The Outlook for U.S. Agriculture: Entering A New Era

By Mark Drabenstott

U.S. agriculture appears to be passing into a new era marked by both greater risk and potentially greater rewards. Proposed legislation would lower the government safety net that for decades has supported farm incomes and reduced the risk of farming. If signed into law by the President, the proposed farm bill would phase down government payments to farmers over the next seven years, but in exchange would give farmers more flexibility to plant the crops that take best advantage of market opportunities. That switch in policy will occur just as the industry faces the brightest prospects in world commodity markets in decades. U.S. crop prices closed out 1995 at the highest levels in years, in part due to a surge in U.S. agricultural exports.

The year just past set the stage for the new period ahead. The farm legislation proposed by Congress in 1995 would mark a watershed in farm policy, leading farmers to rethink what they produce and creating potentially big shifts in farm production across the nation. Another major development in 1995 was a shortfall in U.S. crop production. With stocks already low when 1995 began, the year's crops were crucial in determining whether grain stocks would be restored to the ample levels that have prevailed through most of the 1990s. In the end, the shortfall in production appears to have created tight market conditions that now might hold for an extended period. U.S. farm income was up slightly in 1995, as rising grain prices offset another year of losses in the livestock industry.

U.S. agriculture should have a better year in 1996, although poor livestock profits will restrain gains in income. Crop producers will benefit from strong world markets and potentially modest cutbacks in government payments next year. But the livestock industry will be hurt by continued low prices and high feed costs. Cattle ranchers and hog producers will probably be hurt the most. Problems in the livestock industry could moderate as 1996 wears on, however, if normal-sized crops lead to a decline in feed prices. In the longer run, agriculture's outlook will be driven by the major developments of 1995—a new course for agricultural policy and a bullish turn in world food markets.

SHORTFALL AND EXCESS IN 1995

The year just past was quite a divergent one for U.S. agriculture. Crop producers entered the year

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Chart 1

NET CASH FARM INCOME

* Forecast

Source: U.S. Department of Agriculture, Economic Research Service, *Agricultural Income & Finance.*

with generally weak prices but plans for big crops. Those plans were blunted by a wet spring that significantly delayed planting and an early frost that trimmed yields. The crop shortfall combined with surging demand abroad to lift yearend crop prices to their highest levels in many years. In sharp contrast, livestock producers sent record supplies of meat to market in 1995, and livestock prices sagged for most of the year. Compounding producers' financial squeeze, feed costs rose substantially throughout the year. For the nation, high crop prices offset both smaller crops and livestock losses, lifting farm income slightly. In the Tenth District, where cattle losses were telling, farm income fell modestly.[1]

The nation's net cash farm income, a broad income measure which nets cash expenses from cash receipts, was $1.2 billion in 1995, up 2.8 percent from 1994. Record crop receipts led the increase, offsetting a slight drop in livestock receipts and a slight rise in farm expenses. After a sharp drop in farm income in 1994, U.S. farm income remains at its lowest level since 1986 (Chart 1). When measured in real dollars, farm income edged up in 1995, marking two straight years that income has settled below the low point of the 1980s. Net farm income, a different measure of farm income that takes into account changes in farm inventories, fell about 17 percent as farmers liquidated part of their stockpile of farm products.

Table 1

FARM BALANCE SHEETS ON DECEMBER 21

(Billions of dollars)

	1987	1988	1989	1990	1991	1992	1993	1994	1995
Assets									
Real estate	578.9	595.5	615.7	628.2	624.4	640.6	670.9	703.3	726.0
Nonreal estate	193.8	205.6	214.1	220.4	219.4	227.8	232.1	230.1	230.6
Total assets	772.7	801.1	829.8	848.6	843.8	868.4	903.0	933.4	956.6
Deflated	772.7	771.8	764.1	749.0	717.5	718.3	731.2	740.2	745.6
Liabilities									
Real estate	82.4	77.6	75.4	74.1	74.6	75.1	75.7	77.3	78.7
Nonreal estate	62.0	61.7	61.9	63.2	64.3	63.6	65.9	69.1	72.0
Total liabilities	144.4	139.3	137.3	137.3	138.9	138.7	141.6	146.4	150.7
Deflated	144.4	134.2	126.4	121.2	118.1	114.7	114.7	116.1	117.5
Proprietor's equity	628.3	661.8	692.5	711.3	704.9	729.7	761.4	787.0	805.9
Deflated	628.3	637.6	637.7	627.8	599.4	603.6	616.5	624.1	628.1
Debt-to-asset ratio (percent)	18.7	17.4	16.5	16.2	16.5	16.0	15.7	15.7	15.7

Note: Figures for 1995 and 1996 are forecasts. Also, table excludes operator households

Source: U.S. Department of Agriculture.

In the Tenth District, farm income fell markedly due to losses in the production of cattle, the district's leading commodity, and a drop in crop production. Cattle prices were sluggish in early 1995 and then slid into the low $60-a-hundredweight range in late spring, creating big losses for feedlot operators, although not as big as the huge losses of mid-1994. By late 1995, however, cattle feeders had returned to slim profits but only by pushing calf prices lower, creating big losses for cattle ranchers. Hog producers made profits for the year as a whole, after snapping back from sizable losses in the first half of the year.

The district's crop producers had a disappointing year. Although crop prices surged throughout 1995, many producers saw crop production fall by more than the rise in prices. Wheat producers fared best in the district, with crop production down 17 percent from 1994, while prices jumped 26 percent. Wheat producers in Kansas, the leading wheat producing state in the district, probably just broke even due to a poor harvest. Production of corn, the district's most valuable crop, was down 27 percent, while prices were up much less for the year as a whole. A similar pattern held for soybeans and grain sorghum, the two other major crops in the district.

Despite relatively weak income the past two years, the nation's farmers generally have weathered the period well due to strong balance sheets.

U.S. agriculture's balance sheet showed modest improvement in 1995 (Table 1). Farm assets climbed 3.2 percent, roughly the rate of general price inflation, as farmland values continued to trend higher. In district states, farmland values rose an average 4.1 percent for the 12 months ended September 30, 1995. Farmland values increased the fastest in Missouri and the mountain states and were slowest to rise in Nebraska and Oklahoma.

