

Agricultural Outlook Forum 2005

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OUTLOOK FOR THE U.S. FARM ECONOMY

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Good morning and welcome to Agricultural Outlook Forum 2005. I am going to begin this part of the plenary session with a brief overview of the outlook for the farm economy.

There are many key issues that will shape agriculture's prosperity in the coming years. I think you will agree that the strength of our Outlook Forum is that it addresses these issues: in their diversity and in depth, with both government and private sector experts offering their candid analysis and opinions. At the risk of oversimplifying all that the next two days offers on the complex issues affecting our future, I am going to focus on just a few key factors (Figure 1):

- For example, one key issue is, after finally seeing strong global economic growth in 2004, will it persist and will demand—particularly foreign demand—be strong enough to make a difference in global markets?
- Another key issue is foreign competition. During the past decade, we have witnessed strong foreign competition in global agricultural markets, notably from a number of emerging exporters. Will that competition intensify?
- And last year, many U.S. crops set production records. Will weather, crop and animal diseases, and the decline in crop prices prevent a repeat of 2004's production levels?

I will briefly comment on these issues and then turn to what they mean for the financial performance of U.S. farms.

Macroeconomics and Agricultural Product Demand

The U.S. and foreign economies finally built a strong foundation for future economic growth during 2004. The U.S. economy grew 4.4 percent, up from 3.0 percent in 2003. That growth helped boost food demand. Personal consumption expenditures on food rose a very strong 4.5 percent in 2004, in real terms. That compares with average growth of less than 2.5 percent during the economic slowdown in 2001 and 2002. For 2005, we expect that moderate consumer spending, strong business investment and some improvement in the overall trade deficit will generate U.S. economic growth of 3.5-4.0 percent and that will be supportive of strong domestic food demand.

Foreign economies had a very nice recovery in 2004, growing 3.7 percent after a sustained period of substantially lower average growth (Figure 2). The fitful performance of foreign economic growth had been a factor in the slow growth in U.S. farm exports since the mid 1990s. For 2005, lagging performance in Europe and Japan, slower growth in Former Soviet countries and a number of developing economies are expected to reduce foreign economic growth to 3.1 percent. China, now a \$6 billion market for U.S. farm products, is pegged at 8.1 percent. While these levels are down from 2004, I emphasize that whenever the global economy has had a sustained period of 3 percent or higher growth, global demand for farm products has been robust, and we are in such a period now.

In addition to rising food demand, industrial demand for farm products continues to rise. For example, ethanol production, and now biodiesel production are soaring. For the 2005 crop, we expect corn use in ethanol to be 1.5 billion bushels, accounting for 14 percent of total corn use.

Turning to the trade side, this morning, we released our latest forecast for farm exports in fiscal year 2005: \$59 billion, down \$3 billion from 2004 (Figure 3) and up \$3 billion from our last quarterly forecast. This year's decline primarily reflects a drop in value, not volume, due to reduced crop prices, and it is being constrained by the record-high global production for many crops last year. The forecast also assumes that markets currently closed to our beef exports remain closed. This is not a forecast of what foreign countries will do. It simply reflects our standard procedure to assume the policies foreign countries remain in place until they change them.

The current period of stronger foreign economic growth and a decline in the value of the dollar should show up in higher U.S. agricultural exports in the future and an improving trade balance. The Figure depicts our agricultural trade to 2010 using this morning's trade forecasts for fiscal 2005 and the projections contained in the USDA baseline, released earlier this month and available in hard copy at this Forum. As you can see, projected economic growth drives projections for steady agricultural export increases, as well as import increases. The agricultural trade balance, forecast to be down to only \$1 billion this year, is projected to be a positive \$3.5 billion by the end of the decade.

Developments in Crop Markets

Global markets for principal crops continue to adjust to the record-high levels of grain, oilseed and cotton production achieved in 2004 (Figure 4). The Figure shows world wheat and coarse grain production and use. The late 1990s saw stocks build as production exceeded use and that was followed by 5 consecutive years of demand exceeding production, which led to tight stocks and strong prices. You know what happens then—high prices and tight stocks have inevitably been followed by production rebounds and lower prices, and that is what we are now experiencing in global grain markets. Charts for oilseeds and cotton look very similar to this grain chart. Look carefully at the big increase in global production in 2004; it is very similar to the leap that occurred in 1996. The increase in 1996 presaged several years of rising stocks and lower prices. Are we in store for the same thing now—will history repeat itself?

One difference about the current rising global stock levels for grains is that stocks at the end of the 2004/05 season will still not be excessive when compared with global use (Figure 5). Another point is that foreign economic growth appears sound. This means that continued strong demand, combined with crop yields reverting to their trends, while not changing stocks much through the end of the 2005/06 crop year, would gradually reduce stock levels over subsequent years and steadily strengthen prices, as reflected in our baseline. Also, given current grain stock levels, a combination of continued strong demand coupled with some production problems could lead to quickly rising prices.

A persistent concern in U.S. agriculture is whether we are losing our competitiveness in world markets. The U.S. share of global exports has been declining for decades for wheat, coarse grains, rice and soybeans, and only turned up for cotton in recent years as increased imports of textiles and apparel shifted U.S. textile production overseas, creating higher foreign demand for our cotton. The anxiety over competitive threats heightened during the low prices several years ago, as new competitors emerged (Figure 6). The Figure shows exports from Brazil, Argentina, China, India and the former Soviet Union countries that have expanded into new lands or have low labor costs or rising productivity or experienced policy changes that have spurred higher exports. The Figure shows their share of global export markets rose from 2

percent of world grain and soybean exports in 1994 to 30 percent in 2002. But the threat has stabilized. Their share in 2004/05 is expected to be 20 percent, the same as last year.

In the future, we continue to believe that China will be a steadily increasing importer, that India will consume its grain, and that gains for the Former Soviet Union, while expected to continue, will not come as easily as recent gains—and an inhospitable climate may also make them an irregular competitor. Thus while competition will be strong, there is every reason to think that the United States will be a fierce competitor as well. I did not mention South America, because they will continue to be the most formidable rising competitor.

In fact, the global soybean market shows a very different stock picture than for grains (Figure 7). Global carryover stocks as a percent of expected total use in 2004/05 are forecast at 30 percent, compared with the average of 19 percent over the previous 5 years. Lower soybean prices and a lower value of the dollar against the Brazilian real should help slow area expansion in Brazil but South America remains poised to capture much of the increase in global oilseed demand in coming years, keeping pressure on our soybean market.

As we look to the spring planting season, several factors will affect planted acreage and production. Major crop prices are down from a year ago and the lowest since 2001. This is likely to result in a slight decline in overall planted acreage. Wheat acreage, which has been trending down for many years, is expected to drop 1.7 million acres in 2005 and be the lowest since 1972. Fall seedings were down substantially due to excess rainfall in soft red wheat areas. Soybean producers may be concerned about high soybean stocks, South America's continued expansion and soybean rust, consequently we expect area planted to drop by over 2 million acres. Despite high fertilizer costs, we expect a slight increase in corn planted area, up about a million acres as corn replaces wheat not planted; there is some uncertainty over soybean rust and some disappointment in soybean yields relative to corn. With a very large stock buildup this year, rice area could decline about 3 percent while cotton area may rise about 4 percent following last year's record-shattering yield, strong program incentives and improving export prospects with China.

The wheat, corn, and soybean acreages expected for 2005/06, combined with trend yields, would result in production levels near expected demand for these crops; consequently carryover levels would remain about the same. With continued heavy stocks, weaker prices are expected for these commodities in the near term, with soybean prices declining the most due to large expected supplies in South America.

For cotton and rice, however, lower production is expected to support prices in 2005/06. Even with cotton area rising slightly, a decline from 2004's phenomenal yields will sharply reduce production from last season. Similarly, a drop in rice production is expected to result from reductions in both area and yield. Demand is likely to exceed production for both commodities, drawing down surplus stocks.

Looking beyond 2005/06, modest price increases are expected for all major commodities as stocks-to-use ratios continue to decline. You can learn more about this outlook in the commodity sessions tomorrow.

