U.S. Agriculture on the Mend

By Mark Drabenstott and Alan Barkema

U.S. agriculture staged a strong, broad recovery in 1987. Farm income hit record highs, farmland values bottomed, and the farm financial crisis faded further from memory. After six years of deep recession, the turnaround was welcomed. With many industry observers still focusing on the effects of the recession, the upturn in agriculture came quietly. But the strength of the rebound should not be underrated. For many farms and ranches, 1987 was a banner year.

Just as agriculture's mend in 1987 should not be overlooked, neither should agriculture's longer term problems be dismissed. Although grain surpluses are likely to decline in the year ahead, serious questions remain about the need to take more U.S. farm resources out of production. And even though 1987 saw a rebound in the volume of U.S. farm exports, competitiveness remains a principal concern for the industry as an important new round of General Agreement on Tariffs and Trade (GATT) negotiations begins next year. Finally, world demand for food and coarse grains remains weak—too weak to keep all of U.S. agriculture's substantial infrastructure fully utilized.

Thus, agriculture has found a much brighter plateau as 1988 begins, but longer term the outlook remains clouded by some fundamental supply and demand problems. This article reviews farm developments in 1987 and considers the outlook for 1988 in terms of farm financial conditions, crop and livestock market conditions, and farm exports.

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The year in review

The biggest farm story of 1987 was a dramatic turnaround in the industry's financial condition. As 1987 began, agriculture had endured six years of recession, a time that forced many producers out of business and cut farmland values in many parts of the country by more than half. The recession finally ended in the first half of 1987 as farmland values stabilized and farm income soared on the strength of surging livestock earnings. Farm lenders also began reporting fewer problem farm loans, after staggering losses for the past few years.

Farm financial conditions

Farm income set new records in 1987 due to continued large federal payments, reduced farm expenses, and a rebounding livestock industry. Net farm income hit a record $45.0 billion, up from a revised $37.5 billion in 1986 (Chart 1). Net cash income—gross cash receipts for the sector less gross cash expenses—surged to a record $57.0 billion, up from $52.0 billion in 1986. Government payments, though slightly less than the year before, boosted farm incomes by $23.1 billion. Farmers continued to slash expenses by cutting back on purchases and reducing debt. The principal market factor in the resurgent farm income was large livestock profits. Livestock growers, especially of beef and pork, had their best year in the past ten.

Record farm incomes were shared generally across agriculture. Excellent crops in many parts of the Midwest combined with farm programs to boost incomes. The western Corn Belt and Great Plains states were major beneficiaries of the strong livestock profits. Rebounding exports of cotton and rice lifted farm earnings in the South.

Farmland values bottomed across most parts of the nation in the first half of 1987. At the end of 1986, farmland values in the seven states of the Tenth Federal Reserve District had fallen 55 percent from the market high in 1981 (Chart 2). Values were essentially unchanged in the first quarter but staged a modest rally of 1.2 percent in the second quarter and another 1.2 percent in the third. Changes in land values in neighboring Federal Reserve districts bracketed the changes in Tenth District land values. Land values in the Corn Belt states of the Seventh Federal Reserve District rose slightly more than Tenth District values while values in the Eleventh Federal Reserve District, composed largely of the state of Texas, fell slightly. On balance, land values appear to be stabilizing at a level supported by the cash generated by the land.

Agricultural lenders generally shared in the improvement in farm finances. Evidence mounted in 1987 that problem loans for commercial farm lenders were trending downward. For example, nonperforming loans at the nation's agricultural banks were less at the end of the first half of the year than in either of the previous two years. Agricultural banks, therefore, appear to be moving toward the bottom of their problem loan lists. Though some losses remain to be recognized, the size of those losses will continue to moderate. As much as 80 percent of potential farm loan losses may now have been realized. In short, the farm financial crisis is largely past as problem loans continue to mend.

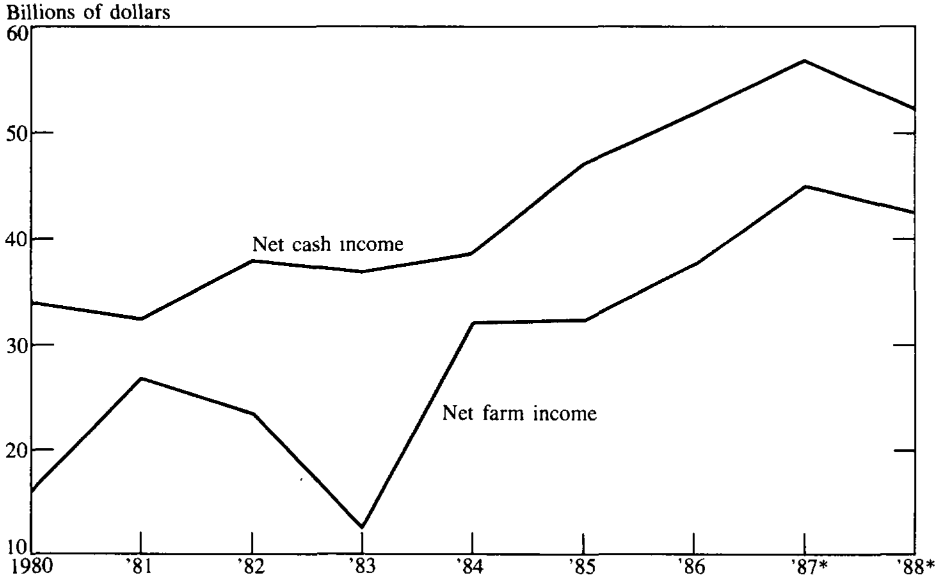
The farm sector balance sheet corroborates the conclusion that agriculture is on the mend. The sector balance sheet for December 31, 1987 is expected to show that after five years of steady erosion, farm assets stabilized in 1987 (Table 1). Farm debt is expected to decline further as farmers continue trimming debt to more manageable levels. By the end of the year, farmers may have lopped off more than $50 billion in debt, or over a fourth of the peak debt they were carrying in 1983. Together, the movements in assets and debt mean the sector's debt-asset ratio will fall to 19.8 percent, the lowest in five years.