For the nation, farm debt increased $4.3 billion in 1995, about the same percentage gain as for farm assets. As a result, the debt-asset ratio held steady at 15.7 percent, a relatively low level by historical standards. The rise in debt may have been greater in the district due to losses in the cattle industry. Those losses and disappointing crops combined to slow the rate of repayment on farm loans to its lowest level in a decade (Ryckman and Barkema). On balance, U.S. agriculture closed 1995 in reasonably strong financial condition. Two straight years of weak income have forced many farmers to tighten their belts, but agriculture's balance sheet remains healthy. Still, another year of difficulty for livestock producers will probably lead to an increase in the number of producers forced from business. While many crop producers had subpar years in 1995, lofty crop prices made most producers and their lenders optimistic about a rebound in 1996.

Another tough year for livestock producers

Most livestock producers were anxious to leave the losses of 1994 behind when 1995 began. Hopes for a quick recovery were dashed, however, as livestock prices sagged and feed bills climbed. By yearend, a modest rebound in prices had restored slim profits to many segments of the livestock industry. Nevertheless, after a second straight year of losses and little prospect of a rapid turnaround, many producers closed out 1995 feeling wary about the future.

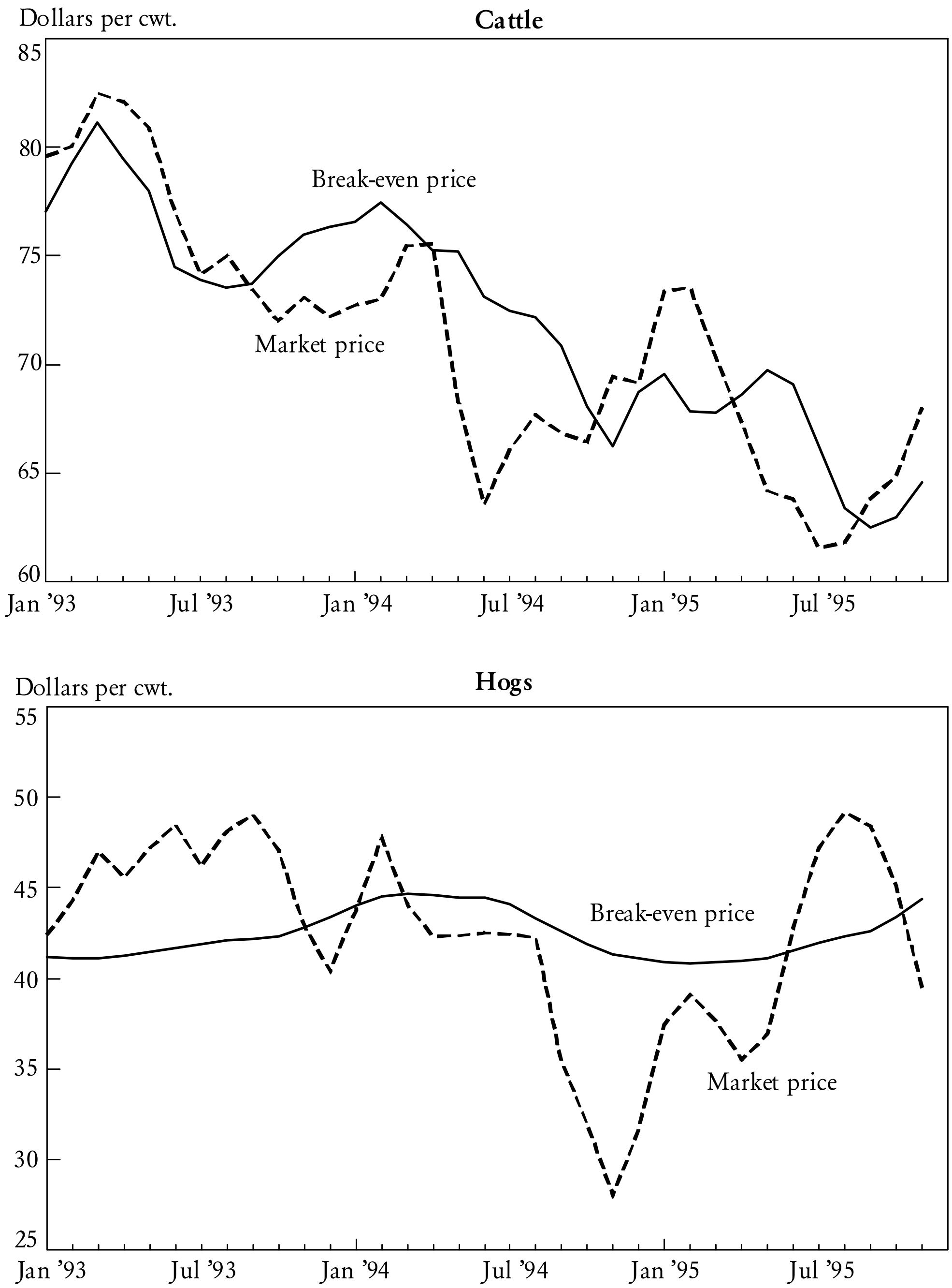
The cattle industry was again the hardest hit part of the livestock sector in 1995. The problem was simple—too much beef. After a 5.8 percent surge in beef production in 1994, many analysts thought beef producers would throttle back production in 1995. Instead, they boosted supplies another 3.0 percent. As the market discovered the increase in supplies in the spring, cattle prices began to tumble and finally bottomed out in summer in the low $60-a-hundredweight range, the lowest prices in several years. Prices rebounded somewhat in the second half of the year as producers began to scale back somewhat.

Prices for finished cattle ranged widely throughout 1995 but were generally weak. For the year as a whole, prices for choice steers in Texas and Oklahoma averaged $66.34 a hundredweight, down $2.50 from the year before (Table 2). Most cattle feeders lost money in 1995, although many had returned to profits by the fourth quarter (Chart 2). The main reason for the turnaround was that feedlot operators bid down feeder cattle prices, essentially pushing the losses on to cattle ranchers. Feeder cattle prices dipped into the low $60-a-hundredweight range throughout the second half, lower than prices had been for many years.

Pork producers were reeling from losses as 1995 began, with widespread doubts about how quickly profits might return. Pork supplies had advanced 3.5 percent in 1994 and, with many producers losing money, many expected herd liquidations to swell supplies in 1995. Instead, producers kept a tight rein on pork production, and pork output increased just 0.9 percent. Coupled with continued strong retail demand, tight supplies led to a run-up in pork prices throughout the year. For the year as a whole, prices for barrows and gilts in the benchmark Iowa-southern Minnesota market averaged $42.18 a hundredweight, up $2.15 from the depressed levels of

Chart 2

LIVESTOCK RETURNS



Source: Iowa State University, Estimated Livestock Returns.

