The Long Road Back for U.S. Agriculture

By Mark Drabenstott

Agriculture had another painful year in 1986. The industry entered the year at perhaps the darkest moment of its deep recession. Farmland values were still falling rapidly in many parts of the country and farm liquidations were the highest in recent memory. But as the year unfolded, a few more signs emerged that maybe the worst news was past. Farmland value declines started to slow, liquidations began to level out, and record high farm program payments added ballast to farm cash flows. In short, the debt problems that plagued farmers and their lenders for nearly five years began to stabilize. That stability was welcomed, but it came even as agriculture's other main problem—chronic surplus—continued to worsen significantly.

Has agriculture fully bottomed? A simple question, but the answer is more complex. Agriculture appears to be embarking on a long road back to recovery. Debt problems remain to be worked through, but the problems are better defined now. With firming land values, lenders and borrowers can arrange workouts with a clearer understanding of the size of the problem. As time goes on, the debt problems should continue to diminish, slowly and steadily. But the road to a smaller grain surplus may be much longer. The world is awash in grain, and even though the United States will undertake more aggressive programs to trim supplies in 1987, the U.S. and global surpluses appear likely to persist for the foreseeable future. Not only will the road be long, it will also be expensive. Farm program payouts reached record levels in 1986, and budget exposure promises to stay large along with the surpluses.

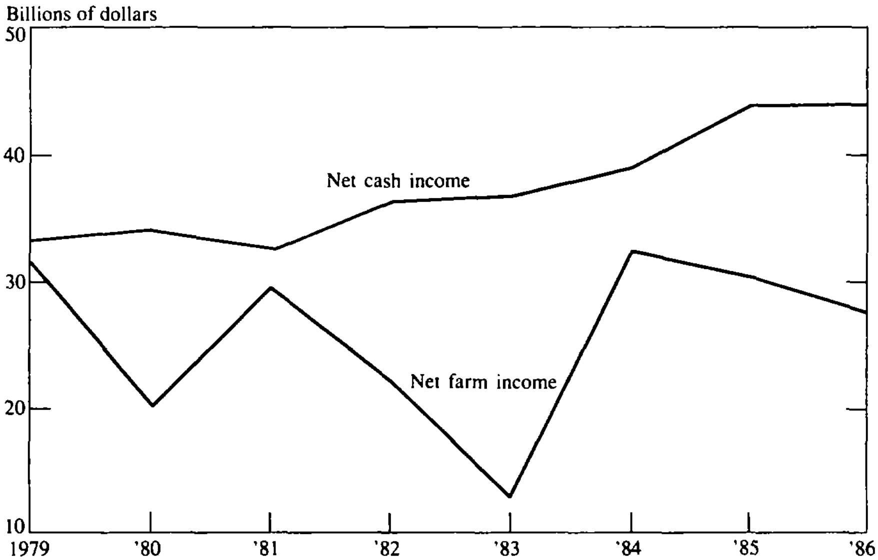
This article reviews farm developments in 1986 and then considers the farm outlook in 1987. The article concentrates on farm financial conditions, crop and livestock market conditions, farm exports, and farm policy.

Mark Drabenstott is a research officer and economist at the Federal Reserve Bank of Kansas City. Lynn Gibson, a research associate at the bank, assisted in the preparation of the article.

The year in review

The year began with widespread expectation that another difficult year was in store for agri-

CHART 1
Farm income



culture. Overall, things turned out only a little better than expected. Land values began to stabilize in many parts of the country and the five-year wave of farm loan problems, though still sizable, appeared to be cresting. Net farm income was only modestly lower than in 1985, and some income measures nearly set records. The improvement in income, however, was due almost entirely to record farm program outlays. In the face of dormant exports and large crop supplies, crop prices dipped to 15-year lows. Livestock producers were expected to have a good year in 1986. That expectation was generally correct, though livestock prices went through some wide fluctuations in the process. The Dairy Termination Program led to a steep temporary fall in both cattle and hog prices. Finally, farm programs generally came under increasing attack as costs mounted while exports remained listless.