Crops

U.S. farmers harvested large crops again in 1987. And while exports began to turn around, surplus remained the principal problem. The size of major crops was held below 1986 levels by government programs that idled more than a fifth of the nation's crop land. The lower production allowed carryover stocks for some major crops to decline, but stocks were so big as 1987 began that overall improvement was slow. Meanwhile, crop prices edged up some from the extremely low levels in 1986 but remained low compared with historical levels.

CHART 1

Farm income



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Source: U.S. Department of Agriculture

CHART 2

Tenth District nonirrigated cropland values

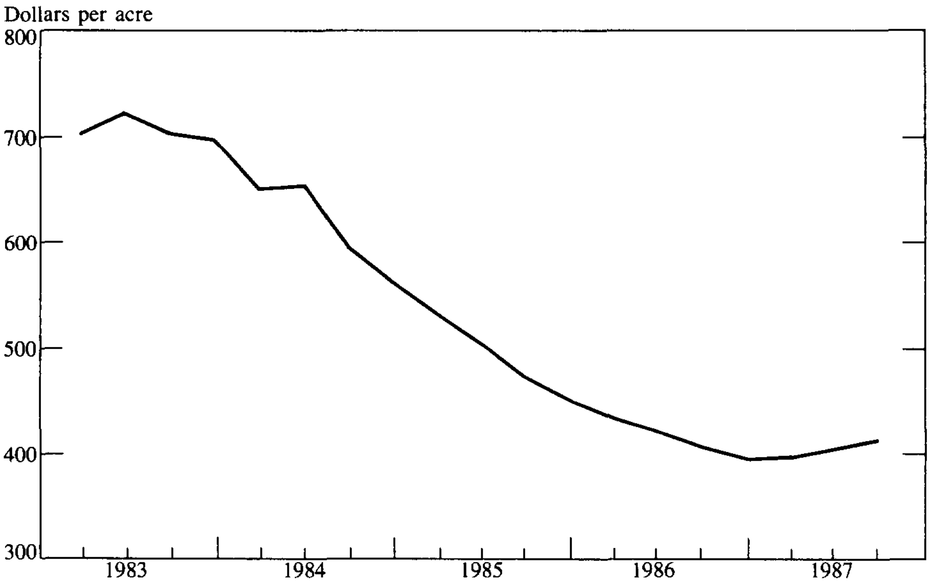


TABLE 1
Farm balance sheet excluding operator households and CCC loans on December 31
(billions of dollars)

	1983	1984	1985	1986	1987f	1988f
Assets						
Real estate	739.6	639.6	558.9	510.1	530.5	538
Nonreal estate	205.4	208.9	191.2	181.5	180.0	177
Total assets	945.0	848.5	750.1	691.6	710.5	715
Liabilities						
Real estate	104.8	103.7	97.7	88.1	82.5	77
Nonreal estate	87.9	87.1	77.5	66.8	58.0	53
Total liabilities	192.7	190.8	175.2	154.9	140.5	130
Proprietors equity	752.3	657.7	574.9	536.7	570.0	585
Debt-asset ratio	20.4	22.5	23.4	22.4	19.8	18.2

f = forecast

Source: U.S. Department of Agriculture

Wheat production was little changed in 1987. Yields were up markedly from the year before, but acreage fell as more farmers participated in the set-aside program. Exports improved, due mainly to the export enhancement program. Wheat is one of the commodities that benefits most from export subsidies. Still, stocks remained large most of the year. Wheat prices averaged $2.42 a bushel in the 1986-87 marketing year, off sharply from $3.08 the previous year (Table 2).

Feedgrain production fell as producers idled more acreage. Yields were once again high, but farmers placed nearly 10 million more corn and sorghum base acres in government programs than the year before. Growing conditions were excellent in 1987. Corn production was 7.2 billion bushels, the smallest corn crop since the PIK-shortened crop of 1983. Corn exports improved in volume, but remained low in value. Corn prices averaged $1.50 a bushel in the 1986-87 marketing year, significantly less than the $2.23 a year before. The enormous corn stocks carried into 1987 depressed prices most of the year.

