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OUTLOOK FOR THE U.S. FARM ECONOMY

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Good morning and welcome to USDA's Outlook Forum 2004. I am going to begin this plenary session with a brief assessment of the state of the U.S. farm economy. My comments will be complemented by Dr. Penn's assessment of global agricultural issues.

- ***Conclusion: a strong foundation is in place for demand for U.S. farm products: economic recovery has taken hold in the U.S. and is gathering force in the rest of world.***

After several years of a weak and variable global economy that began in the late 1990s, the U.S. economy—and with it, the U.S. farm economy—had a very positive year in 2003. The U.S. economy, the world economy and U.S. agriculture are poised to experience another sound and prosperous year ahead.

Any such assessment of the U.S. farm economy must begin with the national and international economic situation. In 2003, we saw the U.S. economy pull itself together, recovery take hold, with the economy growing 3.2 percent (Chart 1). The pump has been primed with liquidity; expansionary fiscal policy, resulting from the budget deficit and the Jobs and Growth Act of 2001; the lowest interest rates since the 1950's leading to rising consumer confidence and spending; and, during the second half of the year, increasing business fixed investment.

With these factors all in place again in 2004, combined with an expectation of even stronger business investment spending, a depreciating dollar, few signs of inflation and stronger foreign economic growth, macroeconomic forecasters foresee U.S. GDP growth of 4.5 to 5 percent. This, together with stronger employment, should provide a large and growing domestic demand base for farm products.

Foreign GDP is projected to grow about 3 percent this year, after averaging less than 2 percent annually over the past 3 years. Japan is finally growing, and Asia and Latin America are expected to propel developing country growth to the highest rate in 4 years. With the European economies lagging, foreign economic growth likely will not push over the 3 percent line, which has often been a level associated with an upward surge in U.S. farm exports.

The improving domestic demand base may be seen in the demand for food, which also drives demand for animal feed. Monthly retail sales of grocery stores, food and beverage stores and food service establishments are usually higher than sales a year earlier (Chart 2). However, the U.S. economic slowdown in 2002 noticeably slowed sales (second line from the top). As the U.S. economic recovery took hold in 2003, sales moved up nicely (top line) and strong sales are again likely for 2004. Of course, the types of products consumers have been purchasing are changing, as attitudes toward diet and health change, and much will be said about these changes in this Forum, beginning with Secretary Veneman's comments in a few minutes.

In addition to rising food demand, domestic industrial demand for farm products is also looking up. As an example, monthly ethanol production is setting new record highs almost every month (Chart 3). In 2004, spurred by phase-outs of MTBE in California, New York and Connecticut, U.S. ethanol production should reach 3.25 billion gallons and account for over 1.1 billion bushels of corn use.

Stronger foreign economic growth should show up in improved U.S. agricultural exports in 2004 (Chart 4). This morning, we released our latest forecast for farm exports in fiscal 2004: $59 billion, up $2.5 billion from fiscal year 2003. This forecast is $0.5 billion below our previous forecast, which was published prior to the U.S. finding of BSE. The new export forecast reflects, in part, the assumption that the markets that are now closed to U.S. beef exports remain closed for 2004. This is not a forecast of what foreign countries will do. It is simply reflects our standard forecasting procedure to assume the policies foreign countries remain in place until they are changed.

At $59 billion, U.S. farm exports would experience the 5th consecutive annual increase since hitting the cyclical low of $49 billion in fiscal 1999, following the onset of the Asian currency crisis. A rising world economy, the declining value of the dollar, low global commodity stocks, and expanded U.S. crop acreage in 2004 will all support export growth for 2004. During the first three months of fiscal 2004, U.S. agricultural exports were up $3 billion over a year earlier. While part of this exceptional performance was unusually large early-season soybean exports to China at a pace that cannot continue, it seems clear that had BSE not been discovered in the cow in Washington, U.S. agricultural exports in 2004 would have exceeded the all-time record $60 billion set in 1996. Also notable is the upward trend we are beginning to see in bulk exports, which, since 1980, have been experiencing a long, slow down trend.

U.S. meat exports were the story of explosive growth in the 1990s but have faced slower growth over the past few years due to animal diseases and policy-driven import limitations in some countries (Chart 5). The U.S. finding of BSE has resulted in the closing of over 90 percent of U.S. export markets for beef and related products (red line in the Chart). However, this, and stronger global incomes, will create export opportunities for pork and poultry. USDA remains hopeful that important beef markets can be reopened during 2004, restoring some of these lost sales.

The performance of the new and emerging export competitors continues to shape the performance of global commodity markets. To see this, add up the soybean exports of Brazil and Argentina, the coarse grain exports of China and the Former Soviet countries, and the wheat exports of India and the Former Soviet countries (Chart 6). These exports grew from less than 10 million tons in 1994 to about 85 million in 2002—from 2 percent of world grain and soybean trade to an amazing 25 percent. This growth limited U.S. exports and market prices. However, in 2003, their exports fell back following lower production in the FSU, China and India. That has been another factor helping to boost U.S. exports and farm prices.

- ***Conclusion: crop supply-demand balances are favorable for strong markets again in 2004, even with normal yields and a rebound in global production.***

Turning to specific markets, most major crops are likely to be in close supply and demand balance for the remainder of the 2003 crop years, and for the 2004 crop years as well. When farm prices are strong, we often see global supply roar back, overtake demand and prices plunge. While we should expect production rebounds in 2004 from last year's poor weather in Europe and the FSU, there are several reasons to think global markets will remain robust.

First, there is a very strong foundation under global grain demand. For the 2003 crop years, global grain demand is expected to exceed global grain production for the 5th consecutive year (Chart 7). Second, this gap means that by the end of the summer, global grain stocks as a percent of use will be at the lowest level since 1972 for wheat, 1981 for rice and the lowest on record for coarse grain. Stocks are also low compared with history for soybeans and cotton. With low stocks and the improving global economy, it is likely that even with a return to normal yields in the key producing countries, crop stocks will remain low and prices firm for most major commodities.

A third factor has been China's production and trade changes. After emphasizing self-sufficiency in the early 1990s and building large grain stocks, China has sharply reduced their grain surpluses (Chart 8). That reduced China's role as a U.S. competitor in grain markets in 2003 and suggests a further diminution in 2004. In addition, their growing oilseed crushing and textile export industries have resulted in soaring soybean and cotton imports (Chart 9). The key question is: are we at the long-awaited turning point where China focuses resources on more labor-intensive crops and becomes a more sustained importer of bulk crops? We believe that will be the long-term trend, but there will be ups and downs in China's agricultural imports and exports in any year. China should continue to be a positive factor for U.S. agriculture in 2004. USDA forecasts U.S. farm exports to China this year of $5.4 billion, imports from China of $1.4 billion, for a trade surplus of $4 billion—a stark contrast to the $120 billion overall trade deficit the U.S. has with China.

The other side of the coin is the continued competition facing U.S. producers. No country captures more attention in this regard than Brazil. Most people know that Brazil has increased its soybean planted area by 25 million acres since the mid 1990s. But, Brazil is not just soybeans. They have increased production of cotton, soybeans, broilers, pork, corn and beef by 25 to 75 percent since the late 1990s (Chart 10). While I am portraying a positive economic picture for U.S. production agriculture in 2004, that optimism should be tempered by potential consequences of the continued production growth of Brazil and other emerging competitors.