Farm income

Farm income declined only moderately in 1986. Net farm income is expected to have been $28.0 billion, about 10 percent less than 1985's revised $30.5 billion (Chart 1). Excellent crops, generally good livestock profits, lower farm expenses, and record government payments kept farm income above the level suggested by weak crop prices. Direct government payments reached an estimated $13 billion in 1986, a new record. In addition, huge net loans by the Commodity Credit Corporation (CCC)—now estimated at $13 billion—added further strength to farm cash flow. In real terms, net farm income in 1986 was an estimated $25.0 billion (1982 dollars), substantially less than in 1985. Ongoing expansion in the general economy raised off-farm income to a record $43.0 billion. That strength in nonfarm earnings was especially important to the two-thirds of all farms that have annual farm sales less than $40,000 and are, in effect, part-time farms.

Net cash income was again record high in 1986. Currently estimated at $44 billion, net cash income would equal 1985's level. Total cash receipts fell moderately to $132 billion. Crop cash receipts were down more than 10 percent while livestock receipts improved slightly. The main improvement in net cash income came in cash expenses, down $6 billion, and in substantially higher government payments. Farmers continued to benefit from lower costs of production—from lower cash rents to lower prices for such inputs as fuel, fertilizer, and chemicals.

Excellent yields and generous farm program benefits produced strong cash flows for many farmers in 1986. Many corn and soybean producers had record or near-record yields. The 1985 Farm Bill did cut crop loan rates as much as 25 percent in 1986, but frozen target prices meant record large deficiency payments.

Nonfarm rural businesses, including farm input suppliers, had another difficult year in 1986. The farm equipment industry continued to retrench. Farm equipment sales were extremely weak as used equipment remained widely available and farmers watched capital expenditures carefully. Large plantings and lower product prices kept demand brisk for fertilizer, seed, and chemicals. Other rural businesses, however, remained depressed. In the Tenth District, surveys showed that one of four nonfarm rural businesses were in serious financial difficulty in 1986.

Farm credit conditions

Farm credit conditions remained extremely difficult in 1986, but as the year unfolded some signs emerged that debt problems were beginning to stabilize. Losses for farm lenders still ran higher than in 1985, and land values edged down further. Nevertheless, the onset of problem loans slowed and loan repayments began to improve, due mainly to large government payments to farmers.

Farm debt declined in 1986, continuing a significant trend that began in 1983. Not since World War II have farmers reduced debt so long or so much. Total farm debt peaked at $204 billion at the end of 1982. By the end of 1986, total sector debt may have dropped to $186 billion (Table 1). Excluding CCC crop loans, which have grown rapidly in the past two years, the debt reduction has been even more dramatic, from $192 billion in 1983, the peak year for non-CCC debt, to an estimated $164 billion in 1986. The sharp drop in debt held by commercial lenders reflects weak loan demand, efforts of both lenders and borrowers to reduce debt relative to earnings, and greater availability of government credit, mainly from the CCC but also from the Farmers Home Administration (FmHA).

Farm assets also declined in 1986, but at a slower rate than in 1985. The sector balance sheet for December 31, 1986 is expected to show an 8 percent decrease in farm assets. Similarly, farm sector net worth is expected to decline more slowly than in 1985. The sector debt-asset ratio is expected to be only slightly higher than last year's 25 percent. Welcome news after six years of increases, that stability could signal some future lessening in farm loan problems.

Farm loan funds were readily available in 1986. The FmHA exhausted its initial direct lending authority in the spring, but an additional allocation from economic emergency funds and increased emphasis on loan guarantees apparently met demand for FmHA loan programs. Agricultural banks had ample funds to lend in 1986. Their problem was finding sufficient loan demand. The loan-deposit ratio at agricultural banks in the Tenth District, for example, dipped to 52 percent, the lowest in ten years.

