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Outlook For U.S. Agriculture

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My presentation this morning will cover the prospects for the domestic agricultural economy in the upcoming year. I will be followed by Under Secretary Schumacher who will focus on foreign agricultural developments. Together, our presentations will provide a general view of how the U.S. has and is expected to fare in the global market. Of course, the real meat of the implications for agriculture will be developed over the next two days in the many sessions of this forum. Consequently, over the next few minutes I will concentrate on what I believe are the most important developments to watch in 1998. I want to cover three areas: first, the macroeconomy; second, a few commodity market highlights; and finally, the implications for overall economic performance of agriculture.

Before beginning, I want to call your attention to the 10-year projections being released at this Forum. These are Departmental projections, developed largely by the Economic Research Service. I think you will find them quite valuable to you for assessing trends, identifying crucial assumptions affecting the agricultural economy and providing a benchmark for conducting policy analysis. Note that these projections were developed in late fall to support the President's budget and do not incorporate some new information that will affect the 1998/99 markets. Therefore some of the projections you will hear from me and others in this forum may differ somewhat from the first year or two that are presented in the baseline projections. We encourage your feedback on the value to you of these long-term projections.

(I) Macroeconomic Environment

Despite the considerable uncertainty raised by the Asian situation, the U.S. economy looks like it will support strong food demand in 1998. We are all watching the developments in Asia and their implications for the world's economies, including our own. At this point, world economic growth looks like it will slow from 1997's 3.1 percent to something closer to 2.5 percent. While less favorable for exports, such growth would still be stronger than the 1.9 percent averaged during the first half of the 1990's.

In the United States, after a very strong 3.8 percent growth in 1997, our analysts expect this year's real Gross Domestic Product to grow about 2.7 percent. A slowdown in corporate profits and consequently less business investment in inventories, a tight labor market, and reduced net exports are expected to contribute to the lower rate of growth. The Asian turmoil is expected to trim 0.3 to 0.4 percentage points off U.S. economic growth. After watching the U.S. economy on a tear in 1997 and initially worrying about the effects of the tight labor market, "irrational exuberance" and the prospects for inflation, it now appears the modest contractionary effect of Asia will do the restraining job that the Federal Reserve might have done anyway had the economy continued to grow in the 3.5+ percent range.

We know the stronger dollar will add to the U.S. trade deficit and be a restraining factor on U.S. economic growth. Even so, there are numerous positives that will keep the growth momentum going. Lower long term interest rates will support investment and construction. Thirty year mortgage rates are the lowest in 26 years. Consumer confidence remains near record highs, and inflation is likely to be little changed, held down by the rising value of the dollar and oil prices that recently hit a 14-year low.

While all of these macro statistics mean we can expect a firm base of demand for meat and poultry, dairy, horticultural products and processed products, they also mean good news on the expense side of farmers' cash flow accounts. With energy prices and interest rates down and feed expenses likely down, farm production expenses are forecast to decline a little in 1998, only the second time that has occurred in the 1990's, with the previous time being in 1992 when recession was ending, interest rates were falling and acreage controls were limiting plantings. (Tables 1 and 2 provide summary performance indicators for U.S. agriculture.)

(II) Commodity Market Highlights

Major Field Crops: Grains, Soybeans and Cotton

Key development--One year ago, we forecast that large U.S. and world crops of grains, soybeans and cotton would lead to a softening in crop prices and a rebuilding of stocks. Those forecasts proved to be fairly accurate as weather was generally conducive to crop plantings and crop development. In addition to large U.S. and world crops, the Asian currency crises has further contributed to the bearish price outlook for major crops. Compared with one year ago, the price farmers received for all crops during January was down 4 percent. However, the price drops have generally been larger for the major crops. The price of corn was down 4 percent, but soybeans and upland cotton were down 8 percent and wheat was down a whopping 17 percent in January. The season-average prices of corn and wheat are expected to stabilize in 1998/99, but soybean prices are expected to fall by nearly 20 percent next year as South American soybean production continues to increase and another large U.S. crop is projected. This outlook for stable-to-down crop prices and returns would be further amplified if the Asian currency crisis spreads to other countries.