The positive situation in the farm economy is reflected in higher U.S. farm price levels (Chart 11). For major commodities, the current USDA published forecasts for the 2003/04 marketing years for crops and the 2004 calendar year for livestock are all well above the previous 5-year average farm prices (last column). The only commodity showing a decline is hogs and that is slight.

As we look to the 2004-crop spring planting season, we will have the highest crop prices at planting time since 1998. This is likely to result in a slight increase in overall planted acreage. Even though total acreage in the U.S. has not changed much in the past few years, fluctuating around 325 million acres, the distribution has changed dramatically since 1990 (Chart 12). The most extreme changes are soybeans (the top line), up by 16 million acres, and wheat (the bottom line), down by 18 million acres.

For 2004, we expect that because of the strong prices, corn planted area will rise about 2.2 percent; soybeans, about 1 percent; and cotton and rice, about 8 percent each. Total wheat acreage is expected to decline about 2 percent, in part because the fall-seeded crop was down 3 percent due to adverse weather conditions. These acreages and trend yields would result in a record high corn and soybean crops of 10.4 billion and 2.9 billion bushels each, a cotton crop of 18.3 million bales, about the same as last year, and a rice crop of 217 million cwt. The wheat crop would be about 9 percent below 2003's level, which had a record-high yield.

Crop prices for the 2004/05 marketing year should rise for corn, be unchanged for wheat, but pull back a little for cotton, soybeans and rice. You can get the full details in the commodity sessions tomorrow. Currently, U.S. futures prices for the new 2004 crops show little difference from prices of the nearby contracts for the 2003 crops. Soybeans are the exception, because the low U.S. yield last year and strong Chinese demand have reduced U.S, stocks to historically low levels, and some rebuilding would occur with trend yields in 2004.

- ***Conclusion: animal diseases create a wall of worry for livestock and poultry markets, yet fundamentals suggest markets should remain firm.***

Turning to animal agriculture, prior to December 23, the livestock sector was poised for another boom year for cattle and beef. Strong demand for meat protein by consumers; the improving global economy; the improving restaurant and hotel business, which uses higher-valued meat cuts such as Choice beef; and Japan's consumer recovery after its BSE issues, combined with a steadily declining U.S. cattle inventory, all pointed toward record-high cattle prices for 2004. With the finding of BSE and the loss of export markets, more beef will have to be consumed in the U.S. market, and that means a decline in prices must occur to absorb the higher domestic supplies.

To clear the U.S. market, per capita beef consumption at retail will have to rise 5 percent in 2004. Consequently, USDA reduced its 2004 fed cattle price projection from \$87.50 per cwt before BSE to \$74.50 per cwt now, down 15 percent, under the assumption that exports decline 90 percent. Because the U.S. beef market was going to be very tight anyway as a result of strong demand and declining U.S. beef production following years of herd liquidation, this would still be the second highest fed cattle price in the past 11 years. We also expect that consumers will respond to retail Choice beef prices during the second half of 2004 that are expected to be 10-15 percent below the second half of 2003.

In the world of hogs, high feed prices are likely to keep production to a modest expansion in 2004, leaving hog prices about the same as 2003. But strong U.S. demand for chicken and rising exports are expected to boost broiler prices to record high levels in 2004 and boost poultry production about 2.5 percent. Asian bird flu is likely to provide some opportunities to expand both U.S. pork and poultry exports. Bans on U.S. poultry exports as a result of low path flu in Delaware, New Jersey and Pennsylvania are expected to be short term.

For milk, a year ago, producers were receiving the lowest prices in 25 years. But, things have changed since then. Production fell in the face of the low prices, and prices have moved up since. Moreover, reduced use of rBST is expected to keep the 2003/04 milk production slightly below a year earlier. The all-milk price is forecast to average \$13.25 per cwt, up 11 percent over the previous marketing year. Still, USDA will probably again purchase in excess of 500 million pounds of nonfat dry milk, as that market continues in surplus at the price support level

While there are many other facets to the outlook for agricultural markets, which will be covered in this Forum's sessions, I want to comment on horticultural markets, which have become such an important contributor to farm income for all size producers. For 2003, cash receipts from fruits, vegetables and greenhouse and nursery crops are forecast to be \$45.3 billion, up 2 percent from last year and 17 percent over 1998. In 2004, we look for larger crops of citrus and processing vegetables while prices for deciduous fruits are strong on tight world supplies. With average weather, farm receipts for fresh vegetables are expected to decline as prices retreat from the strong levels of the past couple of years. Exports for FY 2004 are forecast at \$12.8 billion, up substantially from last year's \$11.9 billion.

- ***Conclusion: despite a pull back in farm income in 2004, cash flow and balance sheet prospects augur for sound farm economy in 2004.***

To conclude my remarks, with trend production and a continuing close balance between supply and demand in most crop markets, we forecast the value of crop production will be a record high in 2004. And, the value of livestock and poultry production, despite the BSE setback, is expected to exceed \$100 billion for only the second time in history. The drop in cattle and calve receipts and somewhat higher production expenses will reduce farm income from

2003's record high (Chart 13). Net cash farm income is forecast at about $56 billion, down 11 percent from 2003. However, this income level would be the same as the average of the past two years and a reasonably good farm income year.

The reduction in earnings from farm sources will have a small effect across the majority of households that operate residential and intermediate size farms, as their incomes are derived mostly off the farm. The incomes of households that run commercial-size operations will be lower in 2004, yet their average incomes will likely remain well above the average incomes of other farm households and all U.S. households.

It is instructive to look at the net cash farm income excluding government payments (the bottom line in the chart). This is an indicator of the underlying fundamental strength of commodity markets. In 2000, we hit the cyclical low at $34 billion. This year, net cash income excluding government payments, is forecast over $45 billion, up 35 percent since 2000. One of the reasons total net cash farm income is not up as much is lower government payments. As markets have strengthened, payments based on prices have declined, so that more of net cash income is now coming from market sales. Government payments in 2004 are forecast at $10.3 billion, the lowest level since 1997.

With another sound income year in prospect, farmland values may rise 3.5 percent in 2004, compared with 4 percent annual gains in the 1990s and 5 percent in recent years. This increase will continue the improvement in the farm sector balance sheet that we saw in 2003.

So, despite questions over the recovery of foreign economies, the weakening of the dollar, issues raised by the Federal budget deficit, fitful trade negotiations, emerging competitors, Asian bird flu, BSE, the challenges in Afghanistan and Iraq, high oil prices and OPEC tightening, and terrorism, I think we can have a pretty good year in 2004.