Farm liquidations in 1986 remained about on par with 1985's rapid pace. According to a survey of agricultural banks in the Tenth District, 7.0 per-

TABLE 1

Farm balance sheet excluding operator households on December 31
(billions of dollars)

	1982	1983	1984	1985	1986p	1987f
Assets						
Real estate	745.6	736.1	639.6	559.6	509	474
Nonreal estate	232.2	220.3	216.4	211.9	197	195
Total assets	977.8	956.5	856.1	771.4	707	669
Liabilities						
Real estate	101.2	103.7	102.9	97.3	92	89
Nonreal estate	102.4	98.8	96.0	94.8	94	86
Total liabilities	203.6	202.4	198.7	192.1	186	175
Proprietors equity	774.2	754.0	657.3	579.3	520	494
Debt-asset ratio	20.8%	21.2%	23.2%	24.9%	26.4%	26.1%

p = preliminary
f = forecast
Source: U.S. Department of Agriculture, 1986 Agricultural Outlook Conference

cent of the farms and ranches in the district fully liquidated in the 12 months ended October 1, 1986. Bankers considered that rate nearly four times normal. Partial liquidations during that period totaled 7.4 percent, almost five times what bankers considered normal. Financial stress remains concentrated in the western Corn Belt and northern plains states, although the severe drought in the Southeast also increased stress there.

Farmland values edged down again in 1986, but at a much slower rate than in the previous two years. Land values in the Tenth District had declined 20 to 25 percent a year in 1984 and 1985. That rate slowed to about 10 percent a year in the first quarter of 1986, and the slower rate continued throughout the rest of the year. The amount of land sold increased somewhat as buying interest picked up, but the amount of land on the market remained high compared with normal levels of the past. At the close of 1986, land values in some parts of the farm belt were at levels that could be justified by the cash flow, though only when farm program benefits were included in the calculation.

Farm loan problems remained prominent for farm lenders in 1986. The number of agricultural bank failures ran about on par with the rapid pace in 1985. Loan losses at the nation's agricultural banks in 1986 likely matched or slightly exceeded the 2.1 percent written off in 1985. At midyear, nonaccrual loans were modestly greater than the same period in 1985. But as the year progressed, the rate of increase in these problem loans slowed, suggesting that problem loans could be nearing their top.

The Farm Credit System remained the most visible and the most severely strained farm lender in 1986. At the end of the third quarter, the system had lost $1.53 billion, with a general expectation that full-year losses would again top $2 billion. Problem loans totaled $12.7 billion at the end of the third quarter, while primary capital (earned net worth and loan loss reserves) was $5.6 billion. The system also reported that it owned more than a billion dollars worth of acquired property.

TABLE 2
U.S. farm product price projections

Crops	Marketing Years 1985-86	Marketing Years 1986-87	Percent Change
Wheat	$3.16/bu	$2.20-2.40/bu	−27
Corn	$2.35/bu	$1.35-1.65/bu	−36
Soybeans	$5.10/bu	$4.50-4.90/bu	−8
Cotton	$.548/lb	N/A	N/A
Livestock	**Calendar Years 1986**	**Calendar Years 1987**	**Percent Change**
Choice Steers	$58-59/cwt	$62-68/cwt	+11
Barrows & Gilts	$51-52/cwt	$52-58/cwt	+7
Broilers	$.57-.58/lb	$.50-.56/lb	−8
Turkeys	$.72-.73/lb	$.64-.70/lb	−8
Lamb	$68-69/cwt	$66-72/cwt	+1
Milk	$12.45-12.50/cwt	$12.05-12.65/cwt	−1

Source: U.S. Department of Agriculture, 1986 Agricultural Outlook Conference

Crops

Crop supplies were big as 1986 began, and they grew even bigger throughout the year. Industry analysts had hoped that reductions in crop support prices provided for in the 1985 Farm Bill would begin to stimulate farm exports. Instead, exports slipped still further. Crop supplies, meanwhile, were abundant as excellent yields more than offset supply control programs that idled a fourth of wheat and cotton acreage and a fifth of feedgrain acreage. Crop prices sagged all year, and by harvest time were reaching lows not seen since the early 1970s. During harvest, corn prices at Corn Belt country elevators sank below a dollar a bushel.

Wheat production was the smallest in seven years, but supplies were still abundant. Total production, at 2.1 billion bushels, was down 14 percent due to smaller yields and reduced acreage. The smaller supply was more than offset, however, by very weak exports. Surplus stocks were large all year, and as a result, wheat prices averaged $3.16 in the 1985-86 marketing year, off somewhat from the previous year (Table 2).