U.S. and world crop production were generally exceptional in 1997/98. In 1997/98, U.S. wheat production turned out to be the highest since 1990, as wheat yields were record high. U.S. corn production turned out to be the third highest on record reaching nearly 9.4 billion bushels. U.S. soybean production exceeded the previous record set in 1994/95 by 210 million bushels, as planted acreage topped 70 million acres for the first time since 1982. And, cotton production of nearly 19 million bales was only slightly below the record set in 1994/95. Globally, wheat production and oilseed production set records in 1997/98.

Large U.S. and world production of grains, soybeans and cotton have lowered U.S. crop prices and raised carryover for 1997/98. U.S. wheat prices are expected to be down about 20 percent and wheat stocks on June 1 are forecast to be up by over 50 percent, compared with one year ago. Soybeans stocks are forecast to nearly double this season, while soybean prices are expected to be down about 12 percent. Corn prices are forecast to fall by 6 percent in 1997/98 as carryover stocks increase by a modest 7 percent.

Lackluster growth in U.S. exports due to large world crops and the Asian currency crisis is also contributing to the drop-off in U.S. grain and cotton prices. Both wheat and corn exports are expected to be well below the average of the 1990's, and cotton exports are expected to be near the 1990's average in 1997/98. U.S. soybean exports, however, are expected to be record-high in 1997/98 as world demand for oilseeds continues to expand.

Despite the decline in corn exports, total corn use in 1997/98 is forecast to be the second largest on record, as domestic use is expected to expand by nearly 9 percent. For corn, growth in domestic use has continued to expand faster than growth in exports. From 1990/91-1996/97, domestic use of corn increased by 17 percent while corn exports were up 4 percent. Continued expansion of livestock and poultry production and lower corn prices are forecast to increase feed and residual use by 9 percent and food, seed and industrial use by 8 percent in 1997/98.

Even though stocks of major crops are expected to increase in 1997/98, stocks will continue to remain at modest levels for most crops, with the possible exception of wheat. The stocks-to-use ratio at the end of the 1997/98 season is forecast to be near 10 percent for corn and soybeans and about 23 percent for cotton. In contrast, the stocks-to-use ratio for wheat at over 28 percent would be the highest since 1990/91.

Turning to the year ahead for major crops, changes in relative returns and a 2-2.5-million-acre decrease in CRP enrolled acreage is expected to result in a small expansion in corn and soybean plantings, while acreage planted to cotton and wheat are expected to decline. Total plantings of major crops will likely be down slightly despite the decline in CRP enrollment, as lower crop prices and returns cause some producers to reduce planted area.

Assuming trend yields, U.S. **soybean** production is projected to exceed this past year's record, reaching nearly 2.8 billion bushels in 1998/99. **Corn** production is forecast at nearly 9.8 billion bushels, which would be 5 percent above last year and the second highest on record. But, lower acreage and a decline in yields from last year's record is expected to cause **wheat** production to fall by 9 percent to 2.3 billion bushels, and reduced planting could lead to about a 7-percent decline in **cotton** production in 1998/99.

Declining foreign production and improved macroeconomic conditions in Asia should enhance export prospects for corn in 1998/99, while large foreign supplies of wheat and soybeans are expected to continue into 1998/99, causing U.S. exports for these crops to remain essentially flat. U.S. corn exports are projected to rebound, reflecting reduced competition, especially from China. China is projected to swing from being a net exporter to a net importer, and Eastern Europe and Argentina are expected to export less.

Prices of corn and wheat are expected to remain firm in 1998/99. For wheat, a small increase in total supplies is expected to be offset by somewhat higher exports and domestic use. The corn market would also appear to be in near balance as domestic use and exports expand to meet the increase in production. The exception is soybeans where another record crop and large foreign production are projected to lead to a further collapse in soybean prices in 1998/99.