Fruits and vegetables continue to provide good news for U.S. agriculture, generating over \$30 billion from the 2004 harvest, nearly 5 percent above 2003. Fruits and vegetables today account for 29 percent of crop production value, up from 22 percent in the mid 1990s. Higher fruit and vegetable yields raised 2004 output quantity by 4 percent. Prices increased slightly as non-citrus tree fruits and nuts offset decreases in vegetables and citrus.

U.S. horticultural trade continues to set records, with 2004/05 exports forecast at \$14.5 billion and imports at \$25.6 billion. In recent years, strong demand for imported products has increased the sector's traditional trade deficit which is forecast at \$11.1 billion in 2004/05. During the last 10 years, domestic production growth has averaged only 0.5 percent. Import growth has averaged 4.4 percent, compared with 2.3 percent growth for U.S. exports. And with commercial and government advice to increase the role of fruits and vegetables in the American diet, the sector's trade deficit likely will continue to grow to meet expanding demand.

Livestock and Livestock Product Markets

Turning to livestock and poultry markets, U.S. meat exports continue to be influenced by the BSE situation (Figure 8). Although we expect rising beef exports in 2005 as trade with Mexico and other countries grows, the Figure shows that expected beef exports—with no resumption of trade to Asia—would still be only a quarter of the level of 2003. The closure of markets to our beef, stronger foreign economies and resumption of more normal poultry trade with Russia and China will likely increase pork and poultry exports. Pork exports were a record in 2004 and are forecast to be 5 percent higher in 2005. Demand for U.S. pork has been strong in Asian markets and in Mexico where economic growth is good. The weaker U.S. dollar is contributing to the strong performance. Export strength should carry into 2006 even as bans on beef are lifted because beef markets will be slow to rebuild and pork prices should be lower. Lower broiler parts prices compared with mid-2004 is helping exports, and trade issues with China have been resolved. U.S. broiler exports are expected to continue to grow, especially in a wide range of smaller markets, for example some CIS countries and the Caribbean.

Despite the loss of beef exports, U.S. livestock markets have been quite strong (Figure 9). The Figure shows per capita meat consumption (blue bars) and the Consumer Price Index for all meat (red line). The year 1998 is circled because that appears to be a turning point for livestock and meat markets. Prior to that year, there was a standard supply and demand relationship; when meat supplies were large prices would fall. After that, it appears price relationships changed—as production and consumption have risen, live animal and retail prices have gone up sharply. Strong consumer demand for meat protein; the improving restaurant and hotel business; improved diversity and quality of meat products; and the better world economy have all contributed to higher live animal and retail meat prices. Despite BSE and the loss of beef export markets, cattle prices set a record high price in 2004. 2004 marked the bottom of the current cattle cycle, and beef production was down 6.5 percent. For 2005, with Canadian fed and feeder cattle expected to begin crossing the border on March 7, beef production is expected to rise 4.5 percent and cattle prices decline about 2 percent from the 2004 record-high price and be in the low \$80 range, which should carry into 2006. Once the backlog of Canadian cattle works its way through the system this year, beef production will be limited by tight cattle supplies.

Despite high hog prices last year, hog producers have been cautious about expanding. In 2005, hog slaughter is expected to be only slightly higher than last year, with pork production up less than 1 percent. Hog prices will be lower in 2005, forecast in the upper \$40's per cwt, but still be nearly \$10 per cwt higher than average hog prices from 1998 to 2003. Hog prices are likely to remain fairly steady next year, with a little larger increase in output than in 2005.

Broiler production continues to set annual records. Output in 2005 is expected to be about 3 percent higher as producers respond to prices that stay relatively high. Production is expected to continue to expand at 2 to 3 percent into 2006.

For milk, market volatility continues to be a hallmark. Two years ago, producers were receiving the lowest milk prices in 23 years. This past year, milk prices averaged a record high \$16.03 per cwt, demand strengthened and production stagnated in the face of the low prices, forage problems and reduced availability of rBST. For 2005, the all-milk price is forecast to average \$14.55 per cwt, down about 10 percent but still the 4th highest price ever. USDA has not purchased nonfat dry milk since November of last year and few price support purchases are anticipated this year.

Farm Finances

Thus far, I have suggested a decline in 2005 crop production due to lower yields and lower prices for wheat, corn and soybeans in the near term due to continued large stocks. I have suggested some pullback from record high livestock and livestock product prices but not a large decline. With such production and price levels, the value of 2005 farm marketings is expected to decline about \$13 billion from the 2004 record of \$235 billion, with two-thirds of the decline in crops. So the net value of production will decline in 2005, a concept we measure with “net farm income.” However, USDA is forecasting another record high in net cash farm income, which measures cash available to farmers to pay their operating and living expenses. For 2005, net cash farm income is forecast at \$78.1 billion, slightly above 2004’s \$77.8 billion (Figure 10).

We expect 2005 to be one of those unusual years when the net production value declines but cash flow increases. The lower production value could presage lower cash flow in 2006. But for 2005, a key reason for robust cash flow is rising government payments. Lower crop prices are expected to result in direct government payments to producers of \$24 billion in 2005, eclipsing the record of \$22 billion set in 2000. Disaster payments, countercyclical payments and marketing loan benefits account for the increase. Another reason is farmers are expected to offset reduced 2005 production by drawing down their inventories built up from the 2004 record harvests. We do expect a rise in energy-based input costs such as fuel and fertilizer; however, lower feed costs and feeder animal prices will help keep total farm production expenses in check.

Net cash farm income will decline for most crop farms, with Corn Belt farms probably facing the largest declines in 2005, while income is expected to rise on cotton farms. Little change in net cash income is expected for most livestock operations. Farm household income should remain close to last year’s level, which is well above the average of all U.S. households.

With another sound income year in prospect, farmland values may rise 4.5 percent in 2005, a little below 2004, but that increase will continue the improvement in the farm sector balance sheet that we saw in 2003 (Figure 11). The red line on the Figure shows real estate value divided by net cash income, similar in concept to a price-to-earnings ratio. The forecast suggests that under current farm programs, expected net cash income and interest rates, asset values will continue up and the P/E ratio does not present an alarming picture.

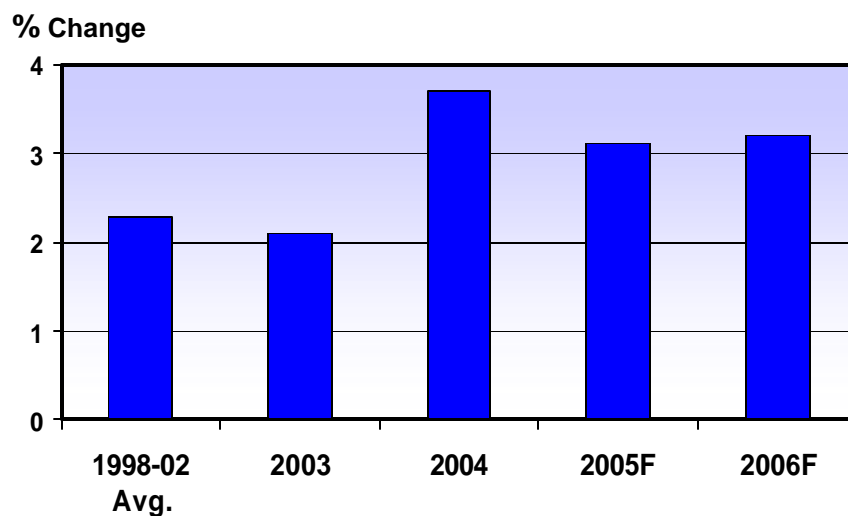
As always there is plenty to worry about: questions over the sustainability of the global economic recovery, the value of the dollar, issues raised by the Federal budget deficit, changeable trade negotiations, emerging competitors, bird flu in Asia, BSE, the Middle East, oil prices, interest rates, and terrorism. Despite these risks, U.S. agriculture appears poised for a fairly good financial year in 2005 despite the crop market pull back and 2006 at this early juncture looks to be more challenging. That completes my comments and thank you.

1--For the Year Ahead, *Will* ?

