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A Rural Rebound in 2010

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In 2010, rural America was at the forefront of the economic recovery. As sluggish job growth reined in the U.S. economy, rural firms harnessed stronger global commodity demand and raced ahead of their metro peers. In fact, rural job growth sped up in the second half of the year with jobs stretching 2 percent above year-ago levels in the third quarter, outpacing metro gains. In addition, rising exports of farm commodities and manufactured goods spurred job and income gains in rural communities, fueling optimism for economic prospects in 2011.

Farm profitability strengthened with commodity markets at the end of the year. Robust agriculture and energy markets also fueled gains in manufacturing and service activity to overcome the headwinds of a weak housing sector. In past recoveries, robust commodity markets and firm manufacturing activity sustained growth in the rural economy for multiple years. Can the rural economy lead the nation's recovery again in 2011?

This article reviews developments in the rural economy and discusses prospects for the year ahead. In 2010, rising global food demand and smaller supplies fueled a booming farm economy. Rural firms seized these opportunities to restore economic activity and job growth on Main Street. Together, stronger farmgate and Main Street activity point to further prosperity in 2011. Rural prosperity, however, will depend on the ability of rural firms to compete in emerging global markets.

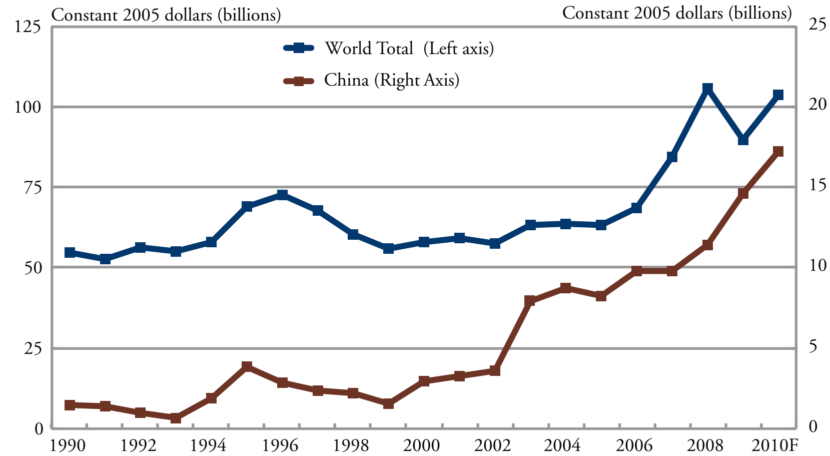
ROBUST FARM INCOMES IN 2010

A stronger global economy and rising demand lifted profits for U.S. farmers and ranchers in 2010. Livestock enterprises were the first to rebound as rising exports and reduced supplies bolstered prices and improved profit margins. Then, crop prices rallied with lower-than-expected global grain production, boosting incomes for crop farmers. Agricultural producers used their profits to pay off debt, purchase equipment and expand land holdings.

With a stronger global economy, worldwide food demand rebounded in 2010. Global economic activity grew 5 percent, with developing countries showing strong gains and spurring agricultural exports.[1] United States agricultural exports rose 16 percent in 2010, driven by a 36 percent gain in exports to China (Chart 1). Red meat and poultry exports rebounded 16 percent during the first three quarters of the year, while dairy exports soared 72 percent. Crop exports rose 15 percent due to strong cotton, corn, wheat and soybean exports.

Small herds and rising demand bolstered livestock prices and profits in 2010. In response to mounting financial losses, many livestock operators culled herds, limiting supplies and keeping 2010 U.S. meat production roughly 3 percent below the 2008 high. By October, smaller supplies and rising demand spurred a 50 percent increase in hog prices and a 25 percent increase in milk prices compared to the year before. At the same time,

Chart 1
Real U.S. Agricultural Exports



Source: USDA

Farmers used their rising incomes to repay loans, upgrade equipment and purchase land. According to Federal Reserve surveys, the stronger incomes led to higher repayment rates on operating loans and fewer loan renewals and extensions for non-real estate loans. In fact, farm incomes were so strong they limited loan demand amid increased capital spending as farmers used earnings to pay for capital investments. Agricultural bankers indicated ample funds were available for qualified borrowers at historically low interest rates.