The market for **rice** present an interesting contrast. Plantings are expected to rise, reflecting firm 1997/98 market prospects boosted by rought rice exports to Latin America and continued expansion of domestic demand. Global trade will be strong in 1998, particularly markets in Southeast Asia, including Indonesia and the Philippines where drought has reduced rice production.

Key uncertainty--The key uncertainty for the 1998/99 crop outlook is the weather. When will El Nino cease to influence weather and what will the weather pattern that follows mean for crop plantings and crop development this spring and summer? At this point, all major crop growing areas expect the Upper Midwest and Northern Plains have more than ample soil moisture. In fact, if there is a concern, it is whether soils in the Southeast and Southwest will be dry enough at normal planting dates. These areas typically begin planting corn late this month, cotton in April, and soybeans in May. The more that excess moisture delays planting in the South, the more likely producers will shift from corn to cotton and ultimately to soybeans. Excessive moisture could pose a similar problem for Eastern Corn Belt producers, although the current National Weather Service forecast calls for a dryer April and May. Delays in planting could leave producers with the choice of planting earlier maturing varieties, with the prospect of lower yields or switching to soybeans. Further switching of acreage to soybeans combined with the prospect of a record South American crop would be more bearish for soybean prices but supportive of corn prices in 1998/99. A wet spring followed by a dry summer would support price prospects for both crops and there are not ample stocks to prevent major price run-ups if a severe drought occurs. If, however, current good conditions for winter wheat continue and other crop yields are above trend, the current, somewhat bearish, price prospects could become much worse.

Major Animal Products: Livestock, Poultry and Dairy

Key development--The most striking developments in U.S. agricultural markets have been occurring on the animal product side, notably, the loss of export growth and the production effects of the cattle and hog cycles. With animal products accounting for 45 percent of gross farm receipts, the economic performance of this sector undergirds the well being of much of agriculture. For 1998, livestock and poultry producers will take a pounding--especially during the first half of the year as record-high per capita meat and poultry supplies drive down returns. Consumers will be in hog heaven as they will find one bargain after another in the meat case of their supermarket. Per capita meat consumption on a retail weight basis was 202 pounds in 1990, averaged 208-210 pounds during the mid 1990's but is expected to surge to an all-time high of 216 pounds during 1998. Obviously, such a high level of consumption can only be accommodated by sharply lower meat and poultry prices. The expected 4-1/2 percent increase in meat and poultry supplies that will move through domestic channels is being caused by the first decline in U.S. meat and poultry exports in the 1990's, a surge of beef imports caused by the rising value of the dollar and weak Asian demand, large increases in pork and poultry production and more beef production than earlier expected.

Let's look into this a little deeper. **For the year ahead for beef,** we will get more supplies in the near term but less later on. A key development of 1997 was the continuing liquidation of cattle, a contraction which began in 1995. Much of the continuing liquidation during the past year has been due to high rates of cow and heifer slaughter. We do know that the very fast pace of cow and heifer slaughter began to slow in late 1997 and early 1998, but there is scant evidence that ranchers are retaining sufficient heifers to begin herd rebuilding and eventually turn the cycle up. Two factors jump out as discouraging expansion--weak prices for feeder cattle, while stronger than the past couple of years, are still below average and short hay supplies, with hay prices setting a record high for the month of January.

The upshot of the continuing liquidation is that beef supplies have not contracted here in early 1998 as we once thought would occur, and fed cattle prices are lower than once expected. Beef production is now expected to be up slightly during the first half of 1998 compared with a year earlier. This is keeping fed cattle prices in the low $60's per cwt. With breakeven prices in the high $60's, feedlots are taking a loss of $5-10 per cwt on cattle now coming out of feedlots which depresses the price they pay for feeder cattle. This will not continue. With fewer cattle on farms, fewer feeder calves will be available to feedlots, fewer steers will be fed, fewer slaughtered and retail supplies of beef will shrink. The question is when? This is expected to begin this spring and could go on through the year 2000. In 1996, beef production was up 1.2 percent. In 1997, beef production was unchanged, and in 1998 for the year as a whole, we forecast a decline of less than 1 percent, although the drop in production will grow as the year unfolds and could be down 3 percent by the fourth quarter. The conclusion then is fed cattle prices will rise and feedlots will have to pay more for feeder cattle. By late 1998, fed cattle could be over $70 per cwt, 20 percent above recent levels, and feeder cattle could be in the mid-