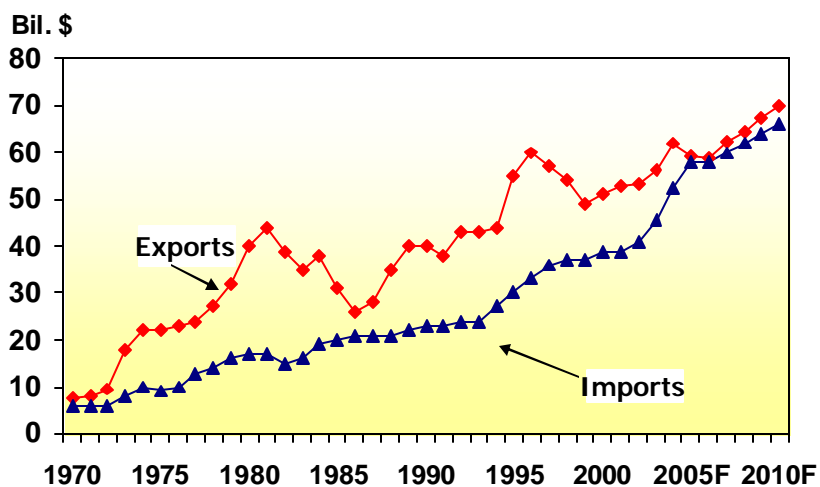
- ... foreign demand strengthen?
- ... foreign competition intensify?
- ... weather, diseases, prices prevent a repeat of 2004's production levels?

And, how will the farm economy and farm household fare?

2--Foreign GDP Growth ... *Improves*

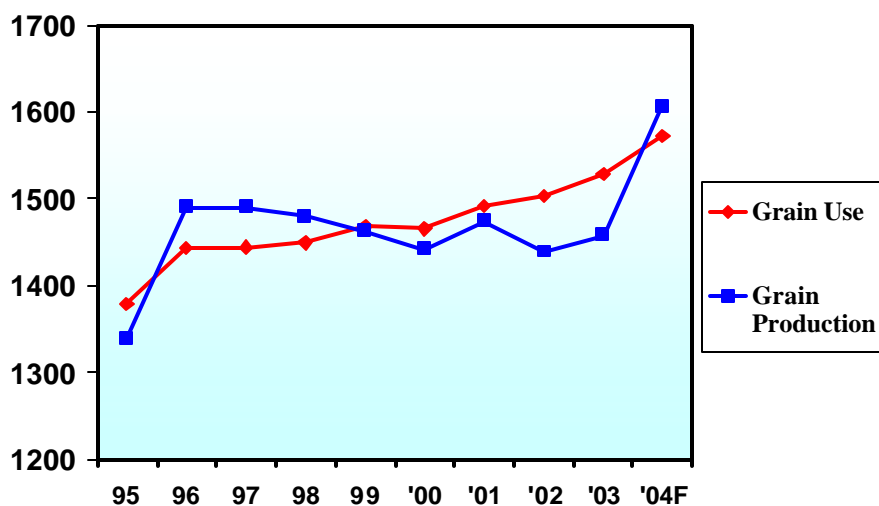


3--U.S. Ag. Trade Surplus ... *Narrows*



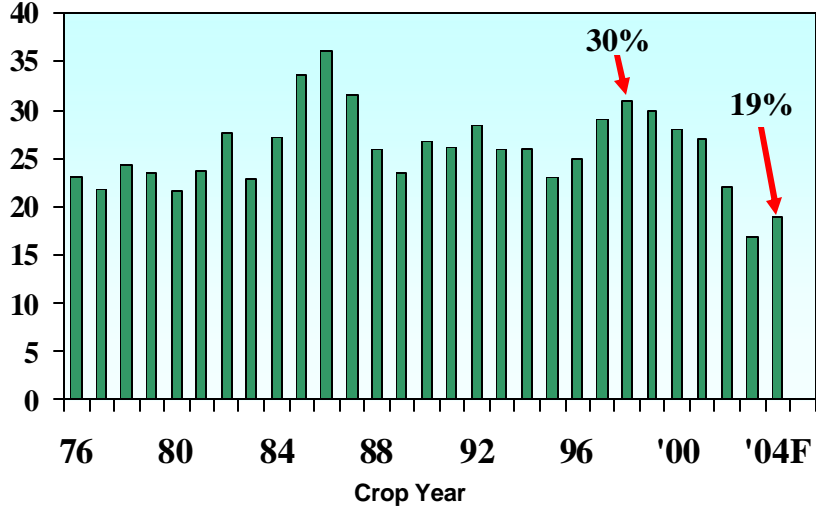
4--Global Grain Production... *Rebounds*

Mil. tons (*Wheat and Coarse Grains*)



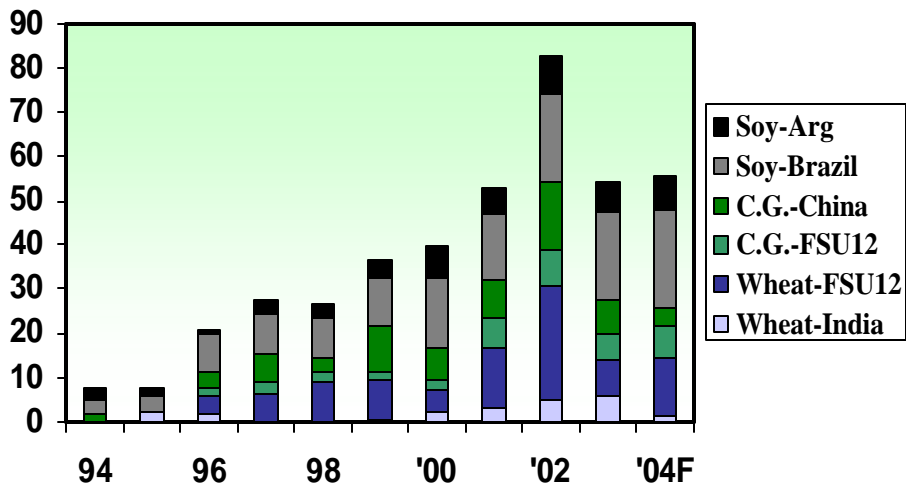
5--World Grain Stocks ... *Up but Not Excessive*

% of total use



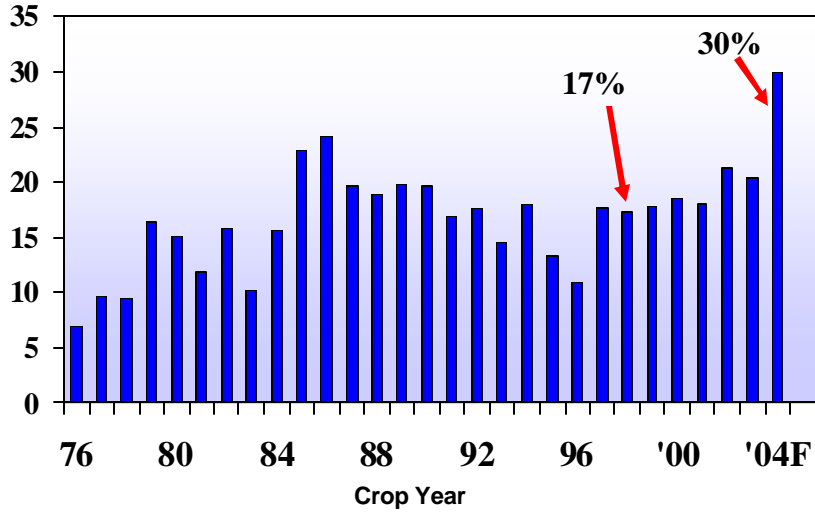
6--Emerging Competitors... *Making a Difference*