Along with paying down debt, farmers increased their capital spending on equipment. The Association of Equipment Manufacturers indicated that during the first 10 months of 2010, four-wheel drive tractor sales surged 27 percent above year-ago levels with smaller gains in two-wheel drive tractor and combine sales. In addition to equipment purchases, construction of grain storage bins was visible across the Corn Belt.

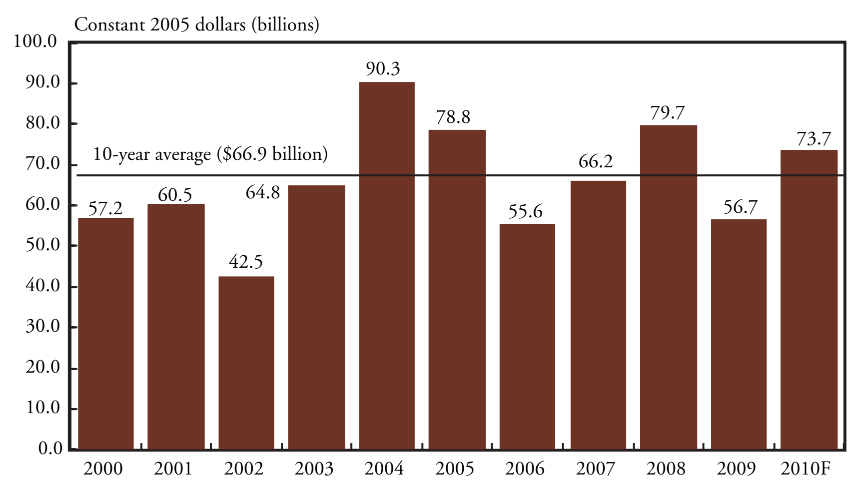
Higher farm incomes were also quickly capitalized into farmland values. After slight declines in 2009, farmland values climbed sharply this year. In the third quarter, nonirrigated farmland values jumped almost 10 percent above year-ago levels, according to survey data from the Federal Reserve Banks of Chicago, Kansas City, Dallas and Minneapolis (Map). Cropland values, however, rose faster than cash rents, raising questions about the sustainability

poultry and cattle prices rose roughly 15 percent from year-ago levels. During the first half of the year, rising prices drove cattle and hog profits higher and narrowed losses at dairy farms. But by year's end, rising feed costs were again threatening profit margins.

Crop prices rose with stronger exports and leaner-than-expected supplies. During the summer, wet weather in the United States and drought in Eastern Europe cut global grain production estimates. Falling 3 percent from June to November, the lower estimates left crop inventories flirting with historical lows and crop prices rallying. In June, the Russian drought triggered a 20 percent rise in crop prices, paced by 50 and 40 percent gains in wheat and corn prices, respectively. Soybean prices rose a more modest 15 percent. Cotton prices surged 25 percent after rising 40 percent in the second half of 2009.

Stronger livestock profits and rising crop prices boosted expectations for U.S. farm incomes throughout the year. At the beginning of 2010, United States Department of Agriculture (USDA) projected double-digit gains in U.S. net farm income due to stronger export activity. A summer surge in agricultural commodity prices led to upward revisions for net farm income in both August and November. Currently, USDA forecasts a 31 percent jump in real net farm income compared to 2009 levels (Chart 2).

Chart 2
U.S. Real Net Farm Income

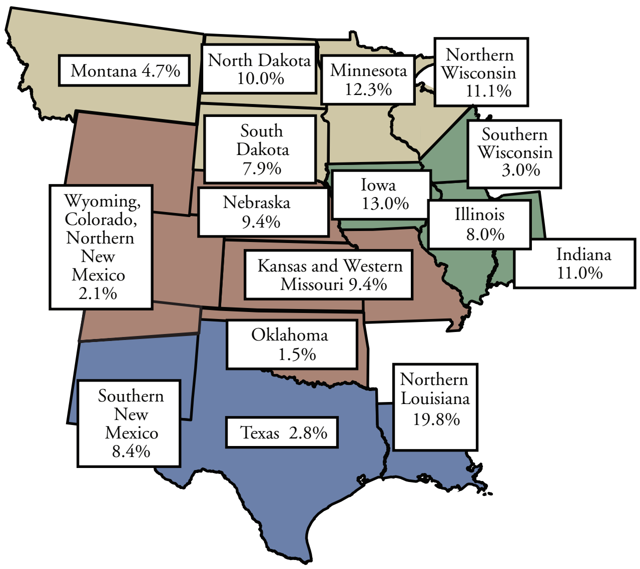


Source: USDA

Map

Good Quality Farmland Values (Nonirrigated Cropland)

