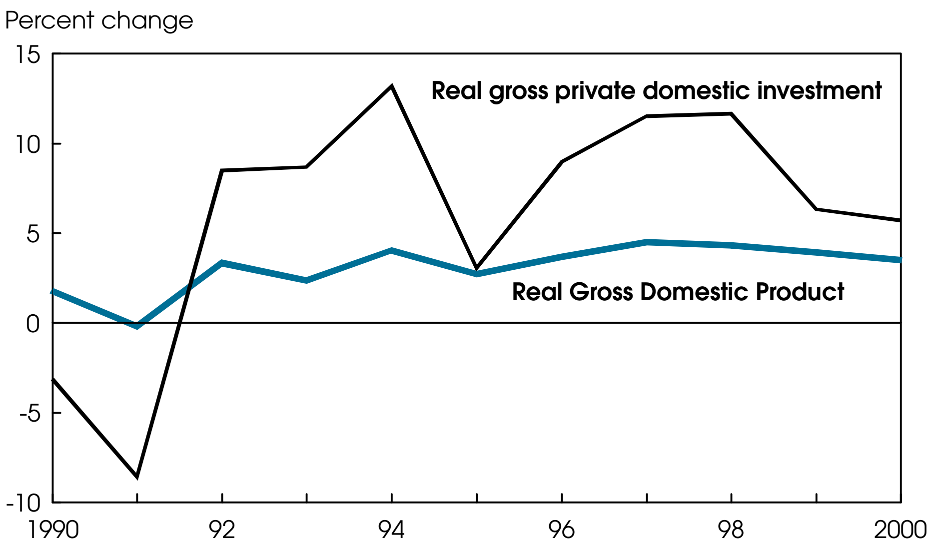
Consumer spending will expand more slowly in 2000 than in 1999, with consumer interest rates higher and credit conditions tighter, but spending should be quite strong, reflecting the very high level of consumer confidence. Over 2.5 million jobs will be added in 2000, and compensation will rise 3.6 percent overall at rates comparable to 1999, triggering a strong rise in personal income.

USDA's Economic Research Service forecasts a growth rate of 3.5 percent in Gross Domestic Product (GDP) in 2000, down slightly from an estimated 3.9 percent in 1999. The larger trade deficit will trim only about $50 billion off GDP compared with the $100 billion it subtracted in 1999, leaving a still healthy growth rate.

The major cloud over the strong U.S. economy in 1999 was the overall weakness of the goods sector—especially manufacturing, farming, and mining—due in part to the record-large trade deficit. The trade gap widened in 1999 as exports fell and imports grew because of a strong dollar and slow world growth. The goods sector had been hit by low prices even prior to the Asian financial crisis, as very large worldwide inventories had been building up in basic manufactured products, field crops, and raw materials such as oil.

Although overall investment rose in 1999, lower overall profits and heavier losses in general manufacturing and field crop operations curtailed construction of new farm buildings and factories. Investment in software and business equipment was up an estimated 30 percent due to strong spending for productivity-enhancing systems, relatively low interest rates, and good profits. Although the frantic pace of investment financing by corporate businesses in late 1999 will show up in early 2000 as spending on plant and equipment, investment spending growth overall is expected to slow to 5.7 percent. In 2000, a slowdown in housing growth (to 1 percent) will offset the projected 7-percent growth in plant and equipment to keep investment growth under 1999's estimated 6-percent rate.

Positive Investment Growth Supports GDP Growth



1999 estimate; 2000 forecast.
Source: Bureau of Economic Analysis, U.S. Department of Commerce.
Economic Research Service, USDA

As GDP growth is above the 10-year trend, the Federal Reserve is expected to raise short-term interest rates 50 basis points (one-half percent) in first-half 2000, helping to keep the rise in inflation—measured by the Consumer Price Index (CPI)—to less than half a percentage point in 2000. CPI inflation should be at 2.6 percent, compared with 2.2 percent in 1999. Long-term Treasury bond rates are expected to rise to an average of 6.5 percent, up from 5.6 percent. Competition from other countries for investment funds as the global economy goes into full recovery is the major reason for the climb in long-term U.S. interest rates.