1994. After substantial losses early in the year, most producers probably made small profits for the year as a whole.

In contrast to beef and pork producers, poultry growers had a good year in 1995. Production was up, demand continued to grow, and margins held up despite rising feed costs. Broiler production increased 5.0 percent, somewhat less than the year before. After being held down by large supplies of competing meats in the first half, broiler prices moved to higher levels in the second half, gains that were particularly impressive in light of weakening export demand in the second half. For the year as a whole, broiler prices averaged 56 cents a pound, the same as in 1994. Producers continued to benefit from strong retail demand, and exports were up 31 percent for the year, although much of the gain took place in the first half. On net, producers earned healthy margins throughout the year.

Turkey producers also enjoyed a good year in 1995. Production rose 2.8 percent to a new record, although output was probably held down by a hot summer. Demand for turkey remained brisk in 1995, as producers continued to bring new products to market. Exports were especially strong, rising 18 percent in 1995.[2] The strong demand kept turkey prices at relatively high levels, especially in the second half of the year. For the year as a whole, prices averaged 67 cents a pound, a penny more than in the previous year. Notwithstanding a rise in feed costs, profits for turkey producers doubled from solid levels in 1994.

A shortfall in crop production

Crop production was disappointing in 1995 due to a wet spring and an early frost. The dip in crop production and a surge in exports combined to lift crop prices to their highest levels in several years. In the district, higher prices were not enough to outweigh low crop yields, especially in Missouri and Nebraska, where late plantings and a shortened growing season led to crops well below the big harvest in 1994.

Wheat producers harvested a mediocre crop of 2.2 billion bushels in 1995, marking the third year in a row that production has fallen (Table 3). The crop was hampered by poor planting conditions in both winter and spring wheat growing regions. In addition, a late frost also hurt the crop in Kansas, the district's leading wheat state. Overall, the national yield fell to 35.9 bushels per acre, the lowest in four years.

Wheat prices were driven higher throughout 1995 by the small crop, small stocks, and continued strong export demand. For the 1994-95 crop marketing year that ended May 31, wheat prices averaged $3.45 a bushel, up nearly 6 percent from the previous year (Table 2). But prices moved much higher throughout the remainder of the calendar year. In fact, prices for hard red winter wheat, the type of wheat that is most important to the nation and the district, topped $5 a bushel at the time of summer harvest, a rare event. The last time it happened was 1973.

A similar pattern of a shortfall in production and rising prices held for corn. Adverse weather held the crop to just 7.4 billion bushels, 27 percent below the 1994 harvest. An extremely wet spring delayed planting across many parts of the Corn Belt, including the district states of Missouri and Nebraska. Fields were so wet that some were never planted. Crop prospects improved as the growing season proved favorable. But the late start left the crop vulnerable to an early frost, and a September cold snap hurt yields in a number of states, including Nebraska. The national corn yield dropped to 113.7 bushels per acre, substantially below its long-term trend level.

Corn prices began to move higher in late spring as rains held back corn planting. Prices fell as

Table 2

U.S. FARM PRODUCT PRICE PROJECTIONS

(December 12, 1995)

	Calendar years			
Livestock	1994	1995*	1996+	Percent change
Choice steers	$68.84/cwt.	$66.34/cwt.	$63-67/cwt.	-2.0
Barrows and gilts	$40.03/cwt.	$42.18/cwt.	$38-40/cwt.	-7.5
Broilers	$.56/lb.	$.56/lb.	$.52-.55/lb.	-4.5
Turkeys	$.66/lb.	$.67/lb.	$.62-.66/lb.	-4.5
Lambs	$66.77/cwt.	$76.44/cwt.	$73-$76/cwt.	-2.6
Milk	$12.97/cwt.	$12.70-12.80/cwt.	$12.50-13.30/cwt.	1.2

	Marketing years			
Crops	1993-94	1994-95*	1995-96+	Percent change
Wheat	$3.26/bu.	$3.45/bu.	$4.25-4.45/bu.	26.1
Corn	$2.50/bu.	$2.26/bu.	$2.95-3.35/bu.	39.4
Soybeans	$6.40/bu.	$5.45/bu.	$6.30-7.30/bu.	24.8
Cotton	$.58/lb.	$.73/lb.	N/A	N/A

*Estimated.

+Projected.

Source: U.S. Department of Agriculture.

growing conditions improved in midsummer. For the marketing year that ended August 31, prices were $2.26 a bushel, 10 percent below the previous year. But prices then began a long upward climb that extended right through harvest. Prices climbed as market participants discovered that the 1995 crop would be down substantially from the year before. That discovery, along with strong, steady export demand, convinced market participants that prices would have to move sharply higher to ration available supplies. Prices topped $3 a bushel throughout harvest, a rare occurrence, and moved still higher by yearend.

U.S. producers harvested a normal-sized soybean crop, thanks to increased acreage and good

Table 3

U.S. AGRICULTURAL SUPPLY AND DEMAND ESTIMATES

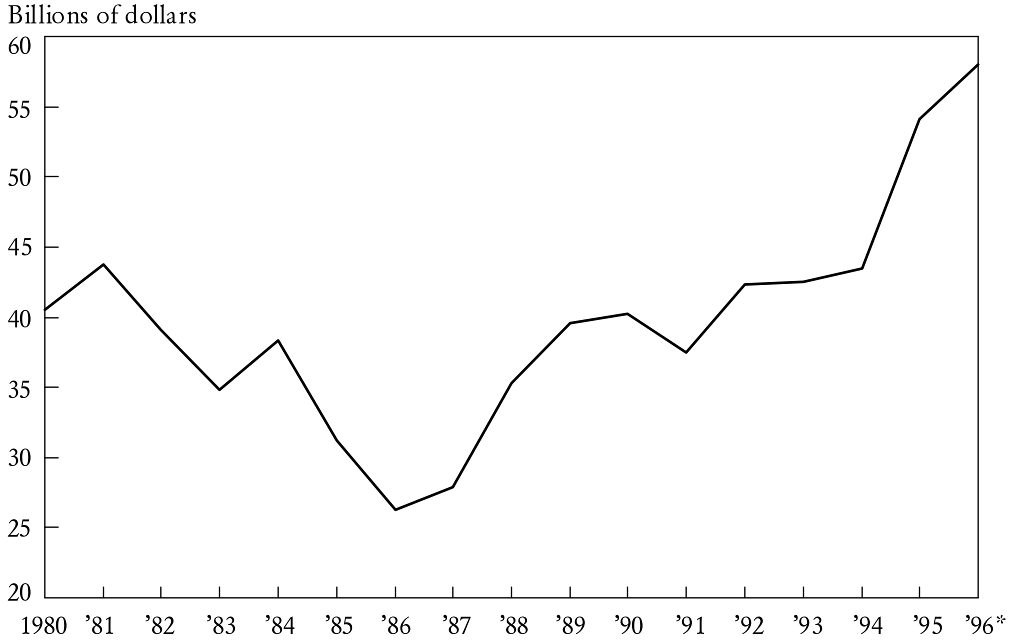
(December 12, 1995)