Outlook For the U.S. Farm Economy

Outlook Forum 2004

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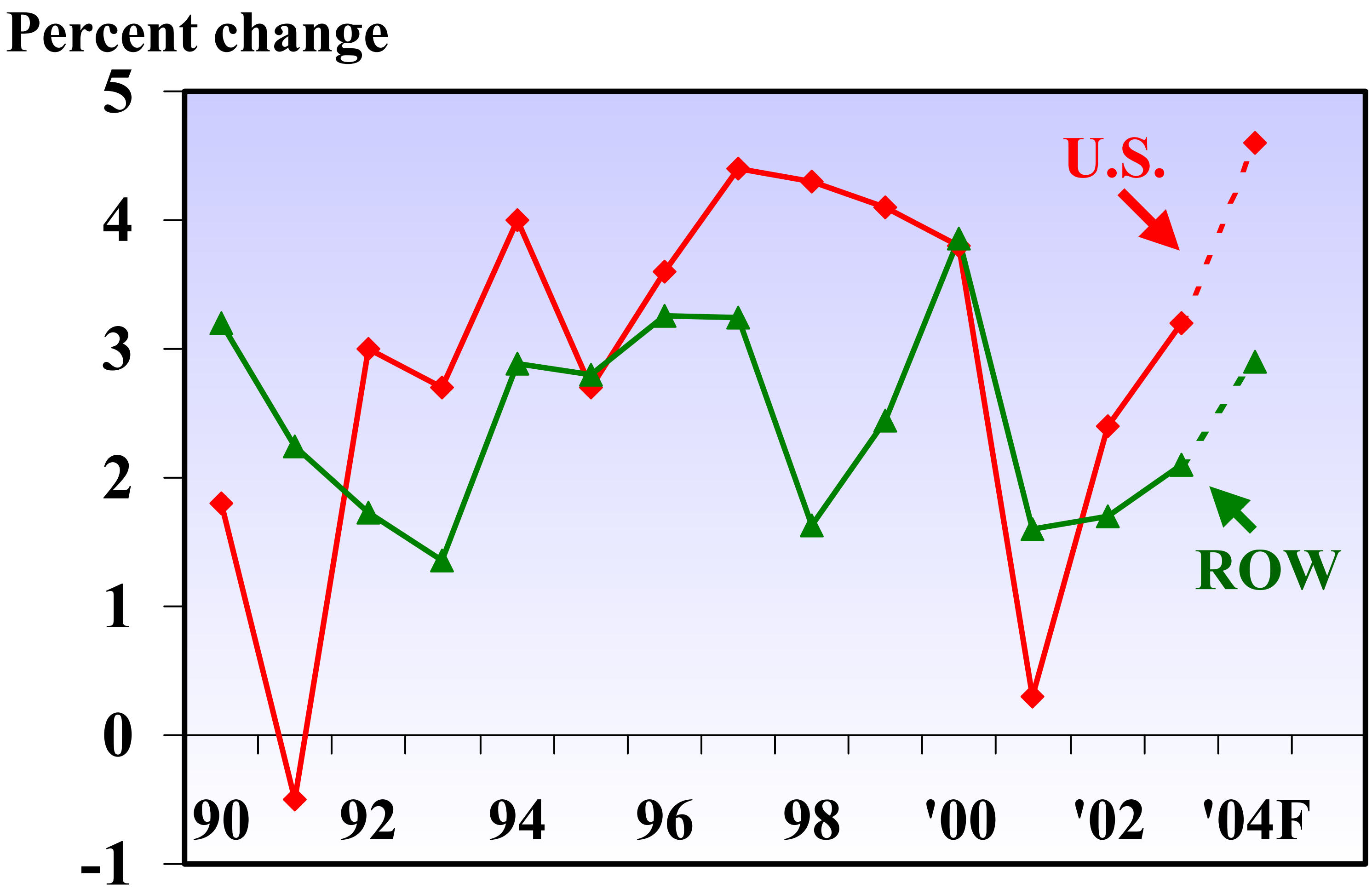
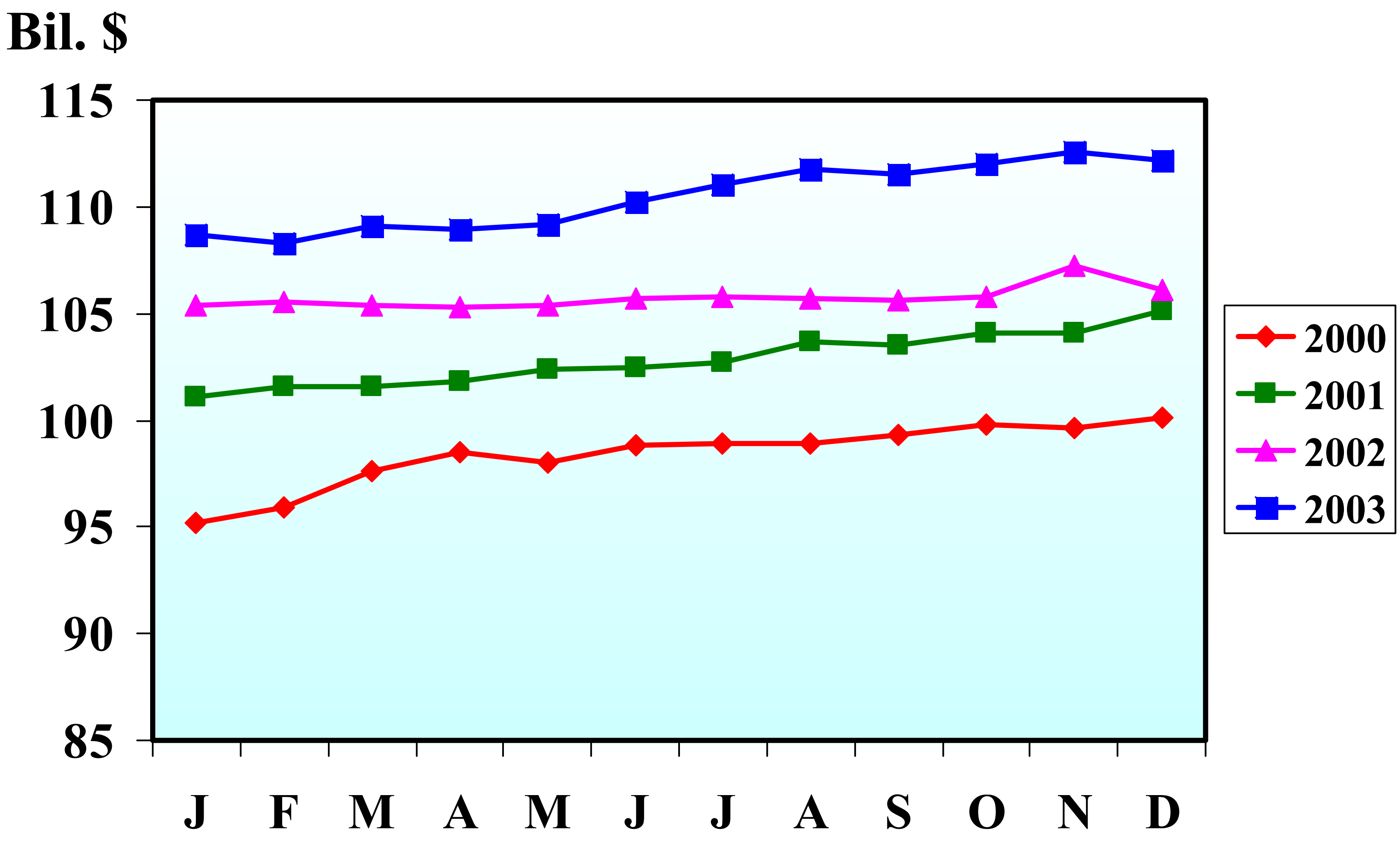
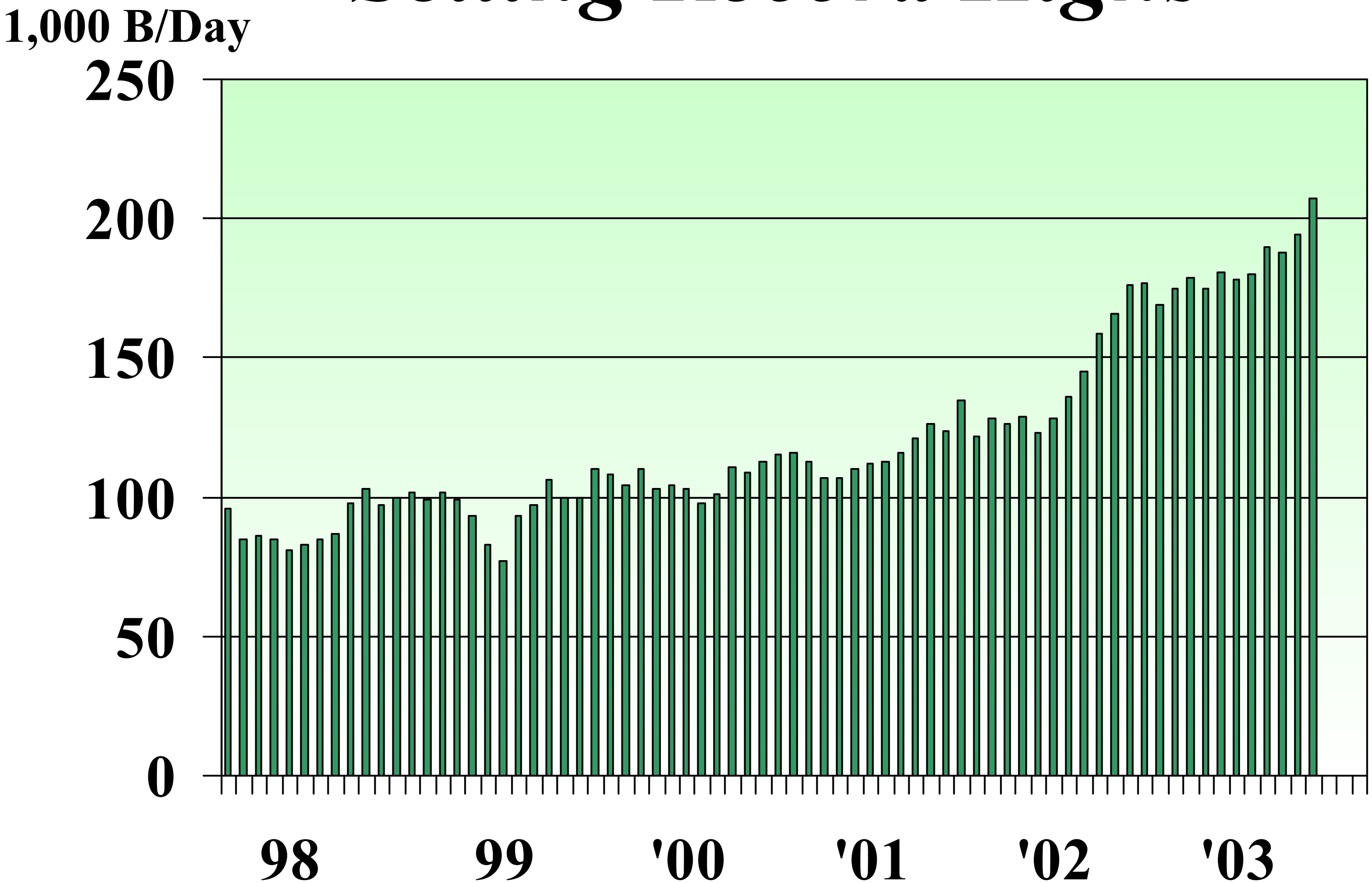
1--U.S. and Foreign GDP…
Recovering