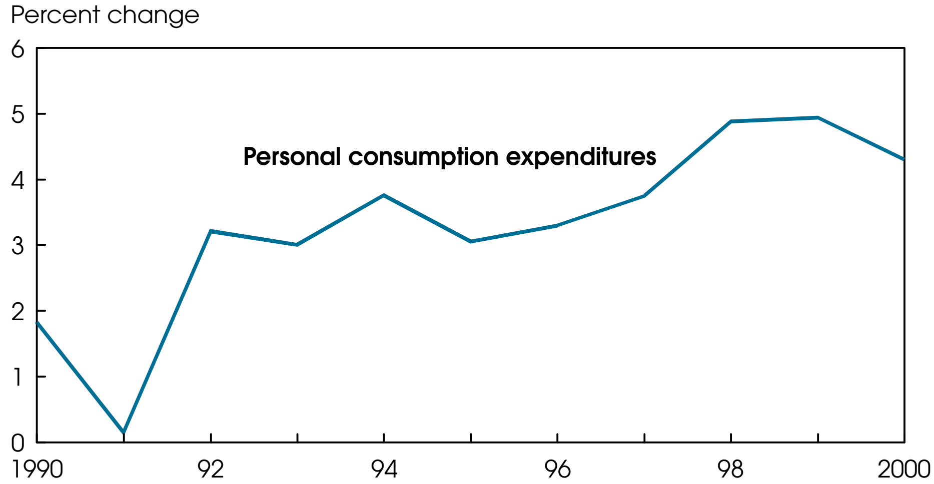
The exception to relatively low general inflation is the energy sector. In early 1999, farm fuel prices were very low as crude prices in late 1998 were the lowest in real terms since 1947. Crude oil prices more than doubled during 1999 as worldwide growth and recovery in faltering economies spurred oil demand. Oil output fell somewhat, despite rising demand, because OPEC members stayed within their production quotas and non-OPEC countries such as Norway did not increase output. The result was significant fuel price increases. For example, the price of diesel fuel in 1999 increased over 30 percent from 1998. Further fuel price increases are expected in 2000 as crude oil prices remain high.

Labor Market Is Resilient

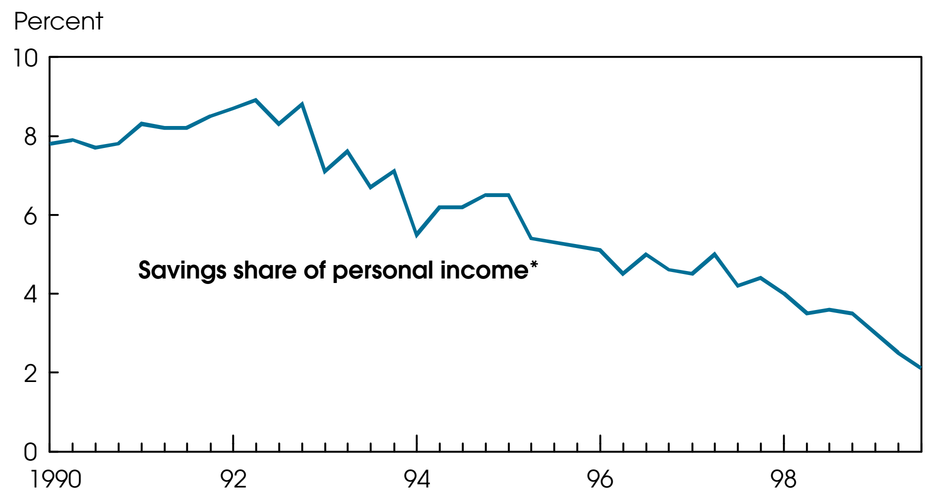
The overall labor market showed continued strength as employment grew by 2.6 million workers over the year. The service sector accounted for net new jobs for the economy in 1999 and is expected to be the primary source of over 2.5 million jobs expected to be added in 2000.

Despite the net job gain in the economy in 1999, the goods-producing sector lost jobs over the year, and manufacturing alone lost about a third of a million jobs, in both durable and nondurable production. Construction —fueled by new home development, government infrastructure projects, and Hurricane Floyd cleanup—was the only goods-sector industry to gain jobs. For the economy as a whole, mass layoffs—defined by the Bureau of Labor Statistics as job losses by more than 50 employees at one location—continued at a relatively high rate throughout the year, with the numbers of layoffs and affected workers both very high.

Consumers Accelerate Spending in the 1990's...



...While Saving Less



Quarterly data. 1999 estimate; 2000 forecast.
*After taxes.
Source: Bureau of Economic Analysis, U.S. Department of Commerce.
Economic Research Service, USDA

The October 1999 unemployment rate, unchanged in November, was 4.1 percent, the lowest since 1970. Unemployment is expected to continue low in the near term. The employment-to-population ratio stayed high, with 64 percent of people aged 16 and above working. Employment increases in some months of 1999 were small, due to shortages of workers, not to soft demand.