(percent change Third Quarter 2009 to Third Quarter 2010)



Source: Federal Reserve District Surveys (Chicago, Minneapolis, Kansas City, Dallas)

of farmland value gains. Still, cropland values are expected to rise further with higher incomes, a limited supply of farms for sale, and robust demand for farmland from both farmers and nonfarm investors. Farmers still buy the majority of farmland, but outside investors are becoming more active in farm real estate markets.

The booming farmland values strengthened the farm balance sheet. Farm real estate accounts for roughly 85 percent of farm assets. In November, USDA projected farm assets to rise 3 percent above year-ago levels with a 2 percent decline in both farm real estate and non-real estate debt. As a result, farm equity is projected to rise 4 percent compared to last year, lowering farm debt ratios. After holding steady in 2009, the U.S. farm debt-to-asset ratio is projected to fall from 12 percent to 11 percent in 2010 with a similar decline in the debt-to-equity ratio.

Slow, Steady Gains on Main Street

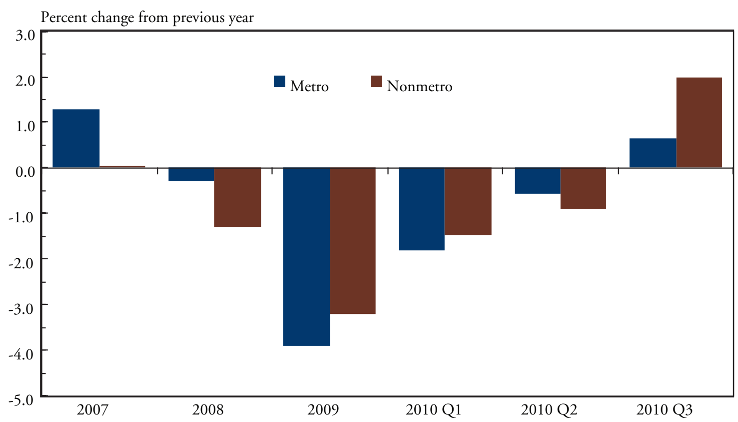
Stronger commodity markets and export activity bolstered business activity on Main Street. Rural energy and manufacturing production rebounded with higher energy prices and stronger exports. Toward the end of the year, the service sector began hiring, and nonfarm business activity improved. Improvements in the construction industry, however, were short-lived as building activity fell when the federal homebuyers tax credit program expired. Despite the weak housing market, the rural economy strengthened as the year progressed, often outperforming its metro peer.

The rural labor market steadily improved in 2010, strengthening with the national economy. After contracting 3 percent last year, rural employment growth rebounded moderately. By the third quarter, rural job gains had stretched 2 percent above year-ago levels, outpacing metro-area gains (Chart 3).[2] With a stronger labor market, rural communities faced a slightly lower unemployment rate of 9.2 percent, lifting rural wages. At the end of 2009, average weekly earnings in rural areas were flat but by September reached 2 percent above year-ago levels.

The vibrant commodity markets also helped buoy rural nonfarm business activity during the year. Booming farm profits spurred capital investments