Mil. Tons Wheat Coarse Grain and Soybean Exports



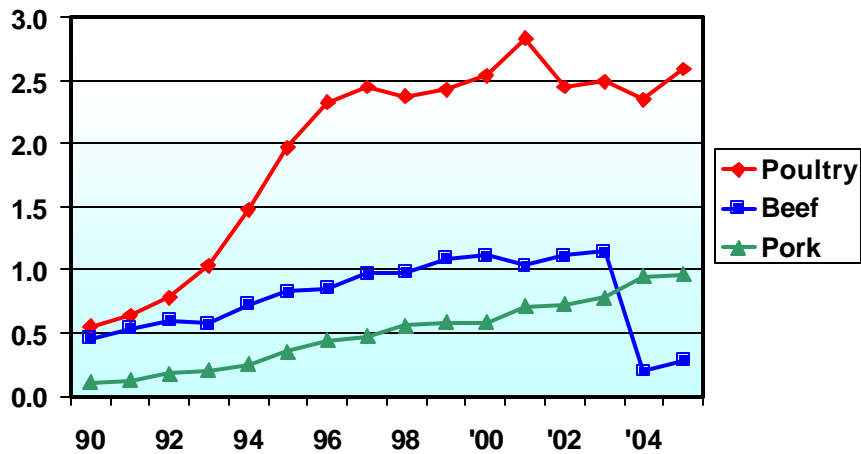
7--World Soybean Stocks ... *Up and Very Large*

% of total use

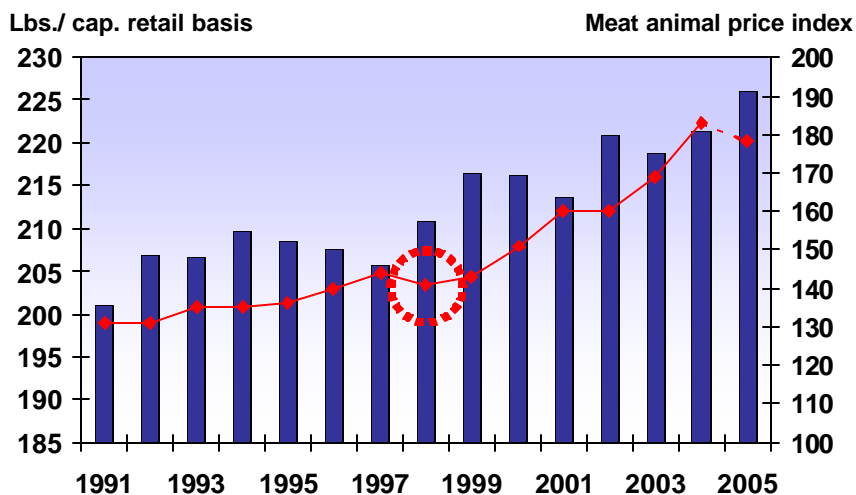


8--Beef Exports ... *BSE Takes Toll*

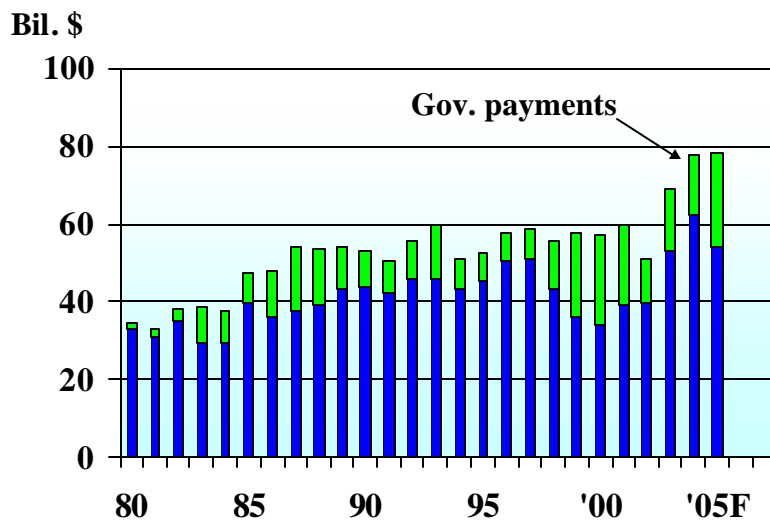
Mil. tons



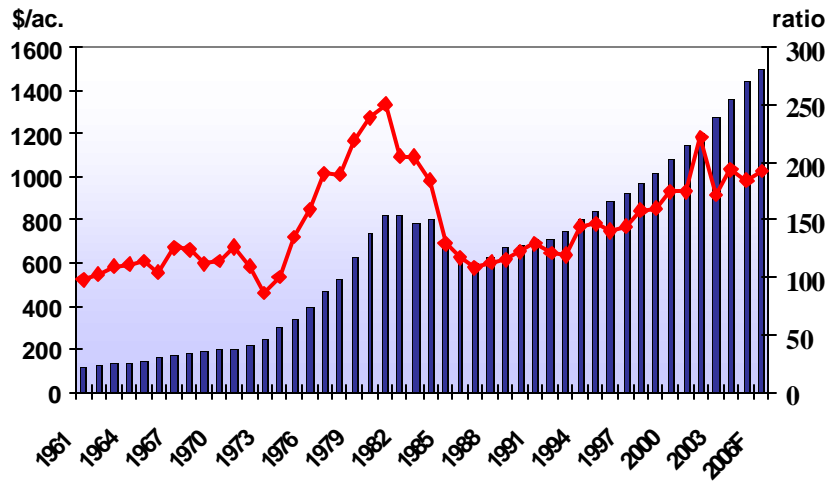
9--Retail Meat Consumption & CPI for Meat (red line)



10--U.S. Net Cash Farm Income ... *Records in 2003, 2004 & 2005F*



11--Value of Farm Real Estate (Jan. 1) and Value per \$ Net Cash Farm Income (red line)



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The Outlook for the Farm Economy

