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OUTLOOK FOR THE FARM ECONOMY

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Over the past couple of years, this session of the Forum has been devoted to presenting a brief overview of the U.S. farm economy in the context of world developments and a discussion of how USDA policies and programs are operating in connection with the farm economy. Today, we will again follow that outline. I will provide the overview of the farm economy, and Under Secretary Schumacher will discuss trade, policy and program developments.

A Change in Climate

During 1998, the outlook for U.S. and world agriculture changed sharply. At home, bad weather devastated many regions, stretching from California to Florida. Abroad, the Asian financial crisis and rising world commodity supplies reduced farm prices and the value of farm exports. In reaction, increased U.S. government assistance to farmers was enacted, totaling nearly $6 billion, and that is helping to maintain farm income and limiting financial hardship for many producers. Unfortunately, exports and prices will probably be lower in 1999, causing increased farm financial stress, particularly in regions that up to now have weathered the downturn in the farm economy, such as states in the corn belt.

But, agriculture is a cyclical industry, and it will not stay deep-in-the-red forever. Over the next 2-4 years, economic recession in a number of countries should give way to economic recovery, lower prices will reduce agricultural production, somewhere weather will create problems, and demand for U.S. agricultural products will rise, bringing stronger farm prices and incomes. At this point, however, this recovery looks like it will occur at a very gradual not rapid pace.

I want to emphasize how important the global economy is to U.S. agriculture. In 1996 and 1997, strong world economic growth and lower trade barriers helped push U.S. agricultural exports to a record high $60 billion in FY 1996. Since then, growing world production and weakening world demand have hurt U.S. exports. Grain, cotton, beef, and poultry exports have all been seriously affected. In 1998, our economy was strong, but the foundation of world demand deteriorated, as Japan, South Korea, Malaysia, Philippines, Thailand, Indonesia, Russia, Saudi Arabia and Brazil all saw recessions. In the boom, period of 1996 and 1997, the world economy grew 3.4 percent per year. In 1998, growth fell to 1.9 percent, and in 1999, we expect a further slide to only 1.7 percent.

The problems in Brazil are an important concern given the free fall of the real during January. For now, the currency has stabilized following the decision earlier this month to allow it to float. But the underlying problem of a large government deficit remains. Until this is addressed, Brazil faces high interest rates and slow growth. Brazil is the largest economy in South America and its performance will affect the entire continent. At this point, indications are not optimistic for 1999.

As a result of anemic world economic growth and lower prices, U.S. farm exports are expected to drop to $49.0 billion this year. That is down nearly $11 billion from the peak in 1996. Exports to Asia account for over 80 percent of the decline in total export value. This drop in exports has given rise to questions like: Can't more aggressive use of GSM credit guarantees boost exports? Wouldn't elimination of trade sanctions help solve the problem? And, would full use of the Export Enhancement Program restore lost trade? The answer to these questions is no. GSM is being pushed to its limit, trade sanctions are having only a minor effect on our exports and the Export Enhancement Program, which is primarily available for wheat, would drive down world wheat prices making it a futile waste of taxpayers' money given the ample competitive supplies on the world market.

Aggregate Indicators of Performance

Given this somewhat pessimistic outlook with respect to demand for farm products, what are the implications for the overall health of the U.S. farm economy? Starting with aggregate cash flow, declining prices caused farm market receipts to fall $10 billion to $198 billion during 1998, and they are likely to stay at that reduced level this year, with crop receipts projected to drop again, and livestock receipts to rise with some improvement in cattle prices.

In 1998, and so far this year, declining interest rates, fuel prices and feed costs have helped reduce production costs, offsetting some of the decline in cash receipts. In fact, total production expenses declined 2 percent from 1997 to 1998, the first significant drop in more than a decade. And, they are likely to change little in 1999.

Direct government payments to farmers reached nearly $13 billion in calendar 1998 and will probably total at least $11 billion in 1999, again providing strong support. For the 1990's, government payments exceeded these levels only once, in 1993.

These figures portray an industry still financially performing adequately as it entered 1999, thanks to higher government payments and lower production costs. Those factors helped push net cash farm income for all of agriculture in 1998 to the second highest ever. And the farm balance sheet was fairly sound, as farm equity steadily increased through the 1990's, and the overall debt-to-asset ratio remained steady at about 15 percent, down from over 20 percent in the mid-1980s.