	Corn (bu.)			Feedgrains (mt.)		
	September 1-August 31			June 1-May 31		
	1993-94	1994-95	1995-96	1993-94	1994-95	1995-96
Supply						
Beginning stocks	2,113	850	1558	63.1	27.4	45.3
Production and imports	6,357	10,113	7,384	190.1	288.1	212.3
Total supply	8,470	10,963	8,942	253.2	315.5	257.6
Demand						
Domestic	6,292	7,227	6,225	185.5	207.7	178.7
Exports	1,328	2,177	2,100	40.3	62.4	59.1
Total demand	7,620	9,404	8,325	225.8	270.1	237.8
Ending stocks	850	1,559	617	27.4	45.3	19.8
Stocks-to-use ratio (percent)	11.2	16.6	7.4	12.1	16.8	8.3

	Soybeans (bu.)			Wheat (bu.)		
	September 1-August 31			June 1-May 31		
	1993-94	1994-95	1995-96	1993-94	1994-95	1995-96
Supply						
Beginning stocks	292	209	335	531	568	507
Production and imports	1,877	2,522	2,188	2,505	2,413	2,268
Total supply	2,169	2,731	2,523	3,036	2,981	2,775
Demand						
Domestic	1,372	1,558	1,508	1,240	1,287	1,190
Exports	589	838	800	1,228	1,188	1,200
Total demand	1,961	2,396	2,308	2,468	2,475	2,390
Ending stocks	209	335	215	568	506	385
Stocks-to-use ratio (percent)	10.7	14.0	9.3	23.0	20.4	16.1

Note: Data represent millions of bushels or metric tons.
Source: U.S. Department of Agriculture.

Chart 3
U.S. AGRICULTURAL EXPORTS



* Forecast
Source: U.S. Department of Agriculture, Economic Research Service, *Outlook for U.S. Agricultural Exports.*

late-season growing conditions. The crop totaled 2.2 billion bushels, down 13 percent from the large crop in 1994 but about equal to the average for the past five years. The wet spring persuaded many Corn Belt farmers to switch some wet fields from corn to soybeans, boosting soybean acreage to the highest level in many years. Although yields were good in many other parts of the nation, fields were so wet in Missouri, Kansas, and Nebraska throughout the early summer that Tenth District soybean production fell about a fourth from 1994.

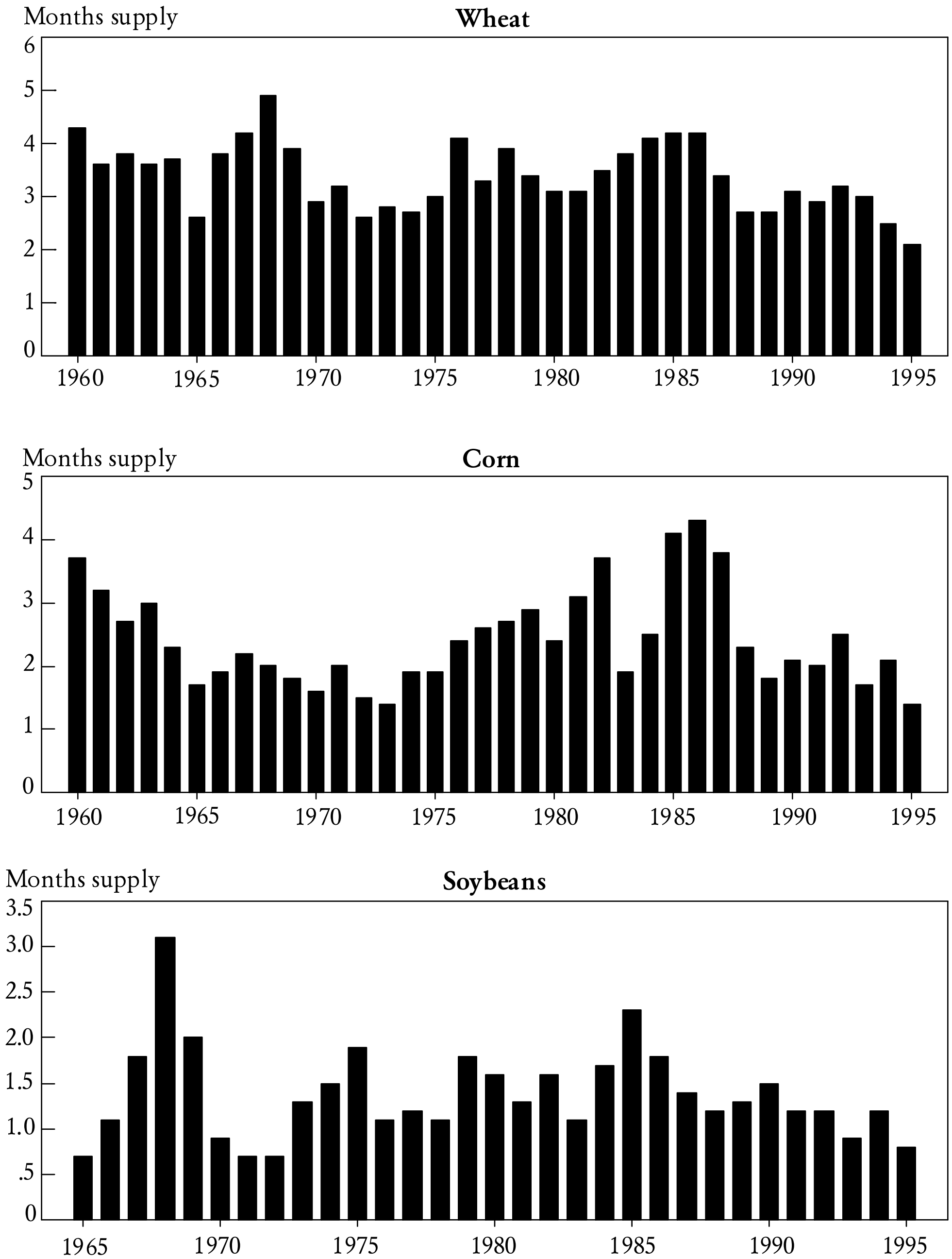
Soybean prices were more sluggish in 1995 than prices for the other major crops because the decline in production was not as severe. For the 1994-95 marketing year that ended August 31, soybean prices averaged just $5.45 a bushel, nearly a dollar under the previous year. By yearend, however, the strong climb in wheat and corn prices, along with a fresh surge in export demand, lifted soybean prices to about $7.25 a bushel.