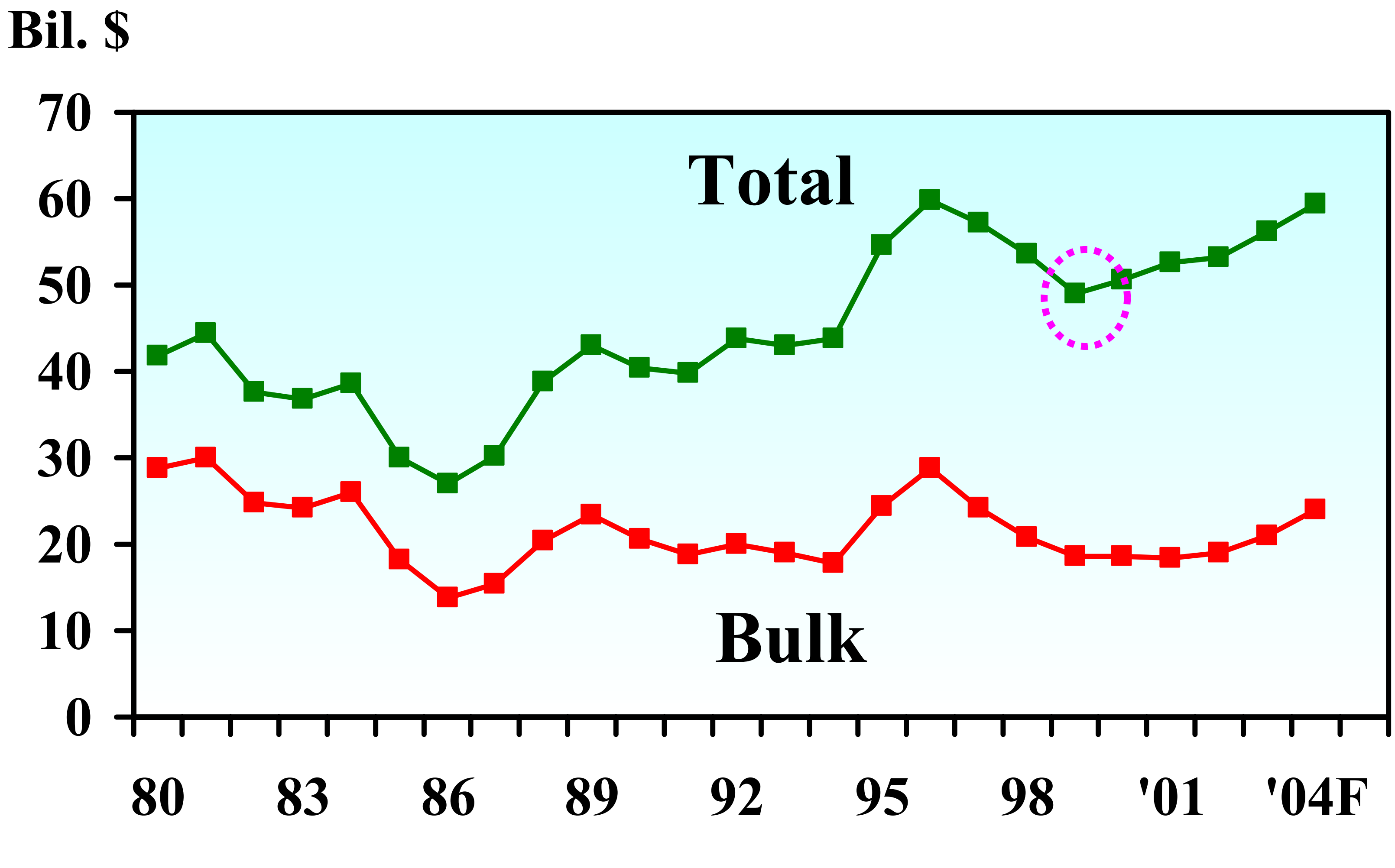
2--Grocery/Food & Beverage/Food Service Sales… *Strong*