Soybean production also was nearly unchanged in 1987. Planted acreage dipped slightly, but yields were excellent. Output totaled 1.96 billion bushels, up fractionally from 1986. Demand remained about the same as the year before, and stocks were little changed. Soybean prices averaged $4.80 a bushel in the 1986-87 marketing year, down 25 cents from the previous year.

Cotton production rebounded from the drought-reduced supplies of 1986. Planted acreage was little changed from 1986, while yields were the

TABLE 2
U.S. farm product price projections

Crops	Marketing Years 1986-87	1987-88	Percent Change
Wheat	$2.42/bu	$2.45-2.65/bu	+5
Corn	$1.50/bu	$1.60-1.90/bu	+17
Soybeans	$4.80/bu	$5.10-5.70/bu	+13
Cotton	$.522/lb	N/A	N/A
Livestock	**Calendar Years 1987**	**1988**	**Percent Change**
Choice Steers	$64-65/cwt	$62-68/cwt	+1
Barrows & Gilts	$51-52/cwt	$37-43/cwt	−22
Broilers	$.47-.48/lb	$.40-.46/lb	−9
Turkeys	$.57-.58/lb	$.51-.57/lb	−6
Lamb	$78-79/cwt	$70-76/cwt	−7
Milk	$12.50-12.65/cwt	$11.70-12.50/cwt	−4

Source: U.S. Department of Agriculture

best in years. Cotton output was 14.3 million bales, up sharply from 1986. Domestic and export demand remained relatively strong in 1987. Cotton prices averaged 52.2 cents a pound in the 1986-87 marketing year. Prices were reduced some by the marketing loan used in 1987.

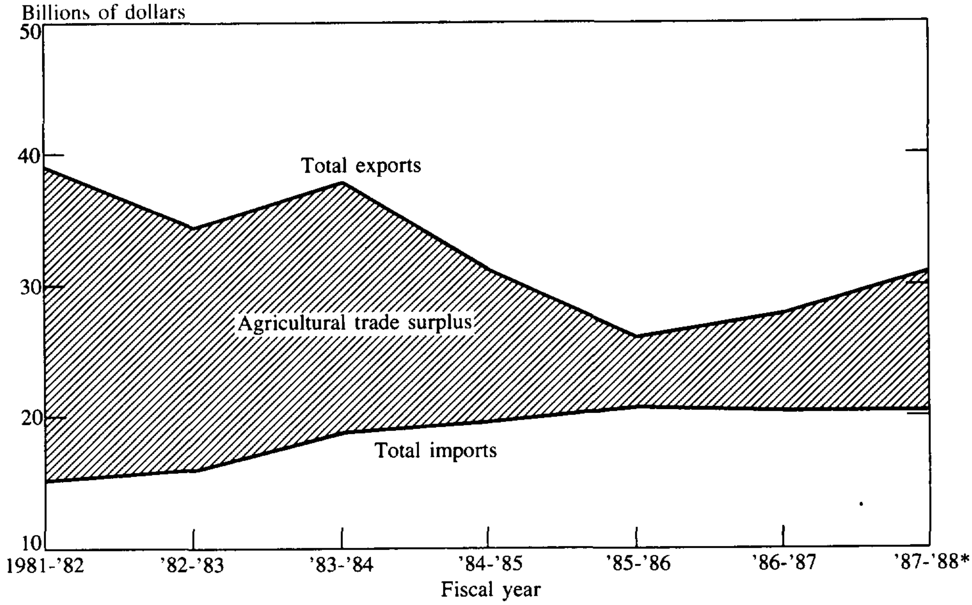
On balance, U.S. agriculture began to turn its surplus problem around in 1987, but only slowly. Government programs idled even more acres, and exports began to recover. Still, the industry remains a long way from having solved its surplus problem, and crop producers remain heavily dependent on government programs for a substantial part of their earnings.

U.S. farm exports

U.S. agriculture's declining fortunes on world markets finally began to recover in 1987 with rising export volumes and nearly stable imports. The volume of U.S. agricultural exports increased to 129 million metric tons in fiscal 1987, nearly 18 percent greater than the dismal performance of 1986. In value terms, however, agricultural exports were $28 billion in fiscal 1987, only modestly greater than in fiscal 1986 (Chart 3). Grains accounted for almost all the increase in export tonnage, but sharply lower prices left the value of grain exports unchanged from fiscal 1986. Most of the increase in export value came from greater livestock, cotton, and horticultural exports.

Agricultural imports, after four years of slow but steady growth, fell slightly to $20.5 billion. With slightly smaller import value and sharply higher export value, U.S. agriculture's net trade surplus in fiscal 1987 rose to $7.3 billion, compared with $5.4 billion in fiscal 1986. Despite

CHART 3
U.S. agricultural trade



*forecast
Source: U.S. Department of Agriculture

this modest improvement, agriculture's fiscal 1987 trade surplus is only a quarter of the industry's trade surplus just six years ago.