Keith Collins, USDA

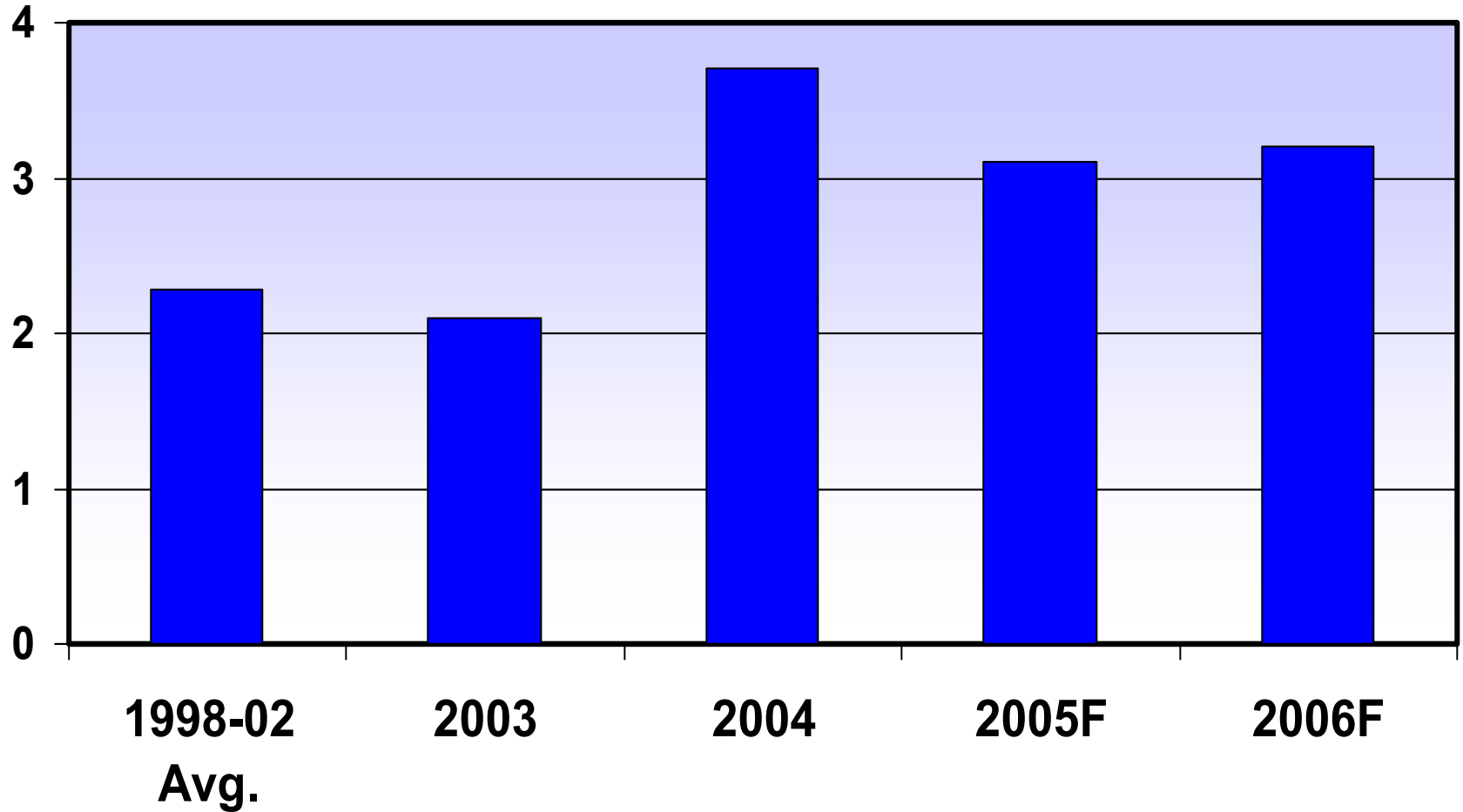
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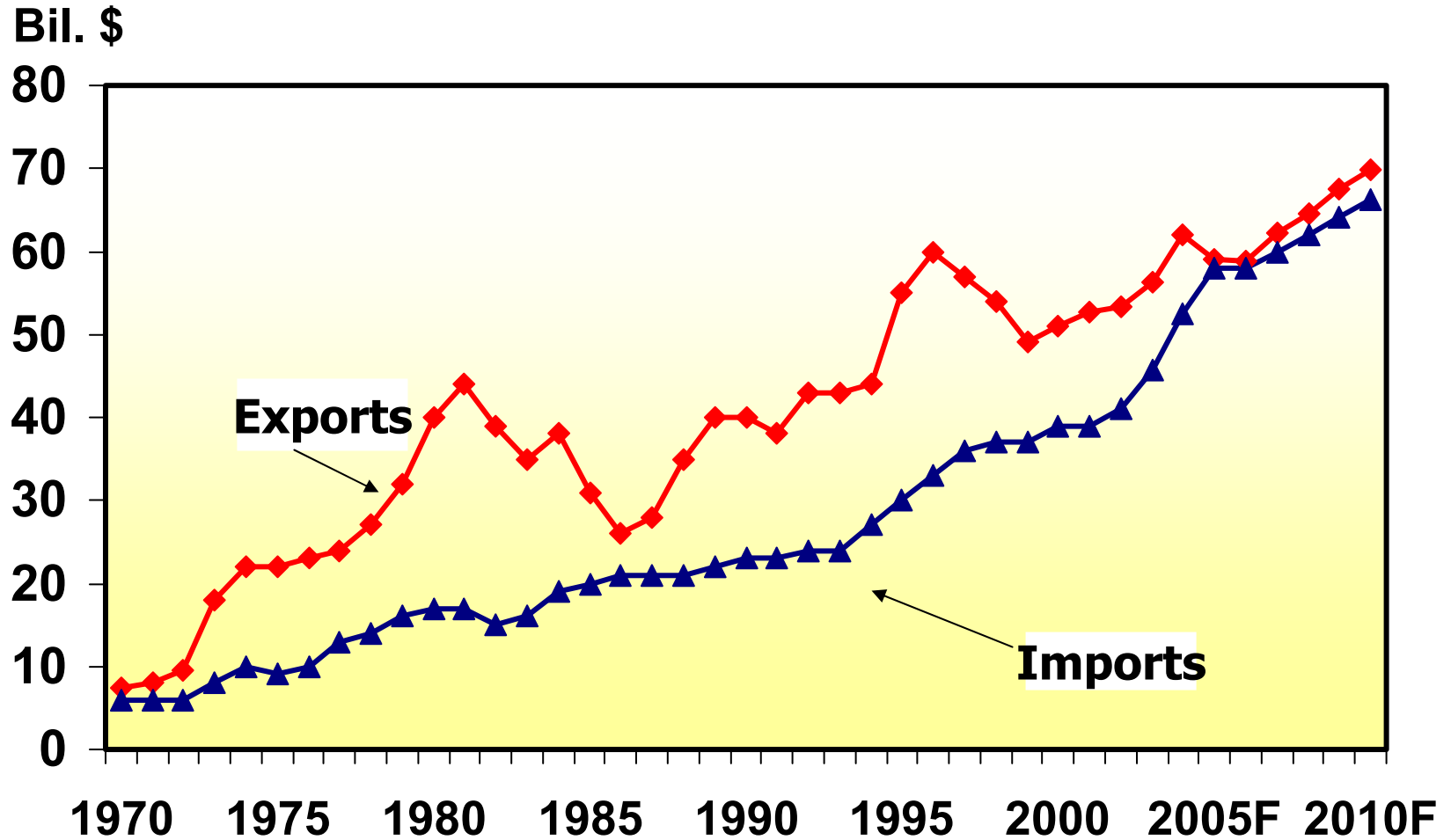
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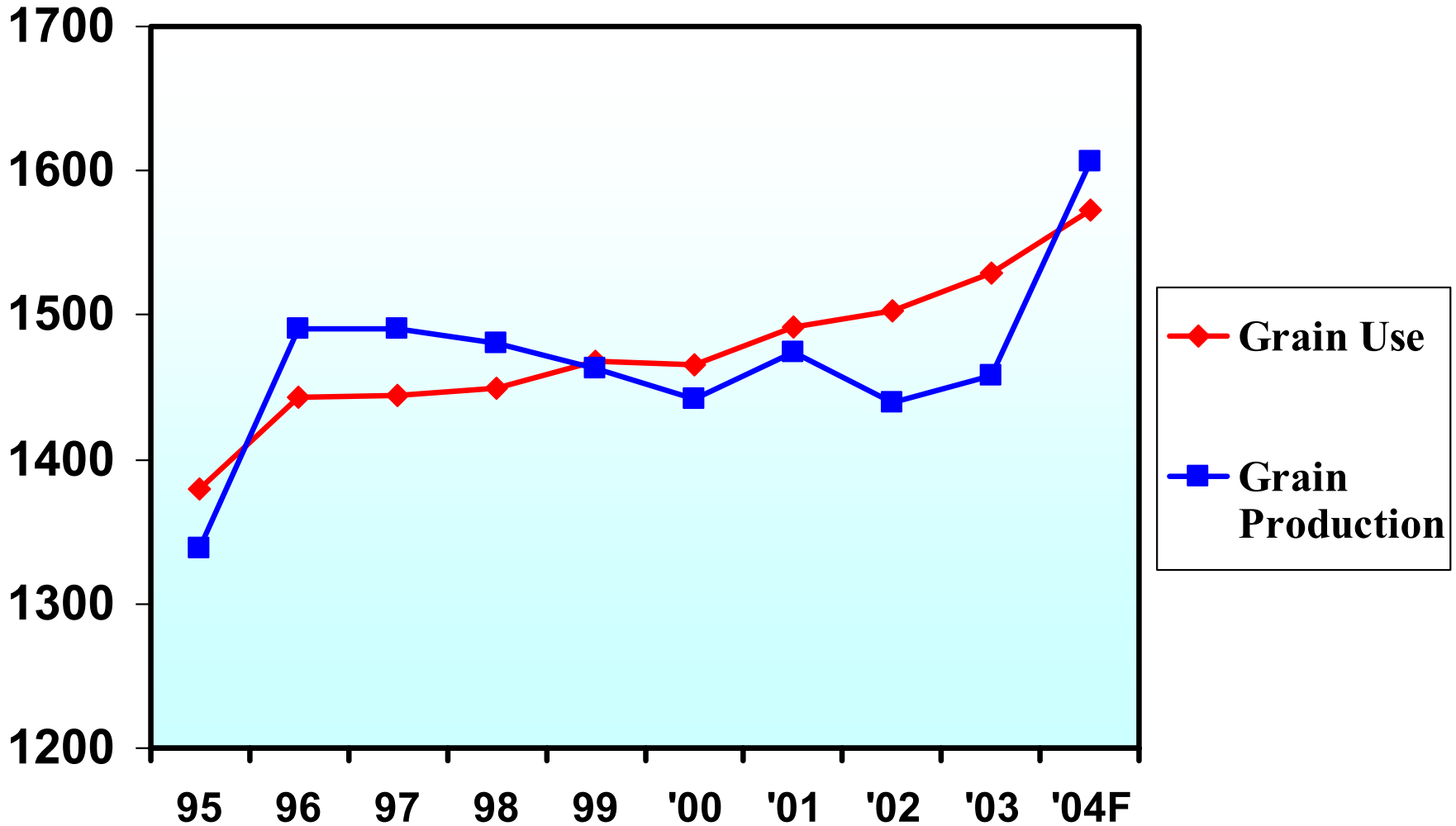
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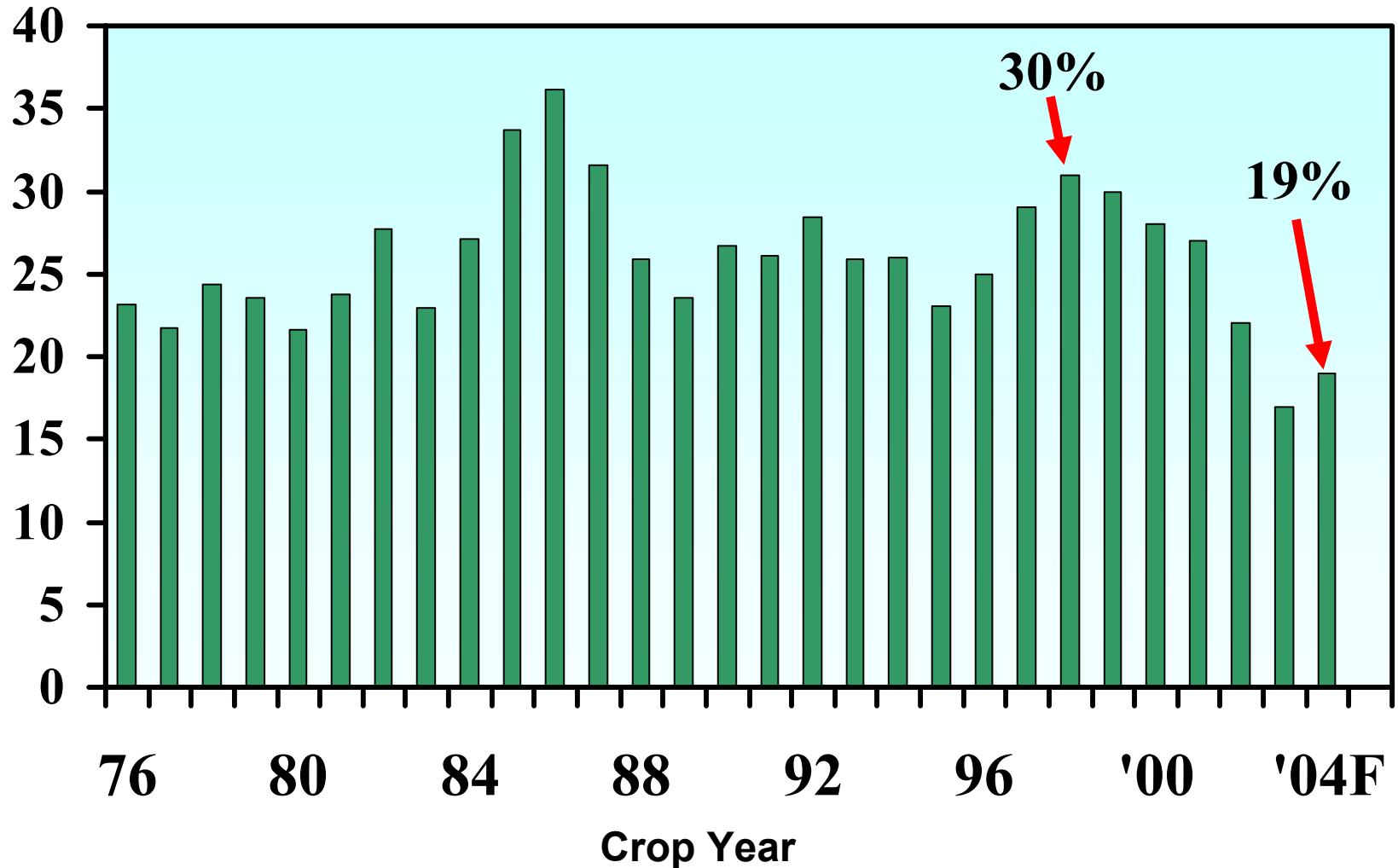
Mil. tons