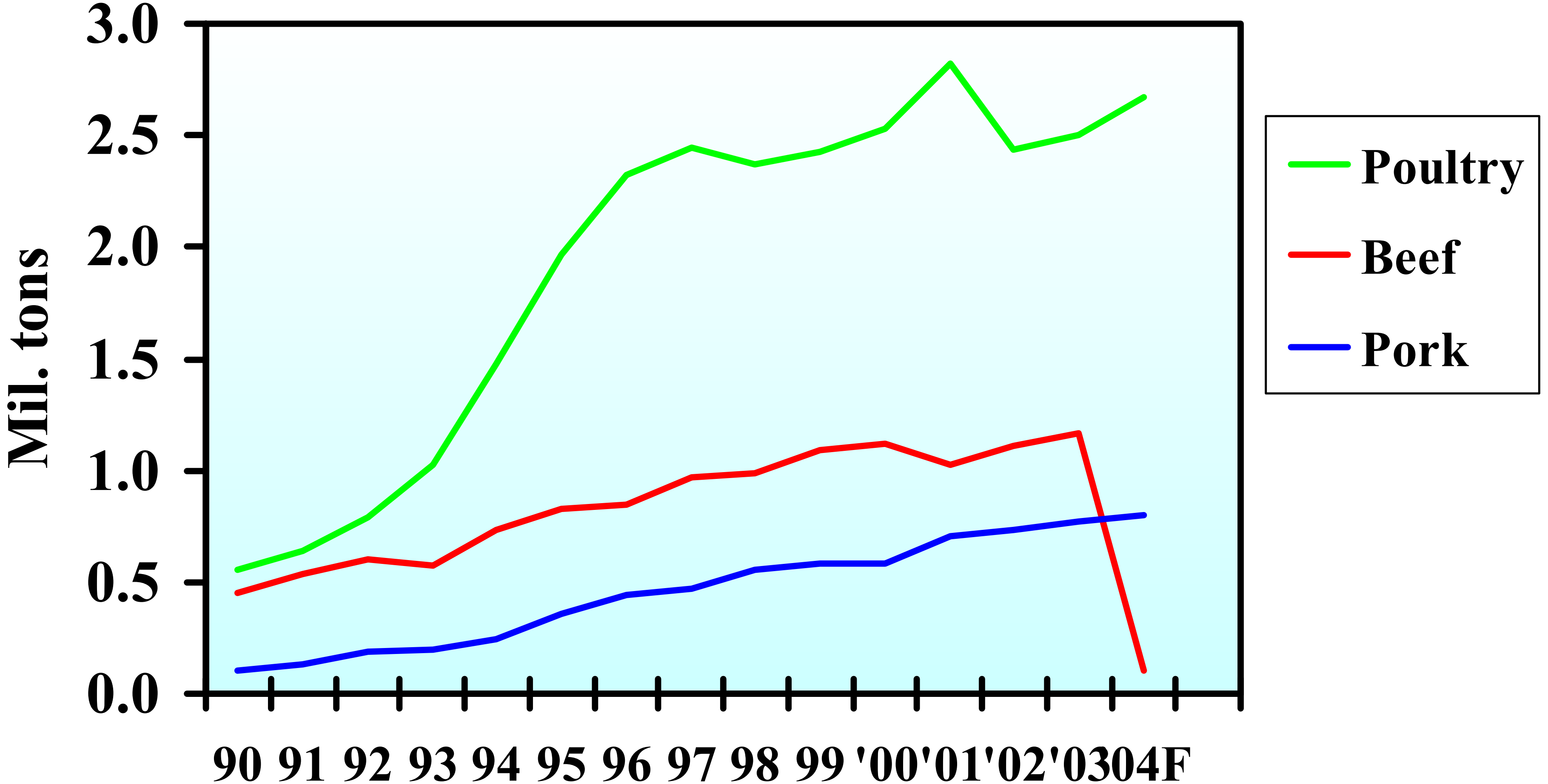
3--Monthly Ethanol Production…
Setting Record Highs



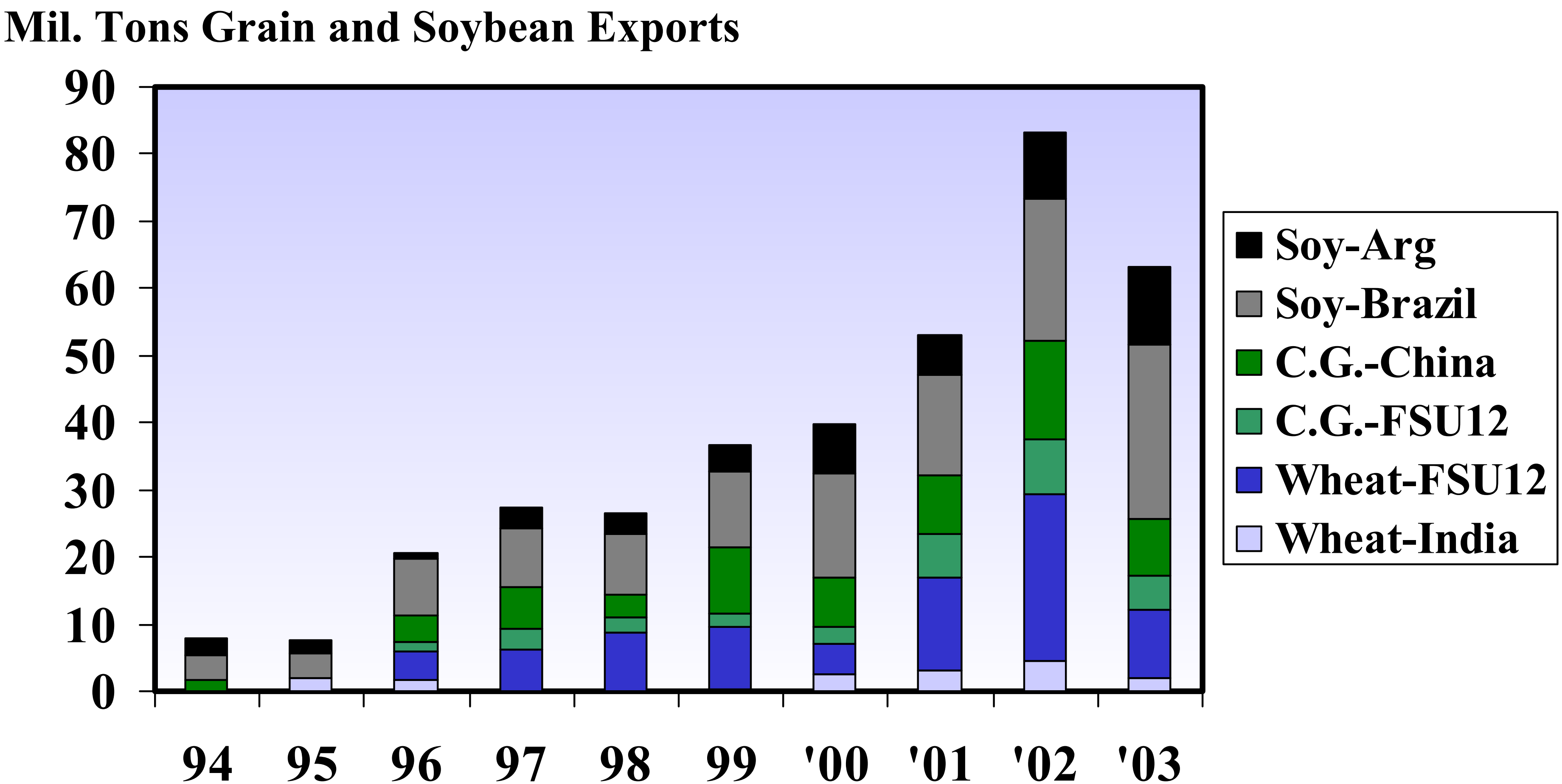
4--U.S. Exports Steadily Rising…
But Disrupted by BSE