But, these aggregate figures mask a marked erosion in market income in many regions and commodity sectors, and all signs now point to higher farm financial stress in 1999. Net cash farm income is currently projected to decline $3-4 billion. While U.S. farm real estate values may rise slightly, land values began declining in a number of Midwestern states during the last half of 1998. The drop in income, coupled with declining asset values for many producers, means many will find difficulty obtaining credit, and those who do obtain credit will use it for variable cash expenses, not investment, and will find themselves squeezed trying to repay debt out of current income. For the many producers who struggled with cash flow in 1998 resulting from low prices and adverse weather, their problems will likely worsen in 1999.

Perspective on Several Major Commodities

I now want to comment on a few key commodities, which will reveal many of agriculture's problem areas and pose challenging questions for the year ahead.

Starting with **wheat**, in 1998/99, farm prices are expected to average only $2.70 per bushel, the lowest season-average price in 8 years. We estimate carryover stocks on June 1 at nearly 1 billion bushels, the highest since 1988. The key outlook question is: Since wheat was the first major commodity to sink after the mid-1990's run up, will it be the first to start reviving? I think, Yes. The Farm Bill envisioned that planting flexibility would help reduce surpluses by causing a cutback in planted acreage when prices were low. This year is the first big test, and the test is being passed for wheat. For the 1999 crop year, the world wheat situation will be tighter with lower U.S. and EU production, so, U.S. wheat prices should rise, but with weak global demand and trade the price increase may be limited to the range of 10 percent.

For **corn**, total supplies in this marketing year are up sharply, and carryover stocks on September 1 are likely to be up nearly 500 million bushels from last year, to their highest level since 1993. USDA's corn price forecast of $1.95 per bushel is the lowest in more than a decade. For the 1999 crop, even with a little less acreage, trend yields would push U.S. corn supplies up again. Total use should expand about the same amount, leaving U.S. corn carryover stocks near the same high levels as this season, making the 1999/2000 price outlook for feed grains about unchanged from this year.

For **soybeans**, U.S. supplies this season are record high, and we face strong competition from Brazil and Argentina. Carryover stocks on September 1 are expected to exceed more that 400 million bushels, the highest carryover in more than a decade. Soybean prices will probably average $5.20 per bushel this season, the lowest since 1986/87.

The key outlook question is: can market forces stabilize or reduce stocks in 1999/2000, such as for wheat and corn? The answer is not likely. In fact, the Farm Bill provisions are causing the pain of grain surpluses to be spread to oilseeds markets. Producers are being drawn to soybeans like filings to a magnet because for the moment it appears to be the least worst alternative. A further increase in carryover stocks and lower prices are likely for the 1999 crop year. Soybean acreage is likely to rise at least 1 million acres, encouraged by the high marketing assistance loan rate for soybeans relative to other crops, benefits of herbicide-resistant soybeans, low out-of-pocket planting costs, and soybean's resilience in adverse weather. With trend yields, prices could average well below $5.00 a bushel and marketing loan payments could be in excess of $2.5 billion.

Turning to **cotton**, it may be the commodity most vulnerable to the world economic slowdown. Lower world demand for cotton textiles and apparel has resulted in the second lowest U.S. cotton exports in 20 years. The demise of the step 2 program has aggravated the export decline and will permit raw cotton to be imported. With a strong dollar and Asian textiles seeking a home, since the start of 1997, the U.S. has seen a 20-percent increase in imported cotton textiles and apparel. Of the total cotton textiles and apparel Americans will buy this year, about 45 percent will be imported. Weak demand has reduced farm prices, despite the drought-reduced crop in 1998. In 1999, a return to trend yields would raise U.S. production but weak world demand could push U.S. ending stocks higher, placing additional pressure on cotton prices.

Turning to meat and poultry, we are in for another year of record-high production in 1999. For **cattle**, market prices eroded further last year, and averaged the lowest level in the 1990s. The continuing liquidation and record-high slaughter weights caused beef production to increase by 1 percent in 1998. We expect a 3-percent decline in beef production in 1999, but much of the year-to-year decline will not occur until the second half of the year. For all of 1999, fed cattle prices are expected to average $65.50 per cwt, compared with $61.50 last year, better, but still low.

Hogs have received much attention this year as prices for all of 1998 averaged a little below $32 per cwt, the lowest since 1972. What was responsible for the drop: 10 percent more production? Constrained slaughter capacity? Imports? Mega farms? A rush to avoid environmental constraints? Answer: all of the above probably had a role. But the most important factor can be summarized by George Bernard Shaw who said, when asked for his thoughts about New Zealand, "Altogether too many damned sheep."