5--World Grain Stocks ...

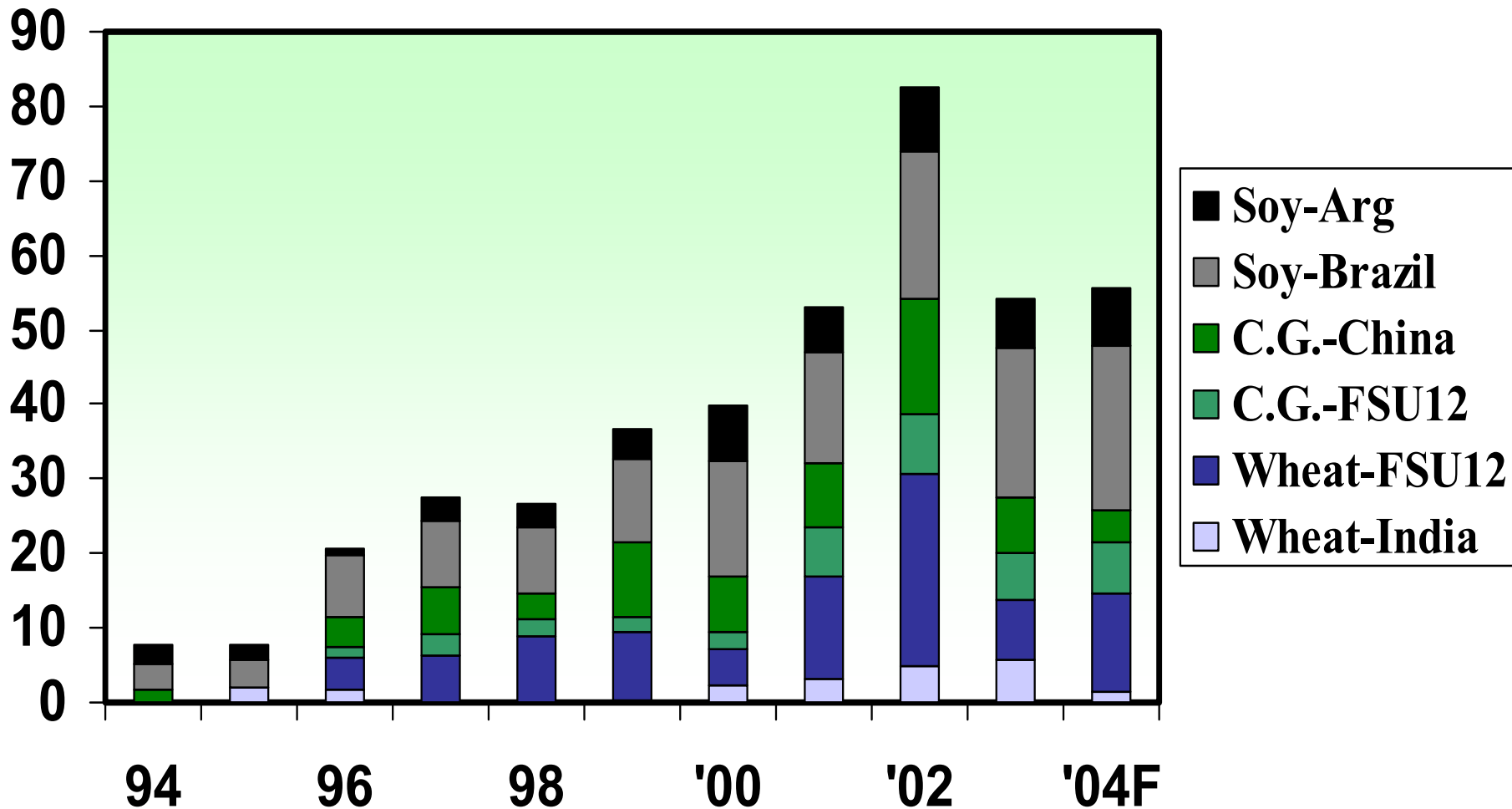
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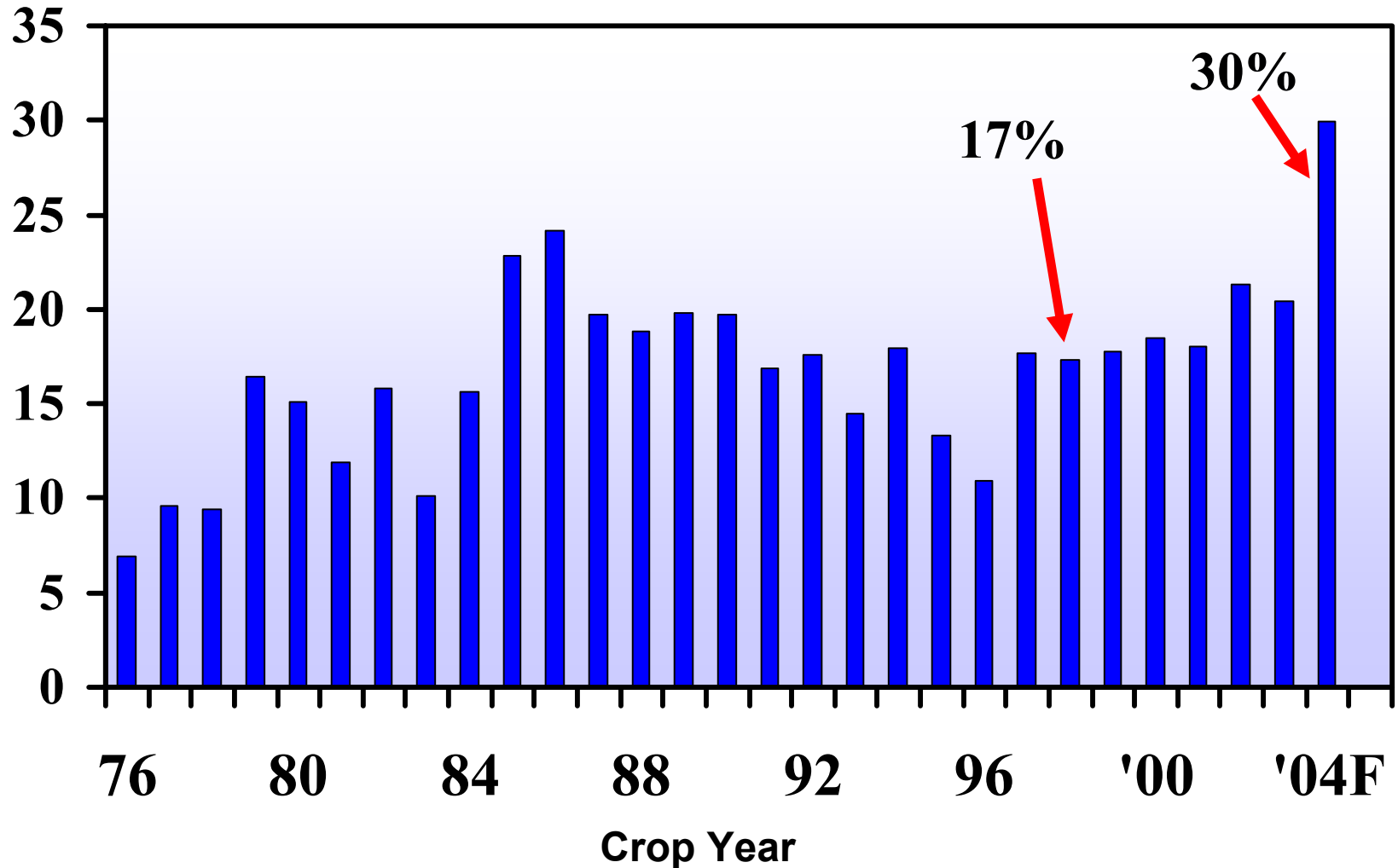