Feedgrain producers harvested huge crops for the second year in a row. Although acreage declined somewhat, excellent growing weather produced record yields. Corn production swelled to 8.2 billion bushels, second only to 1985's record crop. Corn prices averaged $2.35 a bushel in the 1985-86 marketing year, a tenth less than the previous year. Stocks were extremely burdensome throughout the year, and prices fell sharply in the spring, when loan rates for the 1986 crop were cut 25 percent. Prices then remained weak all year, especially as harvest approached.

Soybean production also remained relatively large in 1986. Output totaled 2.0 billion bushels, slightly less than the year before. Yields again were excellent. Stocks remained sizable due to generally sluggish export demand, and the national average farm level price averaged $5.10 a bushel in the 1985-86 marketing year, off an eighth from the previous year.

Cotton production was down significantly in 1986. Planted acreage fell because of the supply control program, and severe drought in the Southeast markedly reduced yields. Output totaled nearly 9.8 million bales, a fourth less than in 1985. Exports fell sharply in the 1985-86 marketing year in the face of abundant foreign supplies and as foreign purchasers anticipated the lower U.S. prices that would result from the marketing loan program implemented in August. Prices averaged 54.8 cents a pound in the 1985-86 marketing year, down three cents from the previous year.

Overall, mounting surplus and sluggish export demand characterized the 1986 crop year. Another bumper crop added to already burdensome supplies. As a result, crop prices trended down throughout the year.

Livestock

Livestock markets were dominated by supply factors in 1986. Producers began the year expecting strong profits as a result of declining meat supplies and low feed prices. That expectation proved true until April. But the April 1 announcement of details for slaughtering 1.5 million dairy cows under the Dairy Termination Program sent red meat markets tumbling. By mid-summer, when the initial surge of marketings was past, prices began to recover. And by the latter part of the year, profit margins had grown relatively wide for many cattle and hog feeders. Consumer demand was relatively strong throughout the year, and total meat consumption was second only to the record set in 1985.

Beef production increased 1.6 percent in 1986 due mainly to the increase in dairy cow slaughter. At the beginning of the year, many analysts had expected a 5 percent decline in beef output. But a substantial 8 percent jump in nonfed and cow slaughter more than offset a decline in fed marketings. Slaughter weights that remained at 1985's record level also contributed to the net increase in beef output. Inexpensive feed and favorable weather encouraged producers to market heavier cattle.

On balance, cattle prices were favorable in 1986, but prices ranged widely due to the effects of the dairy buyout. Prices for choice steers at Omaha averaged an estimated $58.50 a hundredweight, about the same as the year before. Shortly after the Dairy Termination Program was announced, prices fell to around $50, and then recovered to the mid-$60 range by the third and fourth quarters.

Pork production declined 5 percent as producers continued to trim inventories. The nation's hog inventory began falling in early 1984, and by mid-1986 hog numbers had dropped to their lowest level in ten years. The cutback in output combined with record overall meat consumption to push up hog prices. Prices for barrows and gilts at the seven regional markets averaged $51.50 a hundredweight, up nearly a fifth from 1985. In the third quarter, hog profit margins hit new records as corn prices fell to about $1.25 a bushel while hog prices surged past $60.

Broiler production rose 4 percent in 1986 as poultry producers continued to expand. Encouraged by steady growth in consumption and inexpensive feed, poultry producers have now increased output for three years. Consumers ate about equal quantities of pork and chicken in 1986, the first time that has happened. Broiler prices averaged about 57 cents a pound at the 12 city markets, up sharply from 1985. Turkey production increased a substantial 12 percent in 1986 as producers responded to wide profit margins. Turkey prices averaged 72.5 cents, down only slightly from 1985.

The Dairy Termination Program was the principal dairy development in 1986. By the end of the year, upwards of a million dairy cows had been slaughtered. Despite the decline in the dairy herd, production still increased because of continued gains in productivity. Total output may top 145 billion pounds, a new record. Milk prices in 1986 averaged $12.50 a hundredweight, down just slightly from 1985.

The year ahead

U.S. agriculture appears to be entering a stable period. The industry is not likely to decline sharply, as it has in recent years, but it is not likely to improve significantly either. Farm income probably will be steady and farmland values may trend down narrowly. Government support to agriculture will again be very expensive, and the mounting costs probably will precipitate new congressional debate over farm policy. Crop markets will be weak. The crop surplus will be enormous, and exports offer no immediate prospect of emptying U.S. bins. To the contrary, recent upward revisions in estimates of the Soviet grain crop have further depressed crop markets. The cheap grain will be good news to livestock producers, who may have their best year in a decade.