BETTER PROSPECTS AHEAD

After a disappointing year in 1995, U.S. agriculture enters 1996 with more favorable prospects. Crop producers have a good chance to have a bell-ringer year so long as weather conditions permit normal crops. With grain stocks at lows not

Chart 4

WORLD CROP INVENTORIES



Note: Fiscal year data.
Source: U.S. Department of Agriculture, Foreign Agricultural Service.

seen in decades and with export buyers anxious to satisfy their needs, crop markets should stay strong. Livestock producers will have to overcome high feed costs and soft prices, but conditions should improve as the year unfolds. By yearend, many producers will probably have rebounded from the stiff losses of the past two years. Although market prospects generally look favorable in 1996, farmers will also be adjusting to the other defining feature of the new era—less government support. Government payments will drop modestly in 1996, but new farm legislation could put payments on a steady downward path for the next six years. Thus, farmers may view good fortune in the coming year as good reason to save for a rainy day. In developing the outlook for 1996, it is helpful to assess the two defining features of agriculture's new period—healthy export markets and cuts in government payments—before discussing prospects for crops, livestock, and farm finances.

Bright prospects for U.S. agricultural exports

U.S. agricultural exports appear to face their best market prospects in many years. U.S. agricultural exports set a record in 1995 and another record seems likely in 1996. World grain reserves are low and world food demand is growing at a brisk pace, boosted by blossoming trade with the People's Republic of China. This robust outlook seems unlikely to be reversed anytime soon.

U.S. agricultural exports have considerable momentum as 1996 begins. U.S. firms shipped a record \$54.1 billion of agricultural products to foreign buyers in 1995, a jump of more than \$10 billion (Chart 3). The rise was fueled mostly by a surge in grain and other bulk commodity exports, although U.S. agriculture continues to make solid inroads in value-added exports, the largest and fastest growing segment of the world food market. The bulk shipments marked the best performance since 1982, near the peak of the early 1980s boom.

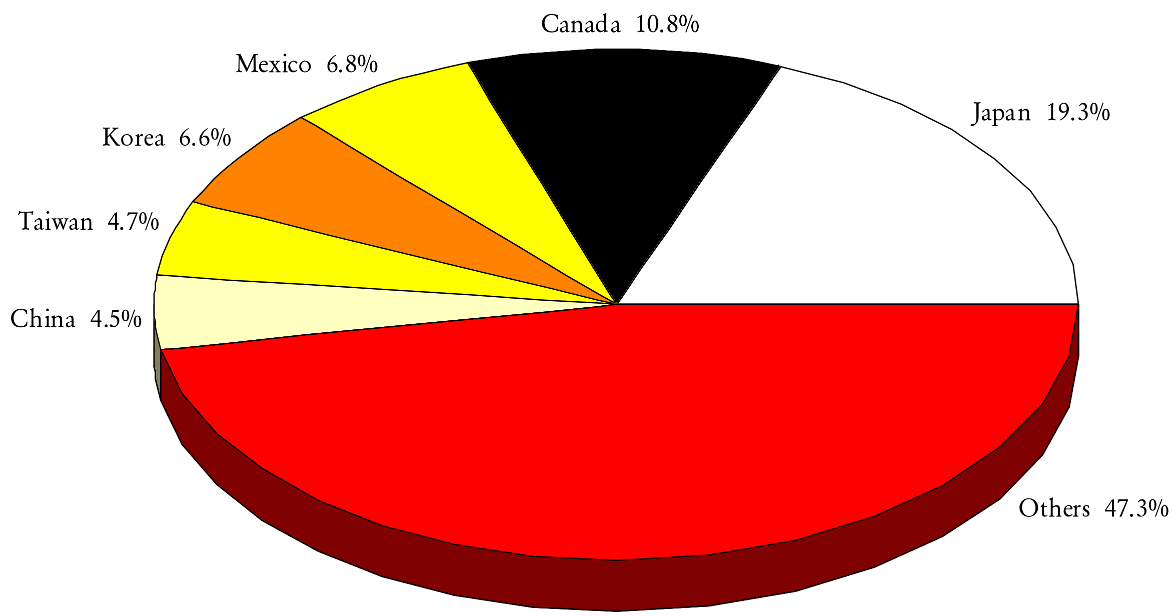
Low world stockpiles of grain and continued growth in world food demand point to considerable potential to expand U.S. exports in the year ahead. World grain markets have become the tightest in the last three decades. Wheat stocks, for instance, are forecast to be about a 60-day supply when the 1995-96 crop year ends (Chart 4). Corn stocks will be down to about a 45-day supply, and soybean stocks will be only a 25-day supply. Taken together, world grain stocks are the lowest since record keeping began in 1960.

Meanwhile, the growth in world demand for food gives no sign of slowing from its recent robust pace. For three straight years, world consumption of wheat and coarse grains has outstripped production, leading to the drawdown of world stockpiles noted above. Rising incomes in countries with modest diets have been the leading factor behind the surge in demand. All across the Pacific Rim, consumers are upgrading their diets as their incomes rise.

No nation typifies this trend more than China. With 1.2 billion consumers, China has long held unfulfilled potential as a market for U.S. agricultural exporters. Now, rapid economic gains in China appear to be unlocking at least some of that enormous potential. U.S. agricultural exports to China have increased eightfold in just the past two years. China is now the sixth most important agricultural trading partner for the United States, up from tenth in 1990 (Chart 5).