Compensation—both wages and salaries, and benefits—increased steadily over the year. At the same time, strong productivity growth kept inflation from moving up sharply, and low inflation meant workers' purchasing power rose. Annual wage growth was about 3.3 percent in the first 9 months of 1999, down from 4 percent in 1998 but about the same as in 1996 and 1997. Since the current tight labor market conditions started in 1996, employers have also been more willing to provide workers with benefits such as more flexible scheduling arrangements and on-site child day care.

Agricultural Economy

Growing labor compensation, strong employment growth, high levels of consumer confidence, and rising household wealth supported a continued consumer spending boom in 1999. Gains in real estate and stock markets provided large increases in household wealth, so that consumers increased spending more than their rising labor income. With every major category of consumer spending growing faster in 1999 than in 1998 (in real terms)—except for housing and energy—it is not surprising that savings as a percentage of after-tax household income was at its lowest level in 50 years. The measured savings rate was positive, but only because of an accounting change in the National Income and Product Accounts that expanded the calculation of total pension savings to include funds held in Federal, state, and local government retirement savings plans.

A low household savings rate would normally trigger a sharp rise in long-term interest rates, given the strong demand growth for investment funds. However, the gap between investment demand and household savings was filled by state and Federal government budget surpluses, large business retained earnings, and a continued net flow of financial investment funds into the country. Long-term interest rates were up only 75 basis points (three-fourths of a percent) by the end of 1999. The relatively modest rise in interest rates allowed the stock market overall to continue bullish in 1999 and supported strong consumer and business spending.

WINDOW on the PAST

Excerpts from USDA publications

U.S. Economy in 1975

A gradual upturn in economic activity is likely in the second half of 1975, despite the possibility of additional energy difficulties and the lack of consensus on a national energy policy. Inventory liquidation, which has already exerted considerable downward pressure on the economy, will continue over the next few months. But significant upturns in production and real GNP are likely this fall.

Although consumer spending probably will be limited by a relatively high saving rate, consumer expenditures should provide the major strength in demand in the coming months. Should consumers decide to spend a larger share of their incomes, the recovery could be considerably more robust than now seems likely.

Businessmen have adopted a cautious attitude concerning future demand growth and output is well below the limit imposed by productive capacity. Thus, despite the strengthening effect of the 10 percent investment tax credit, real business fixed investment probably will show some further decline before turning upward in the early months of 1976. . . .

The Organization of Petroleum Exporting Countries is virtually certain to increase crude oil prices when the current freeze expires on October 1, 1975. While the exact amount cannot be predicted at this time, an increase of at least $4 per barrel (roughly 25 percent) is not unlikely. An increase of this magnitude doubtless would have an adverse affect on both the extent and duration of the recovery. . . .

From the inaugural issue of* Agricultural Outlook, *June 1975

Contact: Anne B.W. Effland (202) 694-5319
aeffland@econ.ag.gov

Strong U.S. Economy Helped Fuel Asian Recovery . . .

In 1999, some of the economies most directly affected by the global financial crises began moving toward recovery. Three primary elements of the Asian economic recovery were: 1) significant reforms by Asian governments and corporations; 2) liquidity provided by the International Monetary Fund, World Bank, and the international community; and 3) export expansion. The strong U.S. economy played a key role in promoting the third ingredient of recovery.

In the short term, the Asian economies needed an increase in aggregate demand. Asian domestic demand was too weakened by rising unemployment and falling domestic wealth to revive growth, despite increased liquidity. Lowering interest rates to raise Asian domestic demand would have further weakened currencies. The weaker currencies would have triggered more capital outflow, lowering demand in the short-term and increasing long-term structural adjustment problems. Moreover, lowering interest rates would have signified a backing away from needed reforms and induced even more capital flight. Lacking a potential stimulus from either private or public Asian domestic demand, the Asian countries needed to increase exports.

As the world's largest economy, the U.S. would be expected to absorb a large share of rising exports from Asia. As it turned out, the world situation made the role of the U.S. indispensable, and larger than many had initially expected.

Most of the rest of the world was in no position to absorb increased exports. Europe and Japan—a major trading partner of the affected Asian countries—were experiencing sluggish growth at best in 1998 and early 1999. Slow-growth countries are poor export markets. Many of the larger developing country markets such as Brazil were themselves caught up in the financial crisis, so their economies would not absorb new imports. The affected Asian countries trade largely with each other, but could not look to each other as sources of new export markets—export growth to an economy in recession is most unlikely. Clearly, the booming U.S. economy was a prime candidate to absorb a very large share of rising Asian exports.