Livestock

Livestock was a bright feature of agriculture's turnaround in 1987. Declining red meat supplies combined with a continued increase in consumer demand to strengthen hog and cattle prices. And profits were further bolstered by low feed costs. In total, livestock growers had their best year in a decade. Consumer demand for meat remained buoyant, as per capita consumption of poultry and red meat hit a new record of 216 pounds in 1987. Poultry continued to command a larger share of total meat demand. Of all meat consumed, 36 percent was chicken or turkey, an all-time high.

Beef production fell 4 percent in 1987 due mainly to a sharp fall in nonfed slaughter. The Dairy Termination Program had boosted cow slaughter in 1986, and such slaughter fell back to more normal levels in 1987. Production of fed beef rose as growers responded to favorable profit levels. Inexpensive feed encouraged feeding to heavy weights, and as a result, slaughter weights were record large.

Cattle prices were strong through most of the year. Prices for choice steers at Omaha averaged $64.50 a hundredweight, up about $7 from 1986. Due to cheap feedstuffs, fed cattle margins were the largest in years. The wide profits for feed lot operators resulted in high bid prices for feeder cattle. Kansas City prices for feeder steers averaged $74.50 a hundredweight, the highest in nearly a decade.

Pork production increased less than 2 percent in 1987, a much smaller expansion than expected.

Record large profit margins in late 1986 had been expected to encourage a sharp increase in hog production, but the expansion did not materialize until late in 1987. The lingering effects of farm financial stress appear to have discouraged capital expansion by hog growers. The new tax law also may have limited expansion. Prices for barrows and gilts at the seven markets averaged $51.50 a hundredweight, up $.30 from 1986. As in 1986, hog profit margins were wide for most of the year.

Poultry output continued to expand aggressively in 1987. Growers responded to the increasing consumer preference for poultry products by expanding broiler production 8 percent and turkey production 13 percent. Per capita consumption of chicken and turkey was 78 pounds in 1987, greater than beef (76 pounds) or pork (59 pounds). Broiler prices averaged 47.5 cents a pound at the 12 city markets in 1987, down 9 cents from the year before. Still, producers maintained solid profit margins. Turkey prices averaged 57.5 cents a pound, down sharply from 72 cents in 1986. Turkey producers lost money during much of 1987 because of the lower prices.

The year ahead

The recovery that U.S. agriculture began in 1987 is likely to continue in 1988, though some significant risks remain. Farm incomes, supported by government payments, will be solid in 1988 but may not be as strong as in 1987. The drawdown in agriculture's huge inventories that began last year will gain further momentum in 1988, from a modest increase in exports and from government programs that likely will hold production of most major crops below usage levels. With a significant portion of crop inventories isolated from the market in government warehouses, crop prices are likely to rise to loan levels or slightly higher. Livestock returns will narrow sharply under the pressure of record large red meat and poultry supplies. The industry's continued reliance on government support is of increasing concern. Clearly, government programs will remain critically important to agriculture's outlook. But agriculture's subsidies can grow only more conspicuous with renewed efforts to cut the federal deficit in response to recent turmoil in financial markets.

Farm income and financial conditions

Farm income probably will not be as strong in 1988 as in 1987. The two strongest sources of farm income in 1987—government payments and livestock returns—are both expected to moderate in 1988. Deficiency payments on crop production will shrink as target prices decline marginally and market prices rise to loan levels or slightly higher. The first reduction in target prices for wheat and feedgrains under the 1985 farm bill—a cut of about 2 percent—comes with the 1988 crops, and phased reductions in rice and cotton target prices also continue. Production expenses are expected to increase slightly after declining steadily for the past three years. Livestock margins will narrow, especially in the second half of the year, as hog and poultry prices sink beneath the weight of record large supplies of red meat and poultry. Together, these factors suggest that net cash income in 1988 could slip as much as 10 percent below the record level of 1987. Higher crop inventory value from higher crop prices probably will maintain net farm income at a level only slightly below last year's record.

Farmland values could increase somewhat in 1988. Current farmland values are consistent with crop returns, when large government payments are factored in. Cash flow from profitable livestock enterprises also has contributed to recent strength in the farmland market. But slipping livestock returns in 1988 could limit the cash flow that would otherwise provide additional buoyancy to farmland values. Nevertheless, farmland values are not likely to decline in 1988 and could rise somewhat—unless investors perceive that government payments will be reduced before markets can support crop returns at current levels.

The strong positive trends in farm financial conditions that emerged in 1987 will likely continue in 1988. The pace of improvement achieved in 1987, however, will probably slow as farm earnings moderate. Total farm equity will increase modestly for the second consecutive year as asset values remain stable or strengthen slightly and the reduction in farm debt continues (Table 1). Declining farm debt means continued slack loan demand for the ample supplies of loanable funds at most agricultural banks. Loan-deposit ratios at country banks will remain low. The pile of problem farm loans still to be worked out by commercial farm lenders will continue to shrink. Though firming land values and regulatory accounting measures have improved the apparent financial condition of the Farm Credit System (FCS), the system continues to suffer operating losses and remains severely strained. Disparities in the financial condition of individual units of the FCS are likely to widen further as the system awaits an infusion of government funds.