$80, compared with the mid-$70's recently. This will mean better news for cow-calf producers. By 1999, returns to cow calf producers should be strongly positive and that would provide and incentive to rebuild herds, but this outcome hinges on good crops this year.

Pork supplies will be especially heavy in 1998 as a 9-percent production increase is expected to combine with export losses and pull 1998 hog prices a whopping 23 percent below the 1997 average. One key development has been the pattern of expansion. In many states we have heard continuing use of words like "permit," "inspection" and "moratorium" when hog expansion is discussed. Consequently, we have been watching to discern whether environmental, structural or other issues could restrain future hog expansion. Current expansion rates are only somewhat revealing. Some traditional producing states such as Iowa and Minnesota are expanding faster than the U.S. average. North Carolina is below is the U.S. average. Southwest and western areas, such as Oklahoma, Texas, Utah, and Colorado, are all expanding faster than the U.S. average. The environmental questions will be addressed in a session tomorrow morning.

Broiler returns were reasonably good during 1997 and have remained above cash expenses even during the period of weak wholesale broiler prices experienced this quarter. In addition, export growth will be slower in 1998 but still positive as Russia, Hong Kong, China and Japan continue to be the major buyers. For 1998, we forecast that production will rise 5 percent, and with abundant meat supplies, broiler prices are expected to average only 56 cents per pound compared with 59 cents during 1997.

Lastly, for **milk** producers, the dairy market has been recovering since the very low prices experienced during the first half of 1997. Strong cheese and butter prices pulled the basic formula price (BFP) for January 1998 to the second highest ever for that month. Nevertheless, the milk-feed price ratio is not strong enough to signal milk production expansion and low hay supplies remain a concern. Consequently, milk production is expected to be about unchanged in 1998 compared with 1997. A good economy and expanding demand will keep milk prices firm, with the all-milk price expected to average slightly above the 1997 level. One uncertainty is the outcome of the Federal Milk Marketing Order hearing to establish a floor on milk used for class I and class II products. Because milk prices are seasonal and likely to go lower over the next several months, a floor, if established, would raise producers' returns above current projections. For example, a $13.50 per cwt floor on the BFP could raise the farm level milk price by 25-35 cents per cwt during the second half of 1998 above what it would otherwise be. However, because the floor is expected to be temporary, little production effect would be likely.

Key uncertainty--Combine the meat surplus story and marginal milk expansion with the fact that feed grain stocks remain relatively low. A bad weather year in 1998 could cause very high feed prices. That would recommence the heavy cattle herd liquidation and spin dairy returns well into the red. Hog prices are now 35 percent lower than in 1996 when cash corn hit $5.00 per bushel. So high, weather-driven corn prices in 1998 would have a much different effect on hogs than they had in 1995 and 1996. The hog

industry would be severely affected and, with continuing shrinkage in cattle numbers, the meat and milk sectors would face serious dislocations, with consumers facing serious retail meat price increases in 1999 and beyond.

(III) Implications for the State of the Farm Economy

Entering 1998, the U.S. agricultural economy continues to come down from the record high income levels of 1996. In 1998, the overall economic performance is expected to be slightly below the average of 1990-97. Areas of concern continue to be producers in regions affected by bad weather, and some wheat, cattle, hog and dairy producers who have had to reduce cash balances or incur debt to withstand short-term financial pressures. Farm cash receipts set a record of $202 billion in 1996 and were similar to that level in 1997, with crop receipts rising well above the average of the 1990s and livestock receipts at about the average. This year, market receipts are likely to decline to $198 billion, as lower grain receipts reduce the total return to crops. Livestock receipts will decline a little as lower returns to hogs more than offset a small increase in cattle returns, while dairy remains about unchanged. Overall production expenses will decline a little, held in check by lower interest rates and feed costs. Consequently, net cash farm income is forecast to decline to about $52 billion, more than $2 billion below the average of the 1990's.