Overall, high grain prices and strong demand should provide another banner year for U.S. agricultural exports. Although sales will depend on the size of U.S. crops in 1996, exports are currently estimated to climb 7 percent to a new record high of \$58 billion. With its beef market opening wider, Japan will supply a big boost in 1996 as its imports of U.S. food products rise an expected 8 percent. Exports to Mexico, the second largest single market for U.S. farm products,

Chart 5
1995 U.S. AGRICULTURAL EXPORTS



Total value of exports = $54.1 billion

Source: U.S. Department of Agriculture, Economic Research Service, *Outlook for U.S. Agricultural Exports.*

are expected to be relatively flat in 1996 as the Mexican economy continues to recover from its financial difficulties.

A watershed in agricultural policy

A potentially new direction for U.S. agricultural policy emerged in 1995. A full review of farm policy was scheduled when the year began because the 1990 farm bill was set to expire in 1995. It quickly became clear that the budget would be a driving factor in the policy deliberations. Agricultural spending was often held out by policymakers and the media as an example of programs that contributed to the federal budget deficit. In the end, the budget was a telling consideration in generating support for new approaches to farm legislation. In fact, a "normal" farm bill was never passed by the Congress. Instead, a short list of agricultural policy changes was packaged into the omnibus budget reconciliation bill that was passed by both houses of Congress in November. At the time this article was written, that budget bill had not been signed into law, leaving the future course of agricultural policy uncertain.

Notwithstanding that uncertainty, the "Freedom to Farm" initiative from 1995 appears likely to receive considerable attention. Under this approach, federal programs would no longer restrict what and how much farmers can plant.

Instead, an Agricultural Transition Program would pay farmers fixed payments over the next seven years while giving them much greater flexibility to respond to market forces. The proposed Freedom to Farm legislation has focused almost entirely on commodity program provisions, leaving many policy issues untouched—such as credit, conservation, and research—with a strong likelihood that these issues will be addressed separately in 1996.

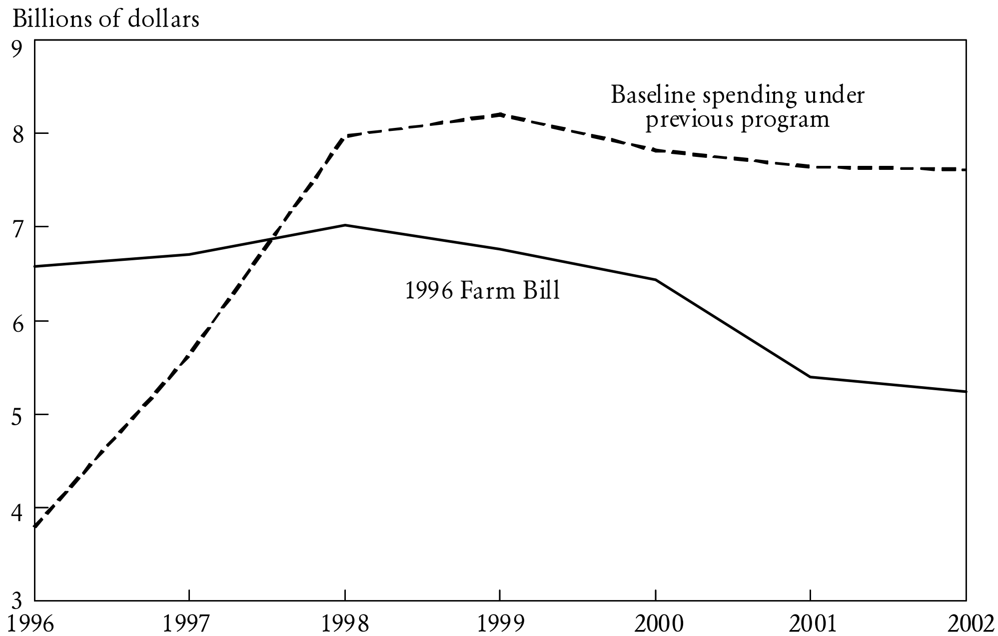
Under the proposed legislation, market transition payments would mark a dramatic change from past farm programs. Traditionally, farmers of the major crops covered by commodity programs have received a payment equal to the difference between market prices and the so-called target price, a level set by Congress, for the output they normally would produce on the acres enrolled in the program. To qualify for these payments, also known as deficiency payments, farmers had to idle a portion of their acres and plant the crop on which their benefit was based. Under the proposed law, farmers would receive a fixed payment in each of the next seven years that will depend neither on market prices nor on the crop produced.

Thus, under the proposed farm legislation farmers would base their planting decisions more on the market and less on government programs. Farmers would also take greater care in managing the risks of farming, knowing that government payments beyond 2002 are highly uncertain. The bill does not specify what farm programs would continue after the transition period is finished, although the downward path in payments would no doubt lead producers to expect a diminished government role in the future. In that regard, it is worth noting that the 1995 farm legislation would repeal the Agricultural Adjustment Act of 1949, the permanent authority that had undergirded U.S. farm programs throughout the postwar period.

A key feature of the proposed legislation is that farm programs would no longer operate like entitlement programs. Under the 1990 farm bill, for instance, parameters like the target price were set in 1990, and annual payments under the five-year law depended on market conditions. Thus, payments ranged from as little as \$6.8 billion in 1995, when commodity prices were high, to as much as \$16.0 billion in 1993, when commodity prices were low. Under the Agricultural Market Transition Program, government farm payments would be capped under a declining schedule from \$5.6 billion in 1996 to \$4.0 billion in 2002. Ironically, federal payments under the market transition program would actually run higher in 1996 and 1997 than would have been the case under the 1990 farm bill (Chart 6). Under the 1990 farm bill, payments would have been small because market prices for crops are expected to remain at high levels. Under the proposed legislation, payments are fixed independently of market prices. From 1998 through 2002, however, the new program is expected to cost less.