Chart 3

U.S. Employment



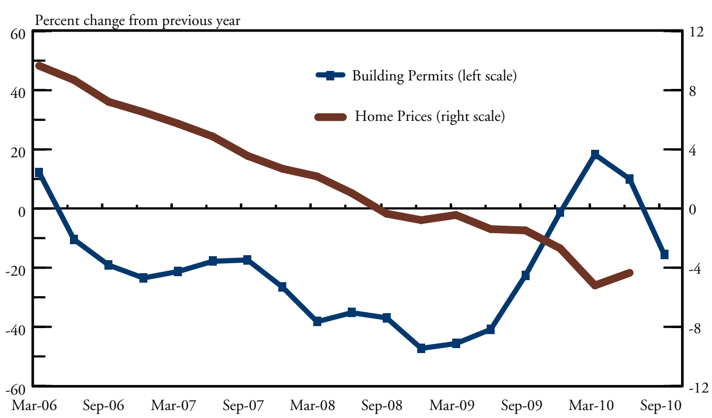
Source: Current Population Survey, U.S. Census Bureau and sales at agriculture-related firms, which in turn lifted employment at agricultural service firms more than 10 percent above year-ago levels. Rising energy prices, primarily crude oil, and limitations on offshore drilling also helped spark an economic rebound in rural areas. Stronger drilling activity in rural communities helped unearth jobs at exploration and mining firms, with some firms reporting a shortage of qualified labor. In addition, production of coal and natural gas topped year-ago levels in the third quarter and caused expectations to rise further heading into the winter heating season.

Stronger agricultural and energy activity helped support a rebound in rural manufacturing. Nationally, manufacturing production started to rise in 2009 and gathered steam in 2010. Through the third quarter, the number of mass layoff events at rural factories plummeted 75 percent from their 2009 peak.[3] To meet rising demand, factories initially relied on overtime to boost production. By midyear, rural factories started to hire additional workers to meet production schedules. In October, manufacturing employment had risen nearly 6 percent above year-ago levels in rural areas, while remaining slightly below year-ago levels in metro areas. With stronger manufacturing production and transportation activity, employment in wholesale trade and transportation firms stabilized.

Service sector firms also contributed to rural economic growth. After plummeting in 2009, service-producing jobs edged up roughly 1 percent in the third quarter. Some of the strongest gains emerged in professional and business firms, which employ lawyers, accountants, architects and engineers. As in metro areas, rural education and health service firms continued to report rising employment. Solid tourism activity boosted demand for leisure and hospitality jobs in both urban and rural destinations, especially during the summer. Despite state and local budget constraints, rural government jobs held steady. In contrast, information and financial activity firms struggled to add jobs after significant downsizing during the financial crisis.

Despite stronger business activity, rural communities struggled to overcome weak housing markets. At the beginning of the year, the extension of the federal homebuyers tax credit program spurred rural home building and slowed the decline in home prices. In the first quarter, rural housing permits rose 18 percent above year-ago levels, which helped stabilize rural home prices at roughly 4 percent below levels in the second quarter of last year (Chart 4[4]). The gains in construction activity, however, were temporary. With the end of the homebuyers tax credit program, residential housing permits dropped more than 15 percent below year-ago levels, and rural home prices remained weak.

Chart 4
Rural Single-Family Building Permits and Home Prices



Sources: U.S. Census Bureau and Federal Housing Finance Agency

THE RURAL OUTLOOK FOR 2011

If recent history holds true, rural America could lead U.S. economic gains in 2011. Stronger commodity markets and export activity have positioned rural America for sustained growth in the year ahead. As the recovery strengthens, consumer spending should reinforce service sector gains and overcome the sluggish housing market.

Since 1990, the rural economy has outpaced metro gains during the first two years of economic recovery. After the 1990-91 recession, annual rural employment and per capita income growth was stronger than in metro areas through 1994[5]. After the 2001 recession, rural areas led metro areas in terms of employment and incomes through 2003.

With both farm and nonfarm economies gaining steam, rural economic activity in the year ahead will again hinge on the global recovery. According to the Federal Reserve System's most recent Summary of Economic Projections, the U.S. economic recovery is projected to strengthen in 2011 with gross domestic product rising between 3.0 and 3.6 percent and the unemployment rate falling to 8.9 to 9.1 percent.[6] The global recovery is expected to strengthen as well with the International Monetary Fund projecting world GDP growth of 4.2 percent in 2011.

Commodity industries could remain the primary drivers of the rural economy in 2011 with limited supplies and rising demand. United States Department of Agriculture projects agricultural commodity inventories to remain just above historical lows next year with increasing demand offsetting strong production. Moreover, the Energy Information Administration projects that global crude oil demand will be larger than global production in three of the four quarters in 2011. Looking ahead, energy and agricultural prices are projected to remain high in 2011 (Table 1).