Continued large hog supplies will pressure prices during the first half of 1999. As hog slaughter begins to decline in the second half, prices should rise above last year's level, particularly by the fourth quarter. For all of 1999, USDA forecasts a slight decline in production and hog prices averaging $34 per cwt., 7 percent higher than last year, again better but still low.

As beef and pork production are reduced, **broilers** will gain increased market share. The loss of the Russian market hurt broiler exports, but prices were still strong in 1998, and with lower feed costs, production will probably be up nearly 6 percent, and it is broilers that will push total meat and poultry supplies to record high levels in 1999.

While the **milk** industry awaits the final decision on Federal Milk Marketing Order Reform and the distribution of the $200 million in relief bill funds, milk production is seeing its first sustained production increases since 1995. And, prices are coming down from the record-high $15.38 average in 1998. For all of 1999, we expect farm-level milk prices to average about $1 per cwt lower than last year--putting them about halfway between the 1997 and 1998 levels. Lower feed costs and high earnings of the past year should help producers through the price decline.

I can summarize my review by pointing out that many of my comments referred to "the highest supplies since..." or "the lowest prices since..." Such descriptors are not the hallmark of a strong economy. Our aggregate farm income estimates include a large, stable, and growing core of commodities that include fruit, vegetables, nursery and greenhouse products and broilers. And, this group's sales will trend up again in 1999. The sales of these commodities exceed the total value of hog and cattle sales. They exceed the total value of food grain, feed grain and oilseed sales. So, it is by looking beneath aggregate U.S. farm income that we find the greatest financial strain in 1999 will be on field crops. We have calculated the average net income over the past 5 crop years just for wheat, corn, soybeans, upland cotton and rice. For the 1998 crops, net income will be 17 percent below the previous 5-year average, and for the 1999 crops, current projections show income 27 percent below the previous 5-year average. Livestock markets may get a little stronger, except for milk, but lower feed costs will help there.

There are many uncertainties that could affect these markets and the well-being of market participants over the next 1 to 2 years. Weather is always a key and could work to make the prospects better or worse. Another major factor will be the world economy. If the Asian economies fail to stabilize or the economic problems in Brazil spread U.S. agricultural exports could drop further. Right now, the engines of growth in the world economy are the U.S. and the EU, which are slowing. Should either of these two regions fall into recession there would be a global recession that would further erode world food and fiber demand and U.S. farm exports.

A final factor is China which has disappeared as a wheat importer and become a export competitor in corn and cotton. Production and policy change there is a great uncertainty.

Looking to the longer term, I call your attention to the *USDA Agricultural Baseline Projections to 2008*, a publication released at this Forum. This assessment provides USDA's view of how the global farm economy would unfold over the next decade under a very specific set of assumptions about policy and weather. This ambitious effort is primarily the work of the Economic Research Service. The projections are used by USDA for budget and policy analysis and planning. While we can be sure that the projections will turn out wrong–because the assumptions never hold–the analysis is extremely useful to understand the possible implications of the underlying trends as we now see them. A few highlights are:

- The global macroeconomy takes 3-4 years to recover to a stable, moderately strong rate of growth. The global economic problems mean a prolonged weakness in global demand for farm products.
- The slow recovery in the world economy and ample supplies in competitor countries results in U.S. agricultural exports not returning to the record level of 1996 until about the year 2003.
- U.S. planted acreage drops only a small amount, and with trend yields supplies remain large, leading to a slow recovery in nominal farm prices and steadily declining inflation-adjusted farm prices throughout the projection period. In particular, real soybean and hog prices decline substantially compared with other

commodities.

- Recovery in the global economy leads to strong growth in U.S. meat and poultry exports after 3-4 stagnant to slow growth years. U.S. cattle production turns up for several years starting in 2001, but then declines under strong competition from hogs and broilers.
- Net farm income grows slowly and throughout the projection period does not reach the 1996 record high of $53.4 billion. Loan deficiency payments are made through 2002.
- The farm balance sheet improves as the overall debt-to-asset slowly declines throughout the projection period in line with the slow declines observed during much of the 1990's.

In conclusion, slow world economic growth and abundant world food and fiber supplies will converge in 1999 to reduce the economic performance of U.S. agriculture. Americans will continue to benefit from ample high quality food choices with food prices rising only 2 percent in 1999. The purpose of this Forum is to explore the details of agriculture's performance and the implications for private sector decision making and public policy.