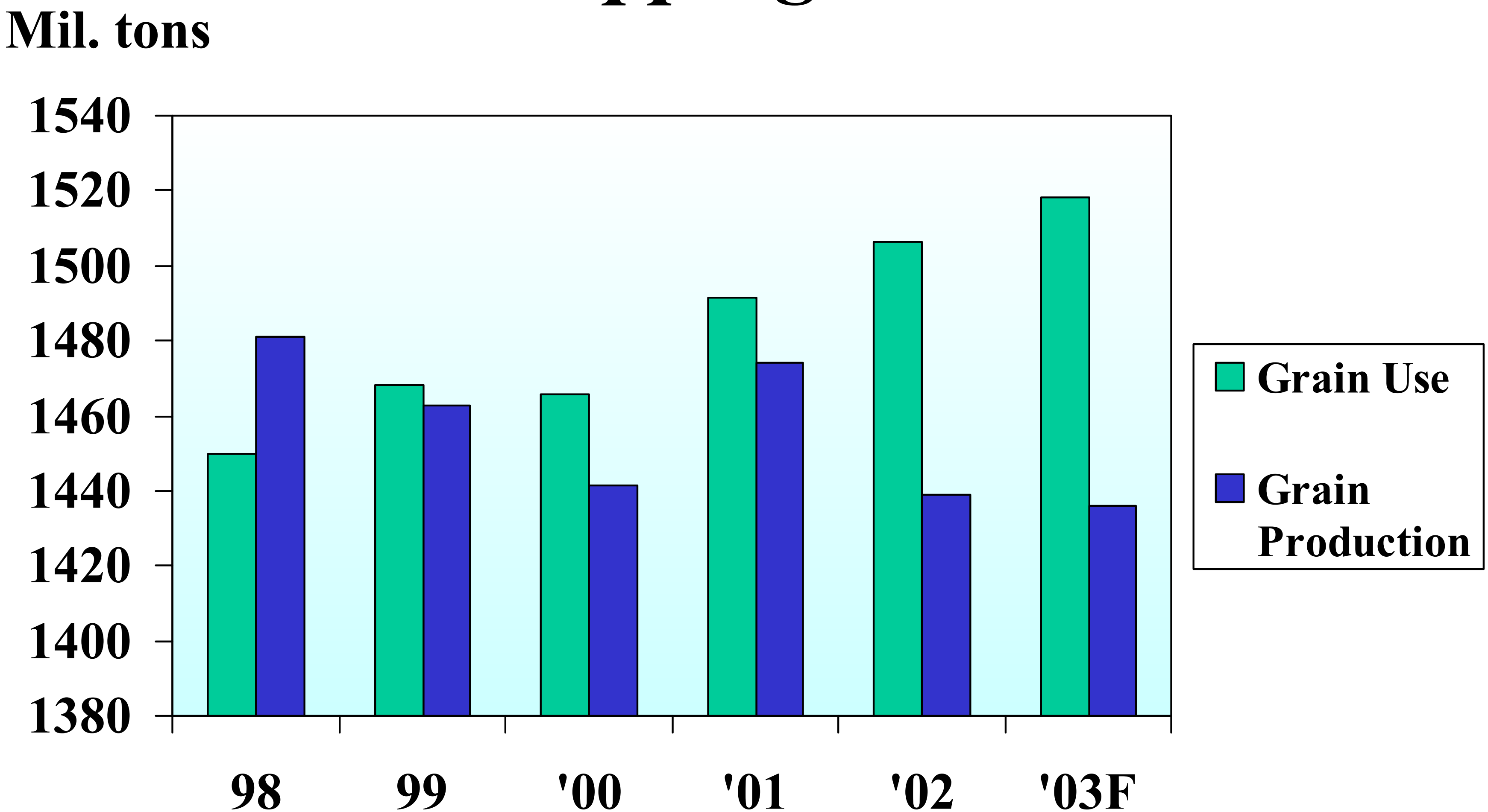
5--U.S. Meat Exports…
A Mixed Story



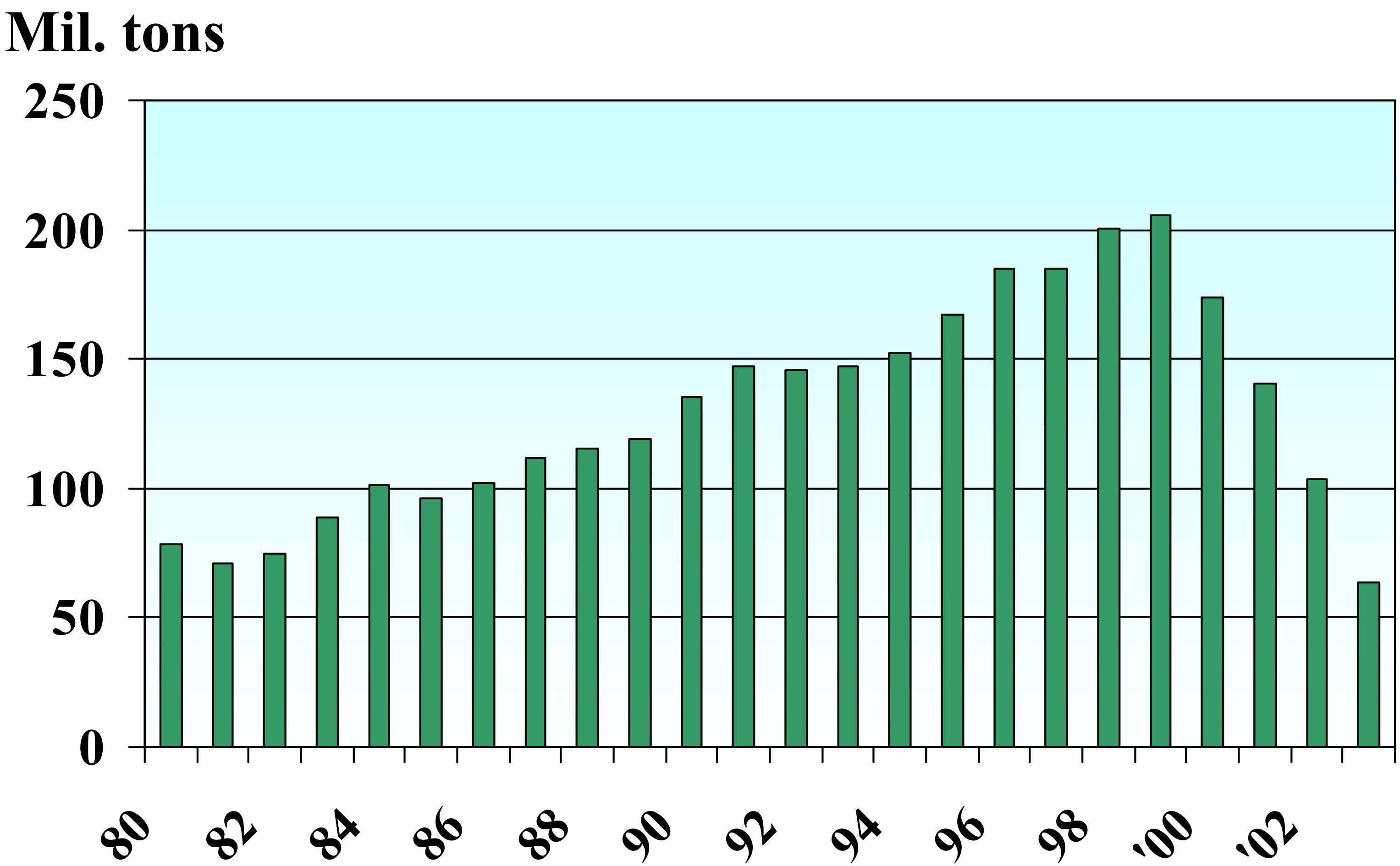
6--Emerging Competitors…
Making a Big Difference