Food prices outlook

Food price increases will remain moderate in 1988. Retail food prices increased about 4.1 percent in 1987, more than the average increase of the previous five years. Higher fresh fruit and vegetable prices and rising red meat prices drove average food prices sharply higher in 1987, especially in the first half of the year. But expanding supplies of pork and poultry slowed the rate of price increase in the second half. The ongoing expansion in pork and poultry supplies will continue to limit advances in food prices to moderate levels in the year ahead. Overall, consumer food prices are expected to increase 2 to 4 percent in 1988.

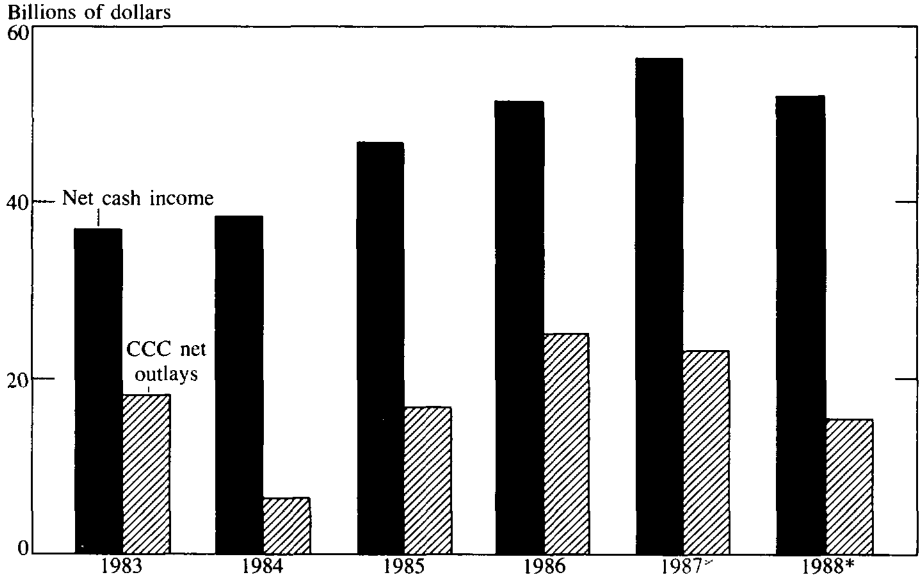
Farm policy outlook

As 1987 draws to a close, three major issues loom on the farm policy agenda. First, efforts to quiet roiling financial markets by reducing the federal budget deficit are likely to reduce domestic farm program spending. Second, the current round of GATT negotiations will focus sharply on agricultural policy and trade issues. And third, Congress will soon complete legislation providing federal assistance to the Farm Credit System.

The high cost of current farm programs is of growing concern in light of renewed efforts to reduce federal spending. Farm program costs have never been higher than under the first two years of the current five-year farm program enacted in December 1985. Net outlays by the Commodity Credit Corporation (CCC) hit a record $25.8 billion in fiscal 1986 and slipped only slightly to $23.1 billion in 1987, nearly twice the annual average in the early 1980s (Chart 4). These huge expenditures have bought a modest recovery in agricultural exports and an apparent turnaround in agricultural financial conditions. Nevertheless, as the administration and Congress focus on excessive federal spending, farm program expenditures undoubtedly will be affected by renewed efforts to reduce the federal budget deficit.

Where and how much farm program spending will be cut are open questions. Under recently revised deficit reduction legislation—the new Gramm-Rudman-Hollings (GRH) bill—the projected 1988 federal budget deficit must be cut $23 billion. Under the provisions of the pending budget agreement designed to satisfy the GRH requirements, farm program spending would be cut $900 million in fiscal 1988 and $1.6 billion in fiscal 1989. Farm spending cuts would fall in three areas. First, target prices could be lowered even more than currently scheduled, probably an additional 2 percent. Second, a "0-92" option allowing producers to receive 92 percent of defi-

CHART 4
Farm program costs and income



*forecast
Source: U.S. Department of Agriculture

ciency payments even though no crop was grown could be implemented. And third, paid land diversions could be reduced. Alternatively, if the budget agreement were not passed into law, farm program spending would be cut 8.5 percent across the board in the "sequestration" process specified in the GRH legislation.

In the longer run, farm policy changes in the United States and other countries could result from the round of GATT negotiations scheduled to begin in earnest next year. The current round of multilateral trade negotiations is the eighth since the GATT was signed in 1947. The U.S. bargaining position in this round of GATT negotiations is simple. First, all participants would agree to phase out, over a ten-year period, all agricultural import restrictions, and all subsidies that directly or indirectly affect trade. Only bona fide food aid and farm income subsidies that are not linked to the amount of production would be allowed. Second, all participants would agree to harmonize health and sanitary regulations. Together, the two provisions would aim to reduce unfair competition while increasing access to markets that are now severely restricted. Adoption of the U.S. proposals would lead eventually to reduced farm program spending and smaller excess stocks of commodities bearing down on world market prices. But trade liberalization could have mixed results for U.S. agriculture as more competitive sectors of the industry would fare better than less competitive sectors.

