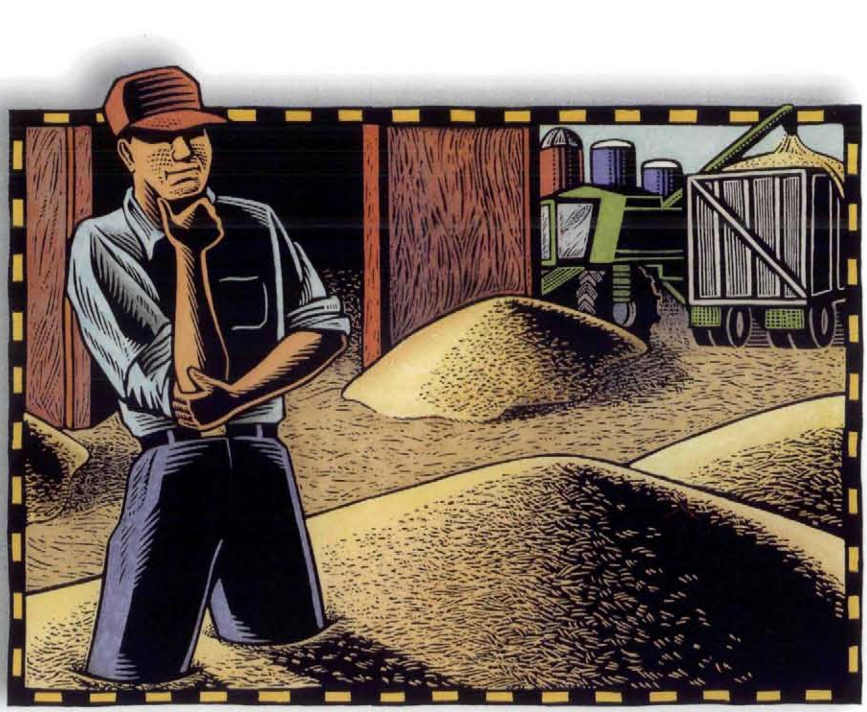

Is the Bloom off the Rose for Eighth District Farmers?

BY KEVIN L. KLIESEN

Sizable declines in crop and livestock prices during 1998 squeezed farmers' profit margins. And even though government projections point to further strains this year, a longer-term view of the farm sector's prospects looks more upbeat. Indeed, several factors last year helped to cushion—and may continue to help cushion—temporary shortfalls on the income side of the ledger. Farm balance sheets remain solid; the macroeconomic environment is exceptional, with reasonably low and stable inflation; oil and interest expenses remain low; and the economic prospects for Asia—an important customer of U.S. food and fiber producers—appear to be improving, at least outside Japan.

What Goes Around Comes Around

With two very good years under their belts, farmers had little to complain about at the beginning of 1998. All told, U.S. net farm income (NFI) averaged $51.6 billion from 1996 to 1997—nearly 30 percent more than the $39.9 billion average from 1985 to 1995—making 1996-97 one of the most profitable two-year periods in recent memory.[1] By the end of 1998, however, it was clear that farm income would fall far short of 1996-97 levels.

Because of lags in data reporting, the books for 1998 are not yet closed. According to the latest projections from the U.S. Department of Agriculture (USDA), however, NFI is expected to total $48 billion in 1998. If realized, this total would be nearly 3 percent below 1997's income and a little more than 10 percent below the 1996 level. Nevertheless, 1998 NFI still would be more than 20 percent greater than the nearly $40 billion average NFI witnessed from 1985 to 1995.

To a large degree, last year's downturn was a product of the good times that had prevailed over the previous two years. Specifically, the relatively high crop and livestock prices that existed for much of 1995 and 1996 spurred farmers to increase their production capacity as much as possible. The result, not surprisingly, was a substantial upswing in crop and livestock production that boosted 1998 farm inventories to their highest level in years.

This bulge in farm inventories severely pressured crop and livestock prices. The USDA's index of crop prices received by farmers declined 11 percent between the fourth quarter of 1997 and the fourth quarter of 1998. Although the agency's index of livestock prices remained unchanged over the same period—thanks to double-digit increases in dairy and poultry prices—cattle prices were off more than 12 percent, and hog prices declined by more than 50 percent.

To be fair, last year's plunge in commodity prices was not entirely a supply-side phenomenon. There also was a marked reduction on the demand side. Specifically, recessionary conditions in several East Asian countries—many of which are important buyers of U.S. agricultural products—contributed to a 9 percent drop in U.S. exports of agricultural commodities in 1998.[2] In fact, agricultural exports were off for the second consecutive year, having fallen 6.3 percent in 1997, when the Asian crisis got under way.[3]

The accompanying table shows pretty clearly why the USDA expects a modest drop in NFI in 1998. An 8.5 percent fall in crop cash receipts, combined with a nearly 4 percent drop in livestock receipts, caused the value of U.S. crop and livestock receipts to fall a little more than 6 percent from their 1997 level. The table also shows the value of 1998 crop and livestock receipts for each of the seven states in the Eighth Federal Reserve District. Although the state-level data generally are consistent with the national numbers, some states have fared worse. In particular, those states that produce abundant quantities of pork, corn and soybeans—commodities that have seen large price declines—experienced the largest drop in cash receipts. States that fall into this category include Arkansas, Illinois, Indiana and Missouri.

Because the declines in cash receipts from crop and livestock production are running well beyond the roughly 3 percent drop in NFI that the USDA is projecting in 1998, there must be some offsetting factors helping to boost farm income.[4] Two can be readily identified. The first is the $5.6 billion emergency aid legislation Congress passed last year. This funding is expected to boost government farm program payments—and thus NFI—to just under $13 billion in 1998. This level of government support is only $500 million less than its 1993 level, when program payments increased substantially following the Midwest flood.