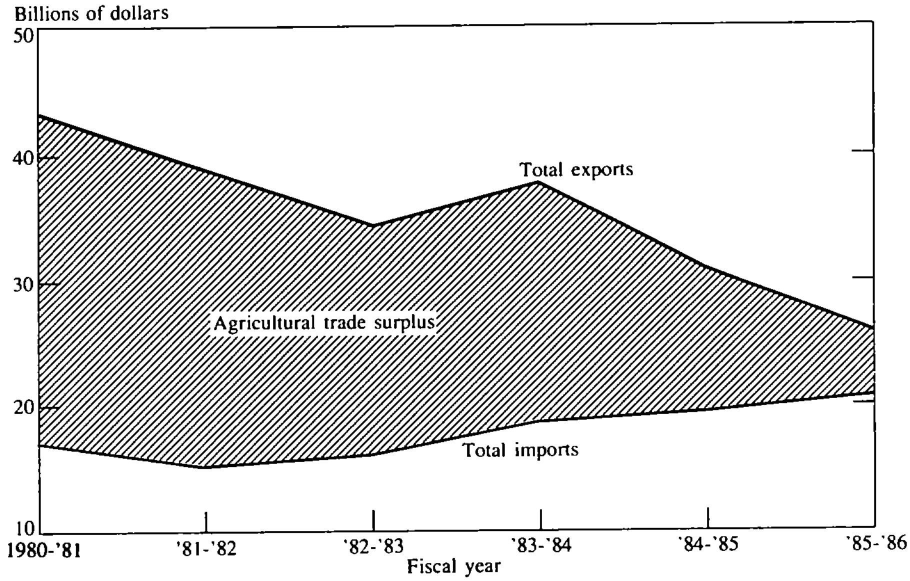
Farm income and financial conditions

Farm income may improve slightly in 1987. Higher livestock profits, lower cash expenses, and continued record government payments probably will slightly offset extremely weak crop prices and a possible decline in crop production. Livestock prices are expected to be fairly strong throughout most of the year and low feedgrain prices may result in record or near-record profit margins for many feeders. Crop prices are likely to remain below loan rates all year. The high proportion of grain stocks now held by the government may result in some seasonal firming in market prices, but the surpluses, huge by any standard, will keep prices depressed overall. Exports may pick up in volume terms, but may show little if any improvement in value terms. Overall, net farm income could increase as much as $4 billion, due mainly to further reductions in farm expenses and perhaps even bigger government payments. Net cash income, on the strength of the large government payments, could exceed this year's $44 billion.

Farm loan problems will remain to be worked through in 1987, but credit conditions should continue to stabilize. Many farm lenders have restructured or written off bad loans in the past couple of years. A substantial portion of the problems, therefore, is out in the open. And as farm asset values stabilize further, lenders and borrowers will gain flexibility and some breathing room to make the necessary financial adjustments that remain. Despite these reasons for restrained optimism about the farm credit outlook, the outward signs of farm lender strains are certain to carry over from 1986. Farm bank closings may keep pace with the high number of failures in 1986. The Farm Credit System will wrestle with a mountain of problem loans. But these developments will owe their origin to the last five years, not to further deterioration in the underlying farm credit fundamentals. To the contrary, those fundamentals could firm somewhat in 1987.

Farmland values may decline narrowly next year. The bearish crop prices expected in 1987 may exert some downward pressure on land values, even though in many parts of the country land values are fairly stable now. That stability, however, appears mainly due to high farm program payments. Current land values accurately reflect returns when government payments are included. But if investors look only at the returns generated by the market, land bought at current prices will not cash flow in most cases. Thus, the future course of land values depends to a considerable extent on farm programs. If government farm spending is reduced, or if investors have good reason to believe programs will be cut, farmland values will adjust accordingly.