The long legislative process dealing with the plight of the Farm Credit System ground toward a conclusion in the final months of 1987. The House of Representatives passed the Agricultural Credit Act of 1987 (H.R. 3030) on October 6 by the substantial margin of 365 to 49. The Senate's version (S. 1665) was passed by a vote of 87 to 6 on December 4. The exact form of the final legislation will be determined in conference committee, where differences in the two versions will be ironed out.

Similarities in the two versions of the FCS assistance package provide an early indication of the final legislation's likely form. Four of the provisions most likely to be included in the legislation when it is eventually passed into law will have the greatest effect on the system's future. First, the FCS would receive direct financial aid that would effectively guarantee the value of borrower stock. Second, a restructuring of the system into fewer units would occur. Third, a number of borrower rights would be specified. And fourth, a secondary market for farm real estate loans would be developed.

Though the provision of federal assistance for the FCS guarantees its future existence, the longer run effect of these provisions on the system's place in the agricultural lending community is less clear. On one hand, combining FCS lending institutions into fewer units within districts or allowing districts to merge could save overhead costs and improve efficiency. By passing these savings along to borrowers, the system would become more competitive in the agricultural lending market. On the other hand, borrower rights provisions that would limit the system's flexibility in handling problem and high-risk loans could increase system costs. The system's competitiveness would be reduced, and the most creditworthy borrowers would seek credit elsewhere. Furthermore, the development of a secondary market for farm real estate loans could drastically alter the farm lending landscape. The secondary market would encourage the entry of several new players into the agricultural lending market, especially if the secondary market were broadened to include farm loans of all maturities. In summary, pending FCS assistance legislation will likely ensure the existence of a somewhat weaker FCS while potentially changing the agricultural lending environment significantly.

Export outlook

Further recovery in U.S. farm exports rests primarily on more competitive pricing, the value of the dollar, and subsidized sales of U.S. commodities under the 1985 farm bill. Cuts of 25 to 30 percent in grain loan rates, a payment-in-kind certificate program that pushes market prices even lower than reduced loan rates, and marketing loan programs for rice and cotton have made U.S. agricultural exports more price-competitive on world markets. Further declines in the exchange value of the dollar also are beginning to boost sales in some markets. Subsidies under the Export Enhancement Program have stimulated wheat and wheat product exports while the Targeted Export Assistance Program has encouraged exports of high-value horticultural products. Demand for U.S. coarse grain exports was boosted by production problems overseas that reduced exportable supplies in several important competitor countries, especially Argentina, Australia, and Thailand.

U.S. agricultural exports probably will continue a trend toward greater export volume and value in 1988. Export volume will rise as world trade increases and the United States retains a larger share of world grain markets. Unlike 1987, improvement in export value is likely to keep pace with gains in export tonnage as prices of high-volume exports remain stable or rise modestly and exports of high-value products increase. Still, a quick recovery to the high export levels of the early 1980s is not likely. U.S. agriculture is most competitive in world markets at high levels of production and export, because of its huge resource base and efficient transportation infrastructure. These competitive advantages will not come into play until the world economy is stronger and more rapid growth in world food trade resumes. Mean-time, U.S. agriculture may be resigned to "purchasing" a significant portion of its export growth with expensive government policies.

Crop outlook

The crop outlook has improved significantly for 1988. The brighter outlook hinges mostly on government programs and reduced stocks of major crops. As the new marketing year begins, grain and soybean stocks are large but smaller than a year ago. Stocks are likely to edge lower again in the year ahead as government acreage-reduction programs hold production below usage levels. Exports, encouraged by low prices, a weaker dollar, and some subsidies, will expand again in 1988. A larger percentage of slightly smaller inventories will be isolated in government warehouses, allowing average market prices to recover to loan levels or higher.

Total wheat supplies going into the 1987-88 marketing year, at 3.9 billion bushels, are smaller than a year ago (Table 3). Domestic demand will probably expand slightly this year, but wheat exports are expected to swell by nearly a half. The sharp expansion in exports is expected from continued strong world wheat consumption, tighter exportable supplies abroad, and more important, aggressive U.S. marketing initiatives, including export subsidies.

Significantly higher total demand, well in excess of nearly constant production, is expected to pull down ending stocks 29 percent to about 1.3 billion bushels, the lowest carryover in six years. Free stocks—that portion of the inventory not isolated from the market in the Farmer-Owned Reserve or CCC inventories—are expected to tighten to only a fourth of the inventory during the year. With tighter free stocks, cash wheat prices are likely to be somewhat stronger than a year earlier. Farm-level prices may average \$2.45 to \$2.65 a bushel, a range exceeding the national loan level of \$2.28 a bushel for the 1987-88 crop (Table 2).

Feedgrain supplies will remain large in the 1987-88 marketing year. Supplies of all feedgrains will fall only marginally from last year's record 380 million metric tons. Supplies of corn, the principal feedgrain, are expected to decline slightly to about 12 billion bushels as a sharp fall in production is nearly offset by larger beginning stocks. Increased feed use from expanding livestock production will likely account for three-fourths of a projected 117 million bushel increase in domestic demand. Corn exports are expected to jump an additional 10 to 15 percent after last year's 21 percent gain due to larger world demand and smaller world production.