Over the next seven years, the proposed program would save a total of \$4.6 billion from spending levels projected if the 1990 farm bill had continued. In addition to eliminating deficiency payments, other savings would come from capping crop loans, reducing funding for export subsidies, and capping the size of the Conservation Reserve Program (CRP)—a program which idles erodible cropland. Although the bill does not reauthorize funding for the CRP, such authority is expected in separate legislation in 1996. The Agricultural Market Transition Program does have one important feature concerning the CRP, however. The law would permit farmers to opt out of the CRP 60 days after providing written notice to the U.S. Department of Agriculture. In addition to the other flexibility provisions in the bill, this would make U.S. production much more responsive to market conditions. With crop prices at high levels as

Chart 6
FARM BILL SPENDING



Source: Congressional Budget Office.

1996 began, a significant amount of CRP land could return to production in 1996.

Taken together, the provisions of the proposed bill would mark a new era in agricultural policy. Federal programs would no longer try to manage the size of U.S. crops or try to stabilize farm income over time. After decades of costly involvement, policymakers increasingly believed that agriculture has largely outgrown the need for government involvement in agricultural markets. Not only has such involvement proven costly to taxpayers, its effectiveness is questioned in an industry that has undergone such dramatic change from the time when the federal programs were first put in place. Recognizing the central role that federal programs had played in agriculture for six decades, however, policymakers may conclude that the payments should be phased out gradually rather than axed overnight.

The new era would mean that farmers will have to prove their mettle in the marketplace. Most producers will welcome that challenge. Agricultural markets are highly developed and provide producers with clear price signals through futures markets. Moreover, many farm producers increasingly tie their business fortunes more directly to the retail food market through the use of production contracts with food processors. Thus, while there could be some pickup in farm exits over the next seven years, a new generation of market-savvy producers appears ready to take full advantage of a farm policy that would encourage quick response to market opportunities.

A banner year for crop producers

Crop producers are poised for an excellent year—perhaps one of the best in memory. Throughout the early part of the year, prices are likely to stay at lofty levels, with the price outlook for the remainder of the year heavily dependent on the size of the 1996 crop. Normal crops would probably lead to lower prices throughout the growing season. Another year of disappointing crops, on the other hand, could push prices to record or near-record levels.

The wheat outlook is strong. World wheat demand is expected to remain robust. U.S. wheat shipments to China, Egypt, and the Philippines have been especially brisk in recent months. Further helping to bolster prospects for U.S. wheat exports is the fact that some competing wheat exporting nations have lower supplies than a year ago. The European Union, for example, has begun restricting wheat exports due to limited supplies. Overall, U.S. wheat exports are expected to edge higher in 1996 from the previous year's already high level.

While export demand will remain strong, domestic wheat use probably will decline due to the high prices. Wheat use in consumer food products should increase modestly, helped by the ongoing trend to consume more cereal grains as part of a healthier diet. But the amount of wheat fed to livestock is expected to tumble a third as livestock growers switch to cheaper grains.

Overall, total demand for wheat—both foreign and domestic—will fall about 3 percent, half the decrease in wheat supplies. As a result, U.S. ending stocks of wheat are forecast to shrink more than a fifth to the lowest level since 1973-74, the year that followed the Soviet wheat deal. The extremely tight stocks will keep prices high. For the 1995-96 marketing year, wheat prices are expected to average $4.25 to $4.45 a bushel, an all-time high.

A tight supply/demand situation is also shaping up for corn in 1996. Concerned by scant world supplies, foreign buyers purchased corn on the world market in the fourth quarter of 1995 at a pace that ran well ahead of the previous year. Demand is especially strong in China, where imports of corn are expected to increase even after a sizable increase in China's area planted to corn. Notwithstanding strong demand abroad, U.S. corn exports are expected to fall 4 percent in the 1995-96 marketing year due to limited availability stemming from the shortfall in the 1995 crop.

Domestic demand for corn will weaken in 1996 as livestock growers cut back in response to high corn prices. Food and industrial use are expected to rise slightly. Feed use, however, is expected to dip 18 percent as livestock producers feed fewer animals and switch cattle to forage instead of grain. The actual drop will depend heavily on how quickly producers decide to liquidate their herds in the wake of recent losses.

Overall, total demand for corn is expected to drop by nearly a billion bushels, mostly as a result of cutbacks in feed use. Even so, demand will still exceed the small 1995 crop, and the corn in U.S. grain bins will shrink to just 617 million bushels, the lowest since 1975. The stocks-to-use ratio will fall to 7.4 percent, the lowest ever. Supplies that tight will keep prices high, and for the 1995-96 marketing year corn prices are expected to average from $2.95 to $3.35 a bushel, the highest since 1983. Stocks were low that year due to an extremely small corn crop brought about by the confluence of two extraordinary factors—a special farm program that restricted plantings (the Payment-In-Kind, or PIK, program) and a severe drought.

The soybean outlook suggests somewhat more ample supplies than for wheat and corn, although strong demand will still lead to fairly tight carryover stocks. Export demand is expected to be brisk, dipping only slightly below last year's near-record level. If dry weather continues to hurt the Brazilian soybean crop, demand for U.S. beans will only increase. Domestic demand will also be quite strong in 1996. High feed grain prices may encourage livestock feeders to use more soybean meal in their feed rations. In addition, soy oil demand is expected to continue growing in the year ahead due to expanding food and industrial uses.

Overall, total demand for soybeans will be about 2.3 billion bushels, only slightly below the previous year. With demand strong and supplies down, soybean inventories are expected to drop by a third in the 1995-96 marketing year to 215 million bushels. Stocks were lower than that in 1993, but compared with expected use inventories will be the smallest since 1972. The tight supplies are expected to push soybean prices to a range of $6.30 to $7.30 a bushel at the farm level in the 1995-96 marketing year, at least a dollar a bushel more than the previous marketing year.

A profit squeeze for livestock producers

Livestock profits will be squeezed in 1996 by high feed costs and meat prices sagging from yet another year of record meat supplies. Meat supplies will be swollen as pork and beef growers liquidate part of their herds in response to a poor profit picture. Continuing recent patterns, poultry producers will probably enjoy the biggest profits, although the profits will be smaller than in the past two years due to high feed costs. If favorable weather leads to normal crops in 1996, however, feed costs could be coming down and livestock profits could be widening as the year progresses.

Beef production will jump nearly 3 percent in 1996 due to a buildup in cattle numbers the past few years and some expected liquidation of cows. Despite two years of big losses, the cattle industry has continued its current production expansion that began in 1993. But that expansion could now be at its peak, and most industry observers expect a sizable liquidation of breeding stock in 1996. While that will temporarily depress prices, it will also set the stage for a return to profitability.