Strong global demand could also support rural export and manufacturing activity. In 2010, agricultural exports were expected to reach their second-highest level on record and remain strong heading into 2011. In addition, resurgent manufacturing export activity could further boost the rural economy. Exports of U.S. nonagricultural goods jumped 21 percent in 2010 with stronger gains in exports of durable goods. With manufacturing activity accounting for roughly 20 percent of rural earnings, persistent gains in exports and factory employment could bolster the rural economy. In turn, stronger goods and commodity production could boost demand for transportation, distribution and other wholesale trade services, supporting further gains in professional and business services.

A hearty economic recovery could also stimulate consumer spending on Main Street. Retail sales strengthened at the end of 2010, and many economists expect personal consumption expenditures to rise almost 3 percent by the end of 2011.[7] Healthy rural employment and income gains could lift consumer spending further in the year ahead.

Still, the rural economy faces stiff headwinds from a weak residential housing market. Similar to the nation as a whole, rural homebuilding remains weak, especially after the end of the federal homebuyers tax credit program. Homebuilding, while weak, is expected by many economists to rebound roughly 5 percent in 2011.[8] Such a gain would keep the industry well below historical highs. But as employment and incomes rise, rural housing markets should improve modestly in the year ahead.

In sum, rural America is leading the U.S. economic recovery. Sparked by stronger demand and smaller supplies, the commodity boom could persist in 2011. Rising incomes, especially in developing countries, are expected to invigorate rural exports. Stronger exports, in turn, could further stimulate commodity and manufacturing production, which might translate into stronger activity for business service firms.

Table 1
Agricultural and Energy Prices

Commodity	2008-2009	2009-2010	2010-2011
Corn ($ per bushel)	4.06	3.55	4.80-5.60
Soybeans ($ per bushel)	9.97	9.59	10.70-12.20
Wheat ($ per bushel)	6.78	4.87	5.30-5.70
Rice ($ per cwt)	16.80	14.00	12.00-13.00
	2009	**2010**	**2011**
Cattle – choice steers ($ per cwt)	83.25	94.81	96-103
Hogs – barrows and gilts ($ per cwt)	41.20	55.29	55-58
Broilers ($ per pound)	72.10	83.4	83-89
Milk ($ per cwt)	12.83	16.35	15.95-16.85
WTI Crude oil ($ per barrel)	61.66	78.98	86.08
Natural gas – Henry Hub Spot ($ per mcf)	4.06	4.50	4.46

Note: Agricultural commodity prices obtained from *World Agricultural Supply and Demand Estimates*, U.S. Dept. of Agriculture. Energy commodity prices obtained from *Short-Term Outlook Report*, Energy Information Administration.

Domestically, stronger employment and incomes could spur additional consumer spending. Thus, the challenges posed by rural housing markets and budget constraints at the state and local levels could wane. As in 2010, rural prosperity will hinge on whether rural firms can meet the rising demand of global consumers.

Endnotes

[1]World gross domestic product (GDP) obtained from the International Monetary Fund (IMF), *www.imf.org*.

[2]Rural employment, unemployment and wages were calculated from the Current Populations Survey (CPS) administered by the Census Bureau.

[3]Mass layoff statistics obtained from the Bureau of Labor Statistics.

[4]Rural building permits calculated from Census Bureau data and rural home price data were obtained from the Federal Housing Finance Agency.

[5]Henderson, Jason 2010 "Will the Rural Economy Rebound in 2010?" *Economic Review* Federal Reserve Bank of Kansas City, first quarter. pp. 95 -119.

[6]Quarterly Summary of Economic Projections of the members of the Federal Reserve System's Board of Governors and presidents of the Federal Reserve Banks, released with the minutes of the November 2-3, 2010, meeting of the Federal Open Market Committee.

[7]Forecast for personal consumption expenditures were obtained from the Blue Chip Economic Indicators, December 10, 2010.

[8]Forecast for housing starts were obtained from the Blue Chip Economic Indicators, December 10, 2010.