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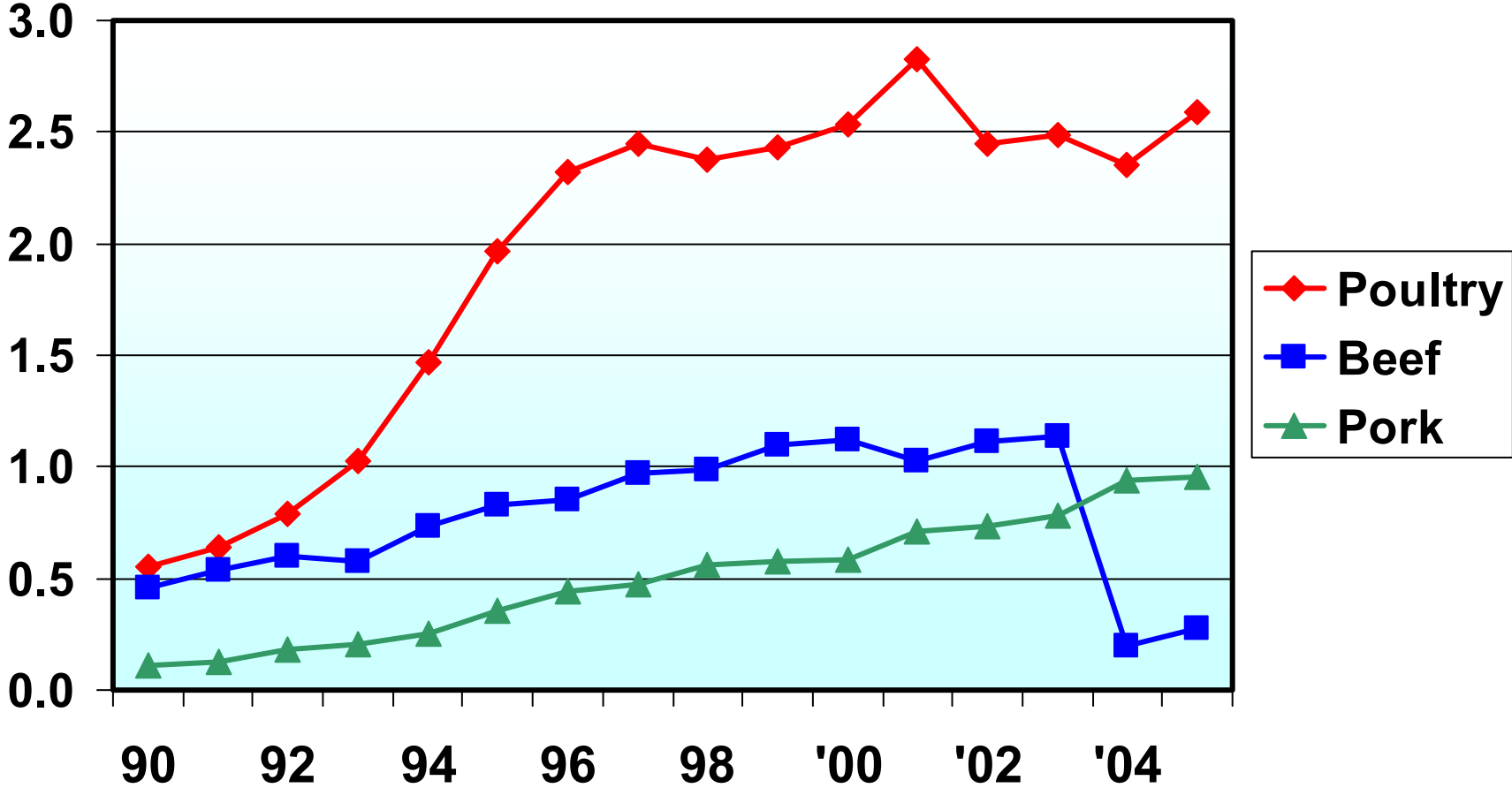
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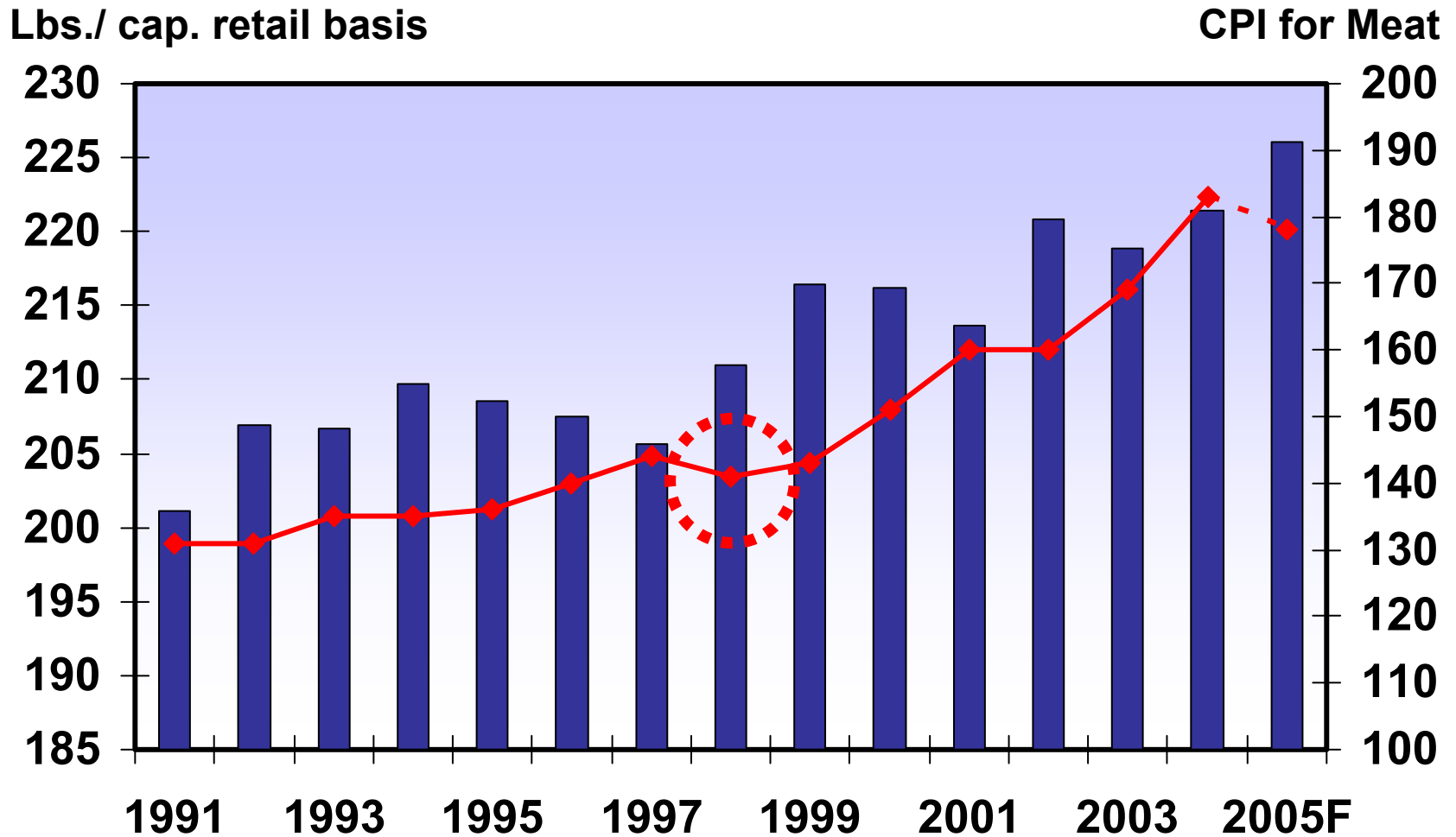