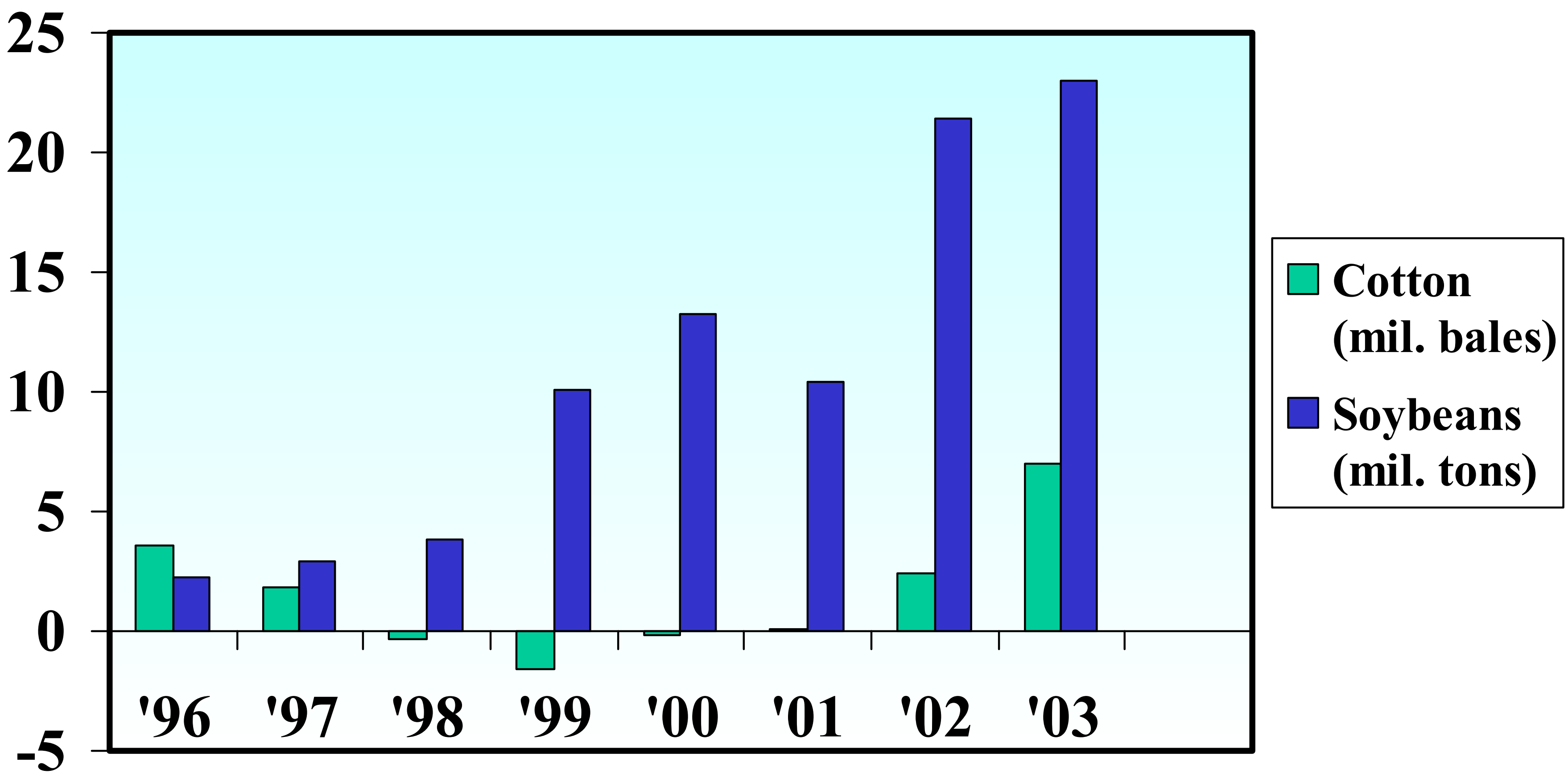
7--Global Grain…
Use Outstripping Production