The second factor that helped offset declines in crop and livestock receipts last year was a 2 percent drop in cash expenses. A good chunk of this benefit reflects reduced fuel and fertilizer costs, resulting from last year's roughly 35 percent drop in crude oil prices. But farmers as a whole also benefited, paradoxically, from declining crop prices, which lowered the feed costs of livestock producers and the seed costs of crop producers. In all, the USDA's index of prices *paid* by farmers fell 4 percent last year.

Onset of a Farm Crisis?

The USDA expects NFI to total $44.6 billion this year, a little more than 7 percent below the 1998 projection, but still well above the 1985-95 average.[5] The agency forecasts modest increases in livestock revenues that will be offset by a similar-size drop in crop receipts. In other words, the USDA projects that the current dollar value of farm cash receipts in 1999 will equal its 1998 level. Cash receipts are expected to decline slightly this year for dairy and poultry producers, as prices retreat from their elevated 1998 levels in response to an expected increase in the production of broilers, eggs and milk. This trend, in fact, is already occurring. At the same time, pork and beef production is expected to fall modestly this year, which will lend some support to prices. All told, cash receipts from red meat production should increase about 11 percent in 1999.

In contrast, crop cash receipts are expected to fall about 2.5 percent this year. Generally speaking, the USDA still anticipates that crop supplies worldwide will exceed demand, thereby keeping prices relatively low. This seems to be the situation in the United States, where stocks (inventories) of corn, soybeans and wheat rose 11 percent, 9 percent and 17 percent, respectively, in 1998. At the other extreme, cotton stocks are projected to fall about 21 percent this year. Reduced foreign demand, however, more than likely will offset most of this benefit. Accordingly, U.S. prices for most major crops are not expected to rebound from the relatively low levels that prevailed during much of 1998. Indeed, corn prices during the 1998/99 marketing year (Sept. 1, 1998, through Oct. 31, 1999) are forecast to fall to their lowest average level in 11 years.

On the demand side, the prospects for continued weak agricultural exports—due in large part to the ongoing difficulties in Asia and Japan, as well as the recent problems in Russia—will pressure U.S. crop prices. Slowing growth in Europe also will put a damper on foreign demand. Although few economists expect a dramatic improvement in the Japanese or Russian economic situations anytime soon—and it is still too early to say whether Europe's largest economies are headed for recession—it appears that some Asian countries have turned the corner. That said, a return to the growth rates of the early 1990s (6 to 8 percent real GDP growth) probably is unrealistic.

Some factors have helped farmers weather these short-term difficulties. The continued improvement of farm balance sheets is foremost among these. On the asset side, the nominal value of farmland prices is expected to rise about 3 percent in 1999—a modest acceleration from the 2.3 percent gain seen in 1998. Meanwhile, total farm debt should decline about 0.75 percent, which will drop the 1999 debt-to-asset ratio to 14.8 percent—its lowest level since 1962, and well below its 1985 peak of almost 30 percent. From a longer-term perspective, recent technological gains and improved planting practices have led to substantial increases in productivity, which therefore trim per-unit production costs. Those farmers that can best capture these benefits will enjoy the greatest prospects for increased profitability.

When the books are closed, last year probably will turn out to have been a decent one for farmers. Although income prospects for 1999 perhaps are modestly worse, the difficulties currently experienced by the farm sector stem largely from short-term supply/demand imbalances and temporary foreign-based disturbances. These problems, in all likelihood, will reverse themselves in a manner similar with past experiences.

U.S. and Eighth District Cash Receipts from Crop and Livestock Sales

(BILLIONS OF DOLLARS)

	Crops and Livestock		Crops		Livestock	
District State	1998 Value	Change from 1997	1998 Value	Change from 1997	1998 Value	Change from 1997
ARKANSAS	$5.42	−7.6 %	$2.20	−10.3 %	$3.22	−5.7 %
ILLINOIS	7.64	−17.6	6.23	−15.1	1.41	−27.0
INDIANA	5.04	−8.4	3.37	−6.6	1.67	−11.9
KENTUCKY	3.62	−0.4	1.82	9.9	1.80	−9.1
MISSISSIPPI	3.48	0.2	1.31	−10.9	2.17	8.4
MISSOURI	4.53	−18.5	2.30	−17.0	2.23	−20.1
TENNESSEE	2.09	−9.0	1.16	−9.7	0.92	−8.2
TOTAL	$31.82	−10.6 %	$18.38	−10.6 %	$13.44	−10.6 %
UNITED STATES	$195.51	−6.3 %	$102.54	−8.5 %	$92.97	−3.7 %

NOTE: Numbers may not add correctly because of rounding.
SOURCE: U.S. Department of Agriculture

Kevin L. Kliesen is an economist at the Federal Reserve Bank of St. Louis. Daniel R. Steiner provided research assistance.

ENDNOTES

1 Net farm income is the sum of: 1) crop and livestock cash receipts; 2) government farm program payments; 3) farm-related income; and 4) noncash income (such as the value of food grown on the farm for home consumption), *less* production expenses, depreciation and real estate taxes. NFI also includes an adjustment for changes in the value of farm inventories. An increase in crop prices, for example, will boost the value of farm inventories and, thus, NFI. Official USDA farm income numbers—both actual and forecast—are expressed in nominal, or current dollar, terms.

2 See farm sector indicator charts on Page 18 for further detail on recent U.S. agricultural developments.

3 See Kliesen (1998).

4 About 90 percent of *gross* cash income is comprised of crop and livestock receipts. See Endnote 1.

5 See USDA (1999).

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