With feedgrain production expected to fall short of higher domestic and foreign demand, corn carryover stocks will be drawn down about 11 percent. Free stocks of corn are expected to decline fully 40 percent. As a result of tightening free stocks, farm-level prices may rise above the loan rate. The national average corn price will likely fall between \$1.60 and \$1.90 a bushel, a range bracketing the national loan level of \$1.82. Similarly, the national loan rate for grain sorghum, \$1.73 a bushel, falls within the range for the likely average sorghum price, \$1.50 to \$1.75 a bushel, up from \$1.37 in 1986-87.

Soybean stocks also will be drawn down during the 1987-88 marketing year. Soybean supplies will fall 3 percent to 2.4 billion bushels as slightly higher production fails to offset a sharp decrease in beginning stocks. Total soybean demand is expected to increase slightly. Domestic demand will remain strong, due mainly to increased feeding of soybean meal as meat production continues to expand. Export demand likely will be stable as Argentina and Brazil continue to expand soybean acreage and world oilseed production rises to a new record.

The outlook for soybean and soybean product prices is mixed. As a result of strong domestic demand for soybean meal, domestic soybean meal

TABLE 3

U.S. agricultural supply and demand estimates on December 10, 1987

(millions of bushels, bales, or metric tons)

	Corn (bu) Sept. 1-Aug. 31		Feedgrains (mt) June 1-May 31		Soybeans (bu) Sept. 1-Aug. 31		Wheat (bu) June 1-May 31		Cotton (bales) Aug. 1-July 31	
	1986-87	1987-88	1986-87	1987-88	1986-87	1987-88	1986-87	1987-88	1986-87	1987-88
Supply										
Beginning stocks	4,040	4,882	126.3	152.3	536	436	1,905	1,821	9.35	5.03
Production & imports	8,255	7,168	253.1	218.2	1,940	1,960	2,092	2,105	9.73	14.28
Total	12,294	12,050	379.5	370.4	2,476	2,396	4,018	3,941	19.08	19.32
Demand										
Domestic	5,908	6,025	181.0	183.4	1,283	1,301	1,193	1,205	7.45	7.80
Export	1,504	1,700	46.3	51.6	757	760	1,004	1,450	6.68	7.20
Total	7,412	7,725	227.2	235.0	2,040	2,061	2,197	2,655	14.14	15.00
Ending Stocks	4,882	4,325	152.3	135.4	436	335	1,821	1,286	5.03	4.40

Source: U.S. Department of Agriculture

prices are likely to strengthen. Prospects for soybean oil are bleak, however. The largest domestic supplies of soybean oil on record and large global supplies of competing oils will allow only modest recovery in soybean oil prices. Strong demand for meal will drive ending soybean stocks down to 335 million bushels—the lowest in three years—continuing a positive trend toward smaller soybean stocks. Significant gains in soybean prices are likely as CCC stocks dwindle. Farm-level soybean prices are likely to average $5.10 to $5.70 a bushel for the year, compared with a $4.80 average last year.

Cotton supplies entering the 1987-88 marketing year are large owing to sharply higher cotton production that nearly offset a major reduction in cotton inventories. Demand for U.S. cotton will remain strong, however, for the second consecutive year. Projected domestic mill use is the largest since 1973-74. Cotton exports will increase to 7 million bales, a volume three and a half times the depressed cotton exports of just two years ago. With total use exceeding production in the 1987-88 marketing year, ending cotton stocks will fall to 4.4 million bales. Narrowing stocks will likely support the average cotton price during the 1987-88 marketing year at the 52.25 cent a pound loan rate, or slightly higher.

On balance, the crop outlook is expected to improve further in 1988. Grain and soybean stocks remain burdensome. But these huge inventories are being worked off as government programs restrict production while lower loan support levels encourage domestic and foreign usage. Tightening free stocks should allow crop prices to recover to loan levels and higher. Still, producers will rely on government payments to fill the wide gap between target and loan rates for a significant portion of their crop income in the year ahead. Thus, the industry is moving toward better balance between supply and demand, but it still has some distance to go.

Livestock outlook

The exceptionally wide profit margins that beef, pork, and broiler producers had in 1987 are destined to narrow in 1988 as supplies of red meat and poultry rise to another new high. Meat supplies are expected to rise about 2 percent above 1987's record output. The expansion will push pork and poultry prices lower, but beef prices may be less affected as a modest rebuilding of the beef herd reduces current beef output. Per capita consumption of red meat and poultry may increase to a record 222 pounds as increased pork and poultry consumption more than offsets reduced beef consumption. Recent concerns over the performance of the general economy do add a measure of uncertainty to the livestock outlook. A sharp slowing in economic activity would be reflected in further reductions in livestock returns as budget-conscious consumers economized on meat purchases.

The beef industry is nearing a point of more stable production as a long period of liquidation of the nation's cattle herd draws to a close. Although total commercial beef production is likely to decline about 4 percent in 1988, the percentage decline will be much greater in nonfed beef than in fed beef. Nonfed production could drop nearly a third as otherwise nonfed steers and heifers are bid into feedlots and cow-calf ranchers stop liquidating herds in response to recently strong profit margins. Forage supplies should remain abundant since farm programs allow grazing on idled land in all but the five principal growing months and hay harvesting in emergencies. Demand for lighter weight feeder cattle to consume otherwise underutilized forages will remain strong.