CHART 2
U.S. agricultural trade



In other respects, farm credit conditions in 1987 will continue trends evident in 1986. Farm loan interest rates may continue to move lower, although it seems likely that farm interest rates will maintain a wide margin over money market rates simply because of the large loan losses many farm lenders still face. Loanable funds will remain amply available. The Farmers Home Administration will have fewer funds available for direct loans, but expects to offset that with expanded loan guarantees. The problem for agricultural banks will remain one of finding creditworthy loans. As in 1986, many agricultural banks will have very low loan-deposit ratios.

Food prices outlook

Food price increases are expected to remain modest in 1987, as they were in 1986. Retail food prices increased 3 percent in 1986, about equal to the average of the last four years. Higher meat prices in 1987 will be offset to some degree by stable crop prices and only modest increases in food marketing costs. Overall, retail food prices are expected to increase 2 to 4 percent in 1987.

Export outlook

U.S. farm exports declined unexpectedly in 1986. As the year began, many observers believed that a falling U.S. dollar coupled with the sharp cuts made in loan support prices would stimulate exports. Instead, exports slid another 15 percent, to $26.3 billion (Chart 2). Export volume also fell, to an estimated 108 million metric tons. Both dollar value and tonnage volume were new lows for the 1980s.

The reasons for the disappointing export performance are the ones agriculture now knows so well. Competing supplies were plentiful—total world grain production was slightly above 1985's record. World demand remained sluggish—world grain trade, at 205 million metric tons, was well below 1985's depressed level. The dollar fell when measured by a general trade-weighted index, but for agriculture, it did not fall against the right currencies. For example, the currencies of Canada, Argentina, and Australia—all important grain exporting competitors—continued to depreciate against the dollar. And finally, the purchasing power of the developing countries—the segment of the world food market with the most growth potential—remained captive to their serious economic and financial problems.

A disturbing corollary to sluggish U.S. farm exports is the ongoing rise in U.S. farm imports. Farm imports were a record $20.9 billion in 1986. The agricultural trade balance, as a result, was a surplus of $5.4 billion, down more than $20 billion from its peak in 1981. Thus, it is readily apparent that U.S. agriculture is no longer fighting only one competitive battle. The industry must compete for sales not only in foreign markets but also in the domestic food market.

The export outlook for 1987 is somewhat brighter, but no boom is expected. U.S. export volume should increase markedly, perhaps as much as a fourth, due to the very attractive U.S. prices. But precisely because of those low prices, export value probably will be little changed.

Farm policy outlook

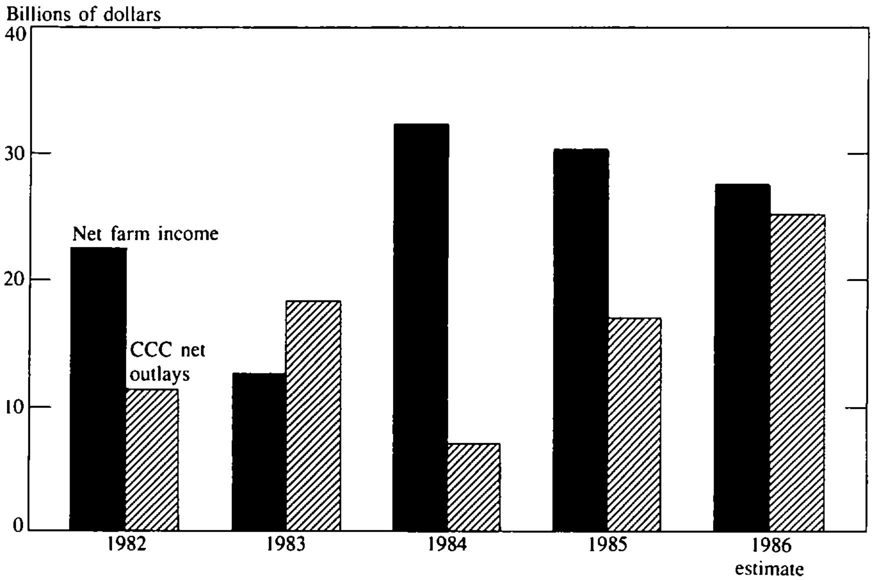
Major reshaping of the farm bill normally would not occur until 1989, because a four-year bill was passed in late 1985. But indications accumulate that Congress may consider substantial changes to that farm bill sometime in 1987. Legislators are concerned about mounting costs and are disappointed in the ineffectiveness of the programs in boosting exports and trimming surpluses. It appears likely, therefore, that Congress will reopen the farm policy debate, possibly in early 1987.