The farm sector balance sheet exhibited further improvement in 1997 as asset values rose more than debt increased. Farm real estate values have risen every year since the mid 1980's, including a 6-percent increase in 1997. A 5-percent gain is expected in 1998. Farmers will take on more debt, reaching the highest debt level since 1985, but the overall debt-to-asset ratio is expected to decline from 15 percent at the end of 1997 to slightly under 15 percent at the end of 1998 as farm real estate rises.

Taxpayers will see stability in farm program costs with direct government payments, forecast at $7.4 billion for 1998, down from $7.9 billion in 1997, and accounting for only 3.7 percent of gross farm income. The big drop in farm payments will come for the 2001 crop year when the production flexibility contract payments drop from $5.05 billion in 2000 to $4.07 billion, about a 20-percent cut.

Consumers will see a year of modest food price inflation in 1998 with the Consumer Price Index for food in a range of 2-3 percent. In 1997, the CPI for food rose 2.6 percent compared with a 3.3-percent increase in 1996 when record high grain and milk prices pushed up retail food prices. In 1998, areas to watch are meats where retail pork prices are expected to decline by 4-6 percent; ample supplies of beef, poultry and fruit will also restrain food price increases. The effects of wet weather on spring vegetable harvests in California could also affect vegetable prices. For this spring's vegetable growing areas of California, heavy rains and flooding would interrupt harvest or damage fields of lettuce, broccoli, cauliflower, and other perishable crops. Already, we expect some harvest gaps as a result of the rains experienced this winter. It's a good bet that consumers will see higher prices for fresh vegetables this spring.

In 1998, American agriculture will continue to adjust to the increasing risks that accompany changes in domestic farm and trade policy as well as the profusion of new technologies and marketing arrangements that are emerging. These risk-creating changes will also provide the chance to lower costs, improve products, shift risks and open new markets internationally.

TABLE 1. ECONOMIC INDICATORS FOR U.S. AGRICULTURE (billion $)

Item	Avg. 1990-95	1996	1997f	1998f
Farm receipts 1/	184.7	213.3	212.9	209.0
Assets	898.6	1,034.9	1,083.0	1,131.5
Liabilities	142.7	156.2	162.2	167.6
Equity	755.8	878.7	920.8	963.8
Farm real estate ($/acre)	741.5	890.0	942	na
Exports (fiscal year)	43.7	59.9	57.4	2/ 58.5
CCC outlays (fiscal year)	9.8	4.6	7.3	8.6
Government payments	9.2	7.3	7.9	7.4

f=forecast
1/ Includes farm-related income. 2/ December 1997 forecast.

TABLE 2. RETURNS ($/unit) 1/

Item	Avg. 1990-95	1996	1997e	1998f
Corn (acre)	174.31	202.33	200.30	194.83
Wheat (acre)	89.81	111.69	84.48	78.75
Soybeans (acre)	138.28	196.27	172.38	125.22
Cotton (acre)	211.91	303.89	247.43	252.77
Hogs (100 lbs)	6.72	5.96	5.13	-3.59
Cow/calf (per cow)	69.00	-43.85	-.01	12.87
Chickens (100 lbs)	5.30	5.36	5.80	3.50
Dairy (100 lbs of milk)	2.42	1.86	2.09	2.53

e=estimated f=forecast
1/ Crops--return over variable costs for program participants and soybean producers for crop years; cow/calf, dairy and hogs (farrow-to-finish)--returns over cash costs with dairy on marketing years; chickens--returns over total costs.