The major unknown facing the beef industry in 1988 is how much beef prices will be affected by continuing expansion in competing supplies of pork and poultry. The modest decline in beef production in 1988 will probably not be enough to drive beef prices significantly higher due to large supplies of competing meats. Choice steers at Omaha could average \$62 to \$68 per hundredweight, little changed from 1987. Cheap grain in feedlots and abundant, low-cost grass available for grazing will lead to continued strong demand and prices for tight supplies of feeder-stocker cattle. Kansas City feeder steer (600 to 700 pound) prices could average in the low to mid-\$70s per hundredweight.

The long-awaited expansion in pork production has finally come on stream and will continue in earnest in 1988. The breeding herd in the last half of 1987 was 9 percent larger than a year earlier, and producers indicated intentions of increasing farrowings 7 to 8 percent in late 1987 and early 1988. These developments suggest that pork production in 1988 could be 10 percent higher than in 1987.

Even though consumers have demonstrated relatively strong demand for pork, the significant boost in supplies will depress prices. Barrow and gilt prices at the seven regional markets may average \$37 to \$43 per hundredweight, a fourth lower than 1987 prices. Hog slaughter is likely to be greater in the second half of the year than in the first. As hog slaughter rises, market hog prices could sink to the upper-\$30 per hundredweight range, reducing farrow-to-finish profit margins to near breakeven levels.

The expansion in broiler production, fueled by four consecutive years of solid profits, will continue in 1988, but at a less furious pace. Broiler production is expected to increase 5 percent in 1988, after an expansion of more than 8 percent in 1987. Per capita broiler consumption may rise to more than 63 pounds, roughly equal to per capita pork consumption. Nevertheless, broiler prices are likely to slip to 40 to 46 cents a pound as competing supplies of both poultry and pork swell. Producer profits are likely to decline to breakeven levels in whole-bird markets, where price declines may be greatest. Returns for highly processed products, which have achieved excellent consumer acceptance, will likely remain strong.

Following an increase of nearly 13 percent in 1987, the expansion in turkey production is expected to continue at a double-digit rate in the first half of 1988. Profit margins fell negative in the last half of 1987, however, and as losses accumulate through the first half of 1988, the expansion will probably slow sharply. Overall, turkey production in 1988 may be 6 percent larger than in 1987. Sufficient production moderation in the second half of 1988 could swing profits into the black again late in the year. Turkey prices may average 51 to 57 cents a pound in 1988, slightly below the 1987 average.

The outlook for the dairy sector is clouded by rebounding milk production following the herd liquidation phase of the Dairy Termination Program (DTP) and uncertainty over the milk price-support level in 1988. The DTP has reduced excess milk production capacity, and CCC purchases to support milk prices have fallen sharply. More recently, however, favorable milk-feed price ratios have led to increasing cow numbers among non-DTP participants and to higher production per cow. Milk production in 1987 is expected to be only 1.4 percent less than the record high of 1986, and projected 1988 production of 144 billion pounds will nearly equal the 1986 record.

A cut in the price-support level is mandatory if rising production pushes projected 1988 CCC price-support purchases above 5 billion pounds—a likely development. The price-support cut required to reduce projected CCC purchases below 5 billion pounds may be accomplished as a direct 50 cent per hundredweight cut on January 1 or as a combination of a January 1 price cut and a Gramm-Rudman spending reduction. These developments suggest that market milk prices in 1988 will likely fall below the $11.10 per hundredweight support level for manufacturing grade milk that took effect on October 1, 1987.

Conclusions

U.S. agriculture is on the mend. The industry began a broad, solid recovery in 1987. The recovery was evident in record farm earnings—shared across crop and livestock farms—and a stabilizing farmland market. Together, these factors underwrote the biggest farm story of the year—a fading of the farm financial crisis and the birth of agriculture's long-awaited recovery.

Agriculture looks forward to another solid year in 1988. Farm income may decline some but still remain relatively high. Crop prices should trend upward through 1988 as supplies tighten further. Farm exports will continue to recover in 1988 and more of the improvement will be measured in value terms, although export subsidies are "purchasing" some of the recovery. Livestock profits likely will moderate in 1988 as poultry and pork producers expand in response to 1987's wide profit margins. Farm loan problems will dwindle still further for agricultural lenders, although lender earnings may recover only slowly because of weak loan demand in rural areas.

The outlook for agriculture for 1988 is sound, but uncertainty surrounds the longer term outlook. The United States is entering an important round of GATT negotiations with agriculture at the center of the table. Preparations for the next farm bill will also begin in 1988. The long-run ability of the United States to compete will be affected by the direction of trade, farm, and macroeconomic policies. To find long-run prosperity, U.S. agriculture must rely on these policies to revive world food trade. Without such a revival, agriculture's recovery could erode as Washington phases down its currently expensive support.