The increase in exports was aided by a flight of investment funds to U.S. financial markets starting in late 1997. The inflow of funds pushed U.S. market interest rates down as foreign investors sought a safe haven in U.S. treasury securities, raising the price of bonds and thereby lowering yields. The inflow of foreign funds also bid up the price of the dollar, making U.S. exports more expensive and imports from Asia cheaper. As a result, the U.S. through 1998 and 1999 absorbed a record level of imports. The overall strength of the U.S. economy allowed a real trade deficit of more than $300 billion while not appreciably slowing U.S. growth. Lower interest rates and low oil prices for much of 1998 and 1999 boosted domestic sectors, more than offsetting contraction in the U.S. trade sectors.

Once the affected economies were jump-started by higher export demand, they provided a large part of the recovery stimulus for each other. Although problems remain in other countries—i.e., the former Soviet Union and parts of Latin America—the contagion of downturn from the Asia crisis is over. By the end of 1999, Asia and much of the developing world was well on the road to recovery. Most analysts expect world growth in 2000 to pick up, with developing countries growing at a 5-percent annual rate—about the same rate as before the financial crisis. Part of the recent oil price surge was in fact due to increased Asian and developing economy growth. Prospects are good for continued Asian growth in the medium term that will generally have a positive influence on U.S. exports.

. . . & Expansion to Benefit Ag Sector & Nonmetro Areas

The typical U.S. farm business has operated in an extremely supportive domestic and world economic environment over the last 5 or 6 years. Rapid U.S. growth that helped to sustain growth in developing countries—even as the European and Japanese economies sputtered—supported expanded exports of farm products and manufactured goods. Oil prices were generally low and farm input price inflation was quite modest as interest rates remained low. The exchange rate of the dollar made U.S. farm products quite competitive until the world financial crisis strengthened the U.S. currency.

Further, an expanding U.S. economy allowed domestic agricultural market (food) demand to remain strong despite cutbacks in public assistance programs and falling food stamp allotments. New jobs often provided recipients of these program benefits with the means to maintain former spending levels for food.

In 1999, U.S. and global economic factors impacting U.S. agriculture were mixed. First, recovery in crisis-affected countries, expectations of a weaker dollar in 2000, and stronger world growth helped to keep U.S. farm export prices from falling even further than they would have as worldwide supplies of major crops mounted. Second, input price inflation overall was low, as costs for wages and industrial materials rose more slowly than in 1998. However, crude oil prices more than doubled from an unusually low level, and diesel fuel prices rose more than 30 percent from late 1998 to late 1999.

By the last half of 1999, long-term Treasury interest rates remained low (up just 75 basis points from 1998). But softness in the farm economy and tightening conditions for credit—both the standards to qualify for a loan and the spread between the prime rate and the rate available to individual borrowers—caused long-term farm interest rates to rise significantly above 1998. Further, the Federal Reserve tightened credit in 1999 to reverse the easing of credit in late 1998, thereby causing short-term Treasury yields to rise about 1 percent by late 1999. Short-term credit rates for farmers rose even more, reflecting the increase in default-risk premium—higher premiums due to higher perceived risk of default—which long-term farm rates and other small business loan rates also confronted.

The situation for farm exports should improve with even stronger world growth and a further weakening of the dollar as investors move funds to Japan and Europe, reflecting more robust financial prospects there. Price inflation for manufactured farm inputs will likely be higher in 2000 than in 1999 as the lagged effects of higher oil prices work their way into the system, with higher fuel and fertilizer prices for the entire year. Crude prices are expected to stay above $20 per barrel, pushing the average price of fuel in 2000 up sharply from the average for 1999—albeit an average that reflected very low prices early in the year. Fertilizer costs, however, will not likely move up, with natural gas prices remaining low because of large inventories.

Prospects for farm businesses are mixed. Overall, net farm income is expected down in 2000, with row-crop producers seeing drops in income although animal-products producers' income should rise. Off-farm income prospects for farm households should improve as the expanding economy and continued labor market tightness make more plentiful and better paying jobs available.

Rising U.S. exports will also benefit nonmetro areas. Nonmetro labor markets, because of their larger share of manufacturing, mining, and agriculture-related jobs, are more dependent on exports than metro labor markets. When crises abroad brought a decline in export growth of U.S. goods in 1997—followed by a sharp drop in early 1998—nonmetro employment growth declined along with goods export growth, while metro labor markets were largely unaffected.

As goods exports rebounded in late 1998 and as the global financial crises abated, the shock to the nonmetro labor market subsided. Employment growth has since been steady in nonmetro areas, although not as high as metro growth. In 2000, higher world growth and a weaker dollar are expected to improve prospects for exports of manufactured goods and farm products, generating additional jobs in nonmetro areas. AO

David A. Torgerson (202) 694-5334 and Karen S. Hamrick (202) 694-5426
dtorg@econ.ag.gov
khamrick@econ.ag.gov