Beef demand should be relatively strong in 1996. Domestic demand will be helped as low slaughter prices put downward pressure on retail beef prices. Export demand will lend further support to cattle prices. Beef exports are expected to expand 15 percent in 1996, continuing the rapid buildup of recent years.

Despite generally strong demand, the sizable increase in beef supplies is expected to hold down cattle prices in 1996. Prices for finished steers in Nebraska are expected to average $65 a hundredweight in 1996, down about $1.25 from 1995. Most feedlot operators will probably earn narrow profits at those prices. Their gain will be the ranchers' loss, however. Prices for feeder steers at Oklahoma City are expected to average just $65 a hundredweight, the lowest price in years.

Pork producers face a difficult year ahead. They are in the midst of a cyclical expansion in pork supplies just as feed prices are hitting high levels. While it is not yet clear if producers will aggressively cut back in response to this outlook, the number of hogs in the pipeline as 1995 ended suggested that pork production will increase 2.7 percent in 1996, reaching a new record high.

Demand will be solid in 1996 but probably not great enough to keep hog prices from slipping. Domestic demand for pork continues to rise as consumers respond favorably to leaner pork products and aggressive marketing. Export demand is expected to be especially strong in 1996, as strong demand in Russia and the Pacific Rim countries leads to record shipments of 900 million pounds. If that forecast holds, pork exports will have increased 80 percent in just two years.

Despite a favorable demand outlook, huge pork supplies appear likely to weigh down pork prices. For the year, hog prices are expected to average $39 a hundredweight, 7 percent below the previous year. Prices may be in the low $40-a-hundredweight range in the first quarter, when pork supplies may be low relative to a year ago. With supplies increasing as the year progresses, however, prices are expected to sag into the high $30s. Prices could come under even more pressure if high feed costs encourage producers to liquidate breeding herds more than anticipated. Most producers will probably break even or endure small losses at these prices.

Poultry producers will also feel the squeeze of high feed prices but are in a better position to hold onto some of their profits due to strong consumer demand for poultry products. After a profitable 1995, poultry production is expected to increase again in 1996. Broiler production is anticipated to rise 6.0 percent in 1996, somewhat faster than in recent years. Turkey production is expected to increase 4.2 percent, suggesting an overall increase in poultry supplies of 5.7 percent. Such an increase would mark yet another record in poultry production.

Even though demand remains strong, poultry prices appear likely to slip due to the bigger supply of poultry and strong competition from low-priced red meats. Domestic demand continues to expand, due mainly to further development of products consumed in restaurants. Export demand will increase to a new record in 1996, but the rate of increase is slowing from the rapid gains of recent years. Overall, broiler prices may average 53 cents a pound, down 3 cents from 1995, while turkey prices may average 63 cents a pound, a 3 cent drop from the year before. Most producers will earn profits at these prices, although profits will be lower due to higher feed costs.

Improved farm finances

The year ahead should bring an improvement in farm finances. With markets strong as the year begins, crop producers will have opportunities to use forward contracts and market their 1996 crops at extremely attractive prices. Dry weather throughout much of the district's winter wheat growing region, however, is tempering optimism among wheat growers. Gains for livestock producers will be measured in 1996, as profits continue to be squeezed by high feed costs. Farm balance sheets will remain generally healthy, shored up by continued moderate gains in farmland values.

Farm income may increase in 1996. Crop producers could have one of their best years in recent memory due to prices that are unusually strong as the year begins. Sales from the nation's crops hit a record $97 billion in 1995, and a new record is likely in 1996. In addition, government payments will be relatively high despite good market conditions. Under the proposed farm legislation, farm payments in 1996 would be fixed at $6.6 billion, with a declining schedule of payments in the years that follow. Income gains will be less for livestock producers as record meat supplies hold down cattle and hog prices. Farm expenses should rise only modestly in 1996, as agriculture benefits from a low rate of price inflation. Overall, net cash income in 1996 could increase as much as $2.5 billion from the year before. Net farm income, which accounts for inventory changes, should increase even more if normal growing conditions permit farmers to refill depleted grain bins.

While income will improve, the farm balance sheet is expected to strengthen only a little. Farmland values are likely to increase only moderately in spite of high grain prices. The phasing down of government support may lead farmers to discount future returns. Farm debt is likely to continue its gradual increase, especially as some livestock producers extend payback schedules. Farm equity may be steady or edge higher in 1996.

Agricultural credit conditions should be generally favorable in 1996. Interest rates for farm loans in the Tenth District states were about 20 basis points higher at the end of the third quarter of 1995 compared with yearend 1994. Nevertheless, the decline in money market rates since then suggests that agricultural rates could decline throughout early 1996 when many farm credit lines will be renewed. Agricultural credit remains widely available, although agricultural banks have their highest loan-deposit ratios in many years. And in the wake of two years of losses for many livestock producers, some loans may undergo a more careful review than in previous years.

SUMMARY

Following two years of weak income, U.S. agriculture appears to be entering a period with better prospects. With world demand growing at a brisk rate and grain stocks at the lowest level in the past four decades, crop prices start 1996 at high levels. Where prices go throughout the rest of the year will depend on the size of the 1996 crop. If production is normal, prices will probably decline somewhat. With another year of small crops, however, grain prices could test all-time record highs. The high grain prices will squeeze profits for livestock producers, although many still expect to leave behind two years of losses in the new year. Overall, farm income may rise modestly in 1996. If the livestock industry can move back toward sustained profits as 1996 wears on, the stage could be set for even better farm profits in 1997.

Farmers will pay especially close attention to the market opportunities in 1996 and beyond as they adjust to declining government support. Long viewed as a leading source of farm income for producers of major crops, commodity programs may be about to end. In their place now may stand a transition program that would provide seven years of fixed, declining payments. The new program would force producers to look carefully to market signals from U.S. and world commodity markets. Fortunately, those signals appear to be pointing up.

ENDNOTES

1 The Tenth Federal Reserve District includes the states of Colorado, Kansas, Nebraska, Oklahoma, Wyoming, western Missouri, and northern New Mexico.

2 Part of the increase in turkey exports was due to a change in the U.S. Department of Agriculture's accounting procedures. Previously, some low-grade turkey parts were included in the "other poultry" category. Beginning with 1995, all turkey parts are now included in the total turkey export number.

REFERENCES

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