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Mil. tons



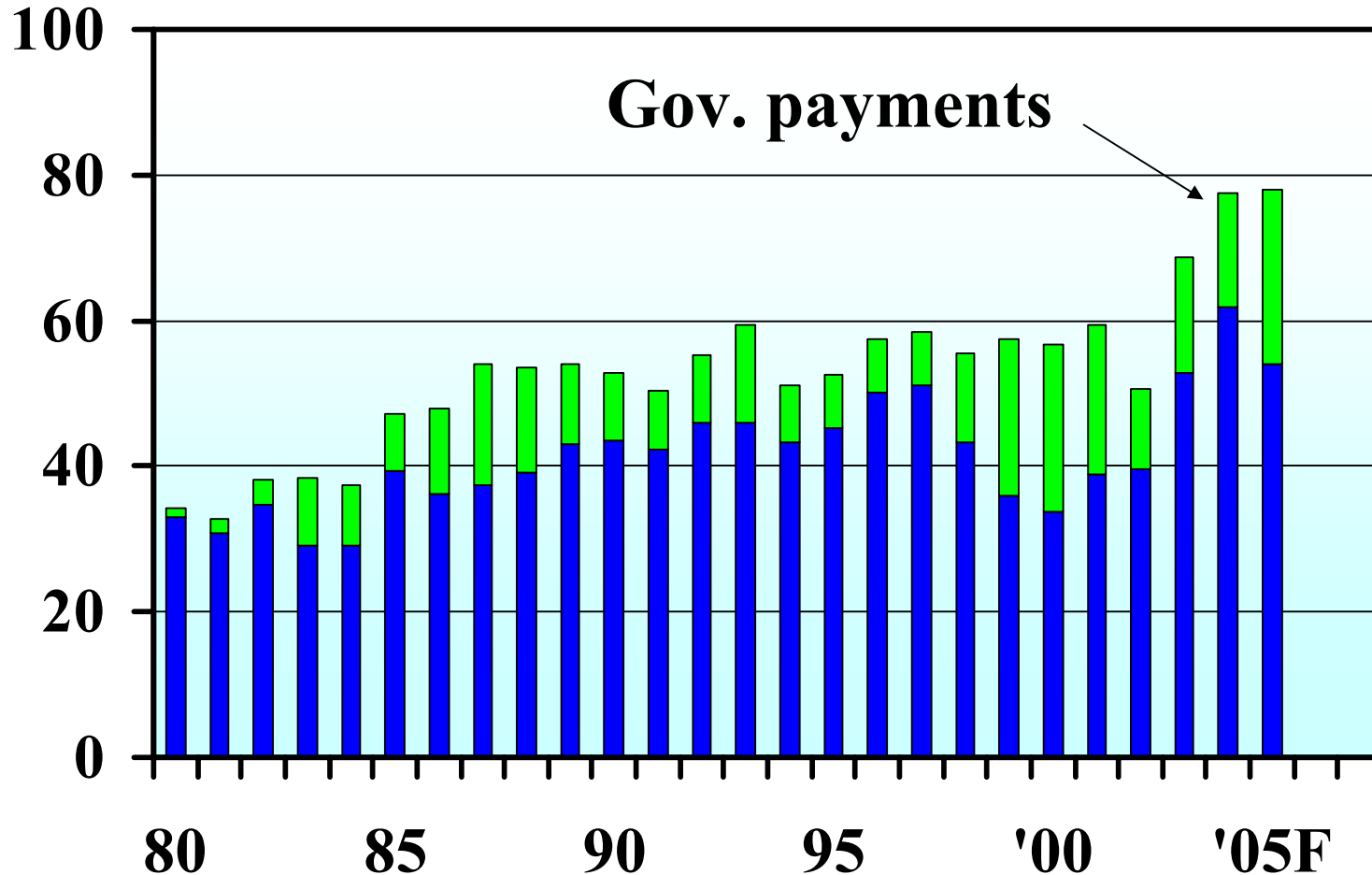
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Records in 2003, 2004 & 2005F

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