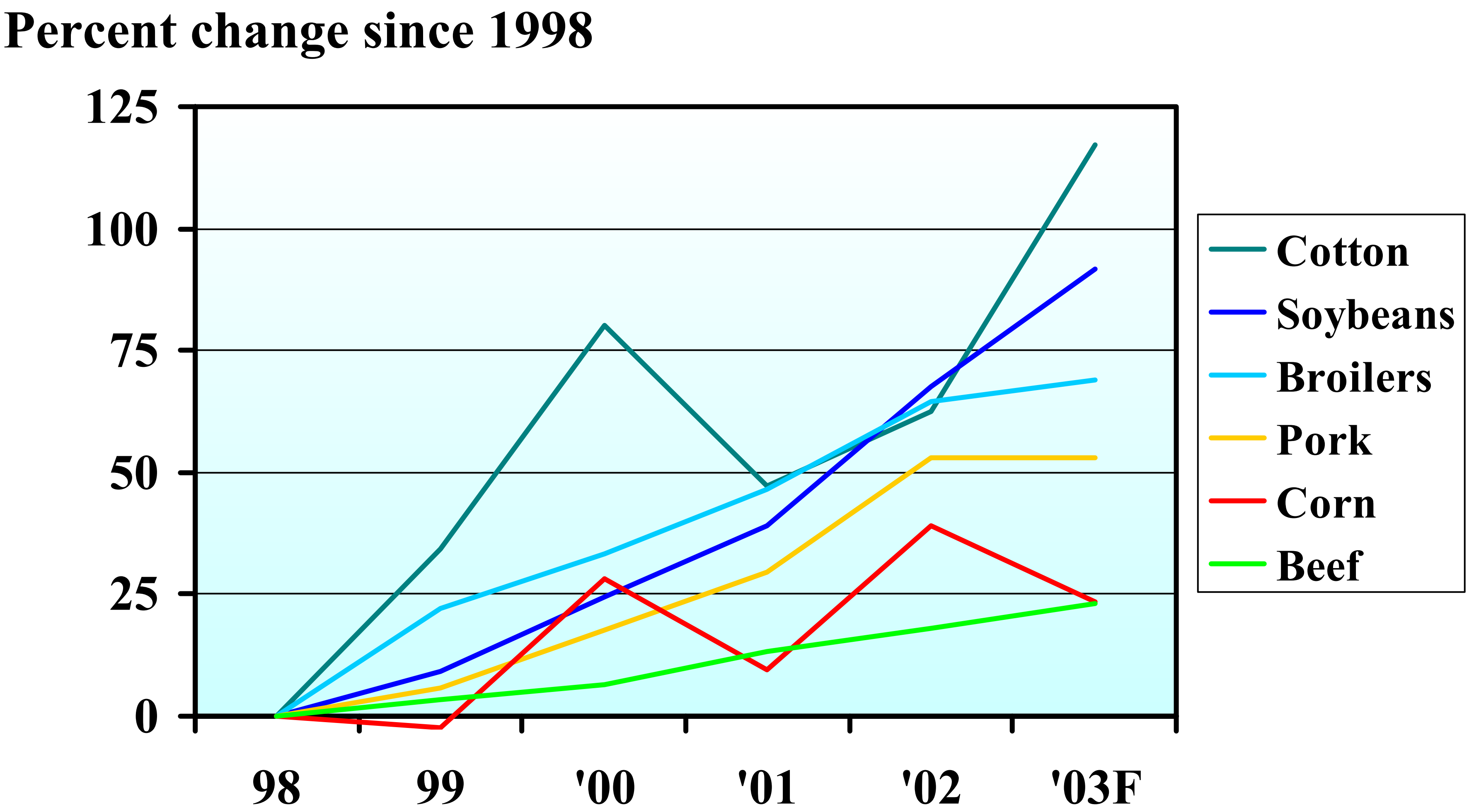
8--China's Grain Stocks …
Tenable Levels?



9--China Imports of Cotton and Soybeans… *Soar*



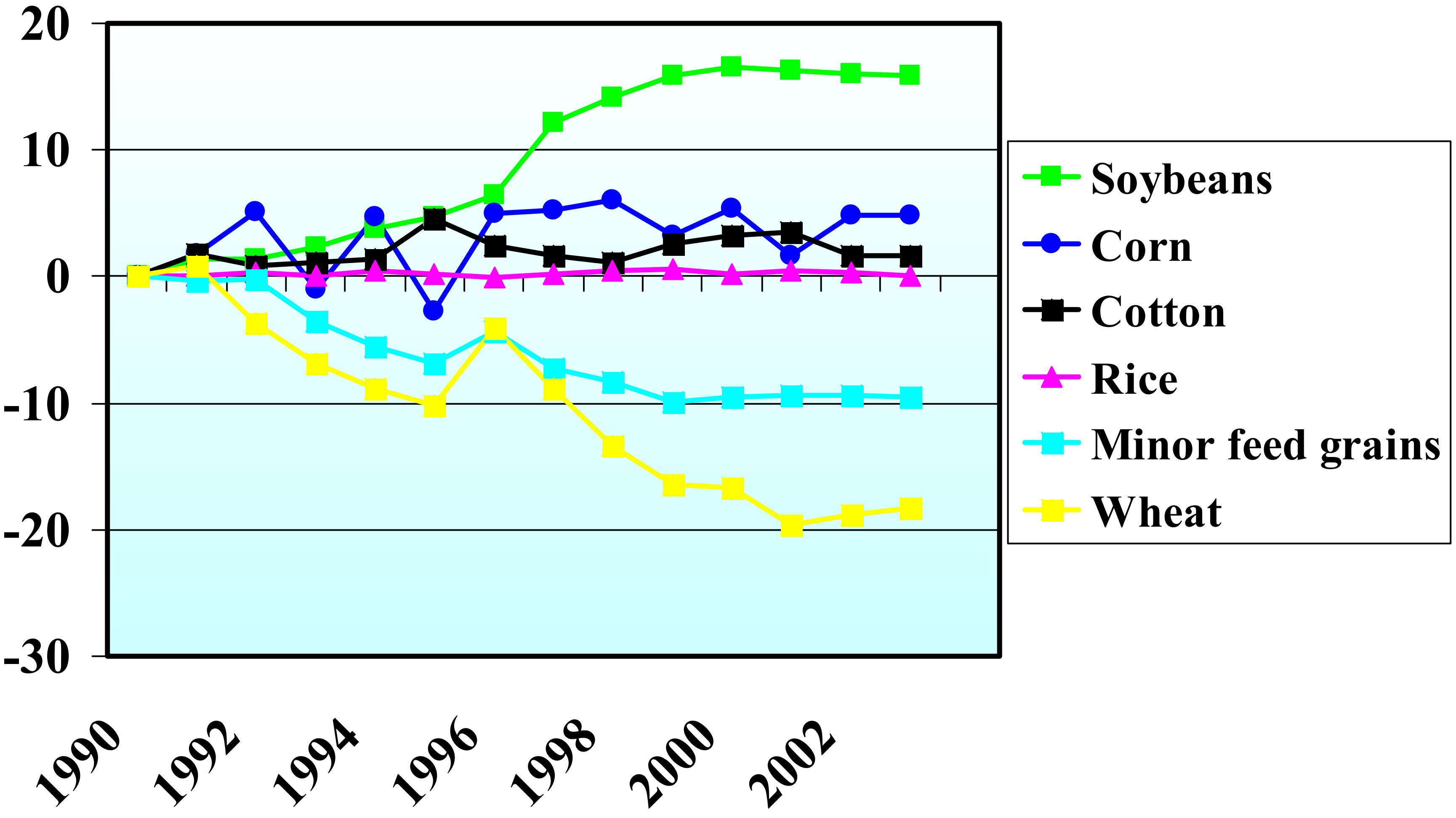
10--Brazilian Production…
Not Just Soybeans



11--Commodity Price Outlook…
Generally Strong

Commodity	*5-yr. Avg.*	*2003/04F for crops 2004F for livestock*	
Wheat ($/bu)	**2.82**	**3.35**	**+19%**
Corn “	**1.96**	**2.45**	**+25%**
Soybeans “	**4.77**	**7.25**	**+52%**
Cotton ($/lb)	**0.46**	**0.63 to Dec.**	**+37%**
Rice ($/cwt)	**5.76**	**7.25**	**+26%**
Cattle “	**71.94**	**74.50**	**+4%**
Hogs “	**39.79**	**39.00**	**-2%**
Broilers “	**58.20**	**70.00**	**+20%**
Milk “	**13.30**	**13.30**	**-0%**

12--U.S. Acreage Changes Since 1990



13--U.S. Net Cash Farm Income…

Record High in 2003