Concerns over mounting costs are legitimate. Farm program costs—net CCC loans plus deficiency payments—skyrocketed in 1986 to a record $25.6 billion, a record that bears striking resemblance to 1986 net farm income (Chart 3). In the early 1970s, by comparison, annual costs averaged $2.4 billion. In the early 1980s, annual costs were much higher, at $11.9 billion, but still much lower than under current programs.

Costs are rising for two main reasons. First, the 1985 Farm Bill reduced loan support prices, to make U.S. products more competitive abroad, but froze target prices for three years. Loan support prices were cut 25 percent in 1986 while target prices were unchanged, resulting in a great amount of budget exposure for the government. Deficiency payments—an amount paid on the difference between the target price and the higher of the loan rate or the market price—rose to a record $13 billion in 1986. Second, a growing portion of farm program benefits are not subject to any payment limitation. In the past, payments to any farm could not exceed $50,000. The 1985 Farm Bill effectively eliminated that ceiling for about 40 percent of all program benefits because of a provision (the Findley amendment) that removed portions of the deficiency payment from a per-farm limit. Thus, large producers are selling grain through government programs, where returns are higher, and leaving the government with more commodities to purchase and store.

The agenda for a possible policy debate in 1987 is still unknown. Three questions will receive the most attention. First, what additional programs can be implemented to boost exports? Many approaches will be discussed—subsidized credit, export Payment-In-Kind (PIK), marketing loan programs, and outright export subsidies. However, it appears that U.S. farm exports will not increase until incomes improve in major trading partners. Second, should some form of mandatory supply controls be implemented? Many policy analysts oppose such controls, as do many in agriculture,

CHART 3
Farm program costs and income



but supply controls are being mentioned with increasing frequency. Mandatory controls would have far-reaching implications for agribusiness segments of the industry and would hand U.S. export markets to competitors. Third, can farm programs target benefits more effectively to medium-size farms? Targeting of benefits remains a considerable problem with current programs, but the very nature of commodity programs—where benefits depend on the amount produced—leads to the problem. Alternative methods of supplementing farm income without using the commodity price mechanism will need to be explored, and the idea of "de-coupling" farm payments from the quantity a farmer produces is gaining some acceptance.

The Farm Credit System (FCS) and its ongoing financial difficulties will also be a concern of Congress in 1987. Important FCS legislation was quietly passed as the 99th Congress adjourned, attached to the final omnibus budget resolution. The legislation, cosponsored by Representative Ed Jones and Senator Thad Cochrane, essentially does three things. First and most important, FCS banks may, subject to Farm Credit Administration (FCA) approval, amortize over 20 years loan losses that exceed 0.5 percent of all outstanding loans. Second, FCS banks can "refinance" long-term debt and spread the cost over 20 years. This refinancing occurs only on paper and does not involve an actual recall of system bonds. Third, FCS institutions are given more independence from the FCA in setting interest rates. The legislation has the effect of giving the system time to work out its loan problems—but only through regulatory accounting—and will delay if not negate the need for government assistance provided in the amendments to the Farm Credit Act passed in December 1985. The issues that will remain in 1987 are how the

TABLE 3
U.S. agricultural supply and demand estimates
December 10, 1986
(millions of bushels, bales or metric tons)

	Corn (bu) Oct. 1-Sept. 30		Feed grains (mt) Oct. 1-Sept. 30		Soybeans(bu) Sept. 1-Aug. 31		Wheat (bu) June 1-May 31		Cotton (bales) Aug. 1-July 31	
	1985-86	1986-87	1985-86	1986-87	1985-86	1986-87	1985-86	1986-87	1985-86	1986-87
Supply										
Beginning stocks	1,648	4,038	57.5	126.3	316	536	1,425	1,905	4.10	9.35
Production & imports	8,876	8,226	274.8	251.0	2,099	2,009	2,425	2,077	13.43	9.79
Total	10,524	12,264	332.2	377.3	2,415	2,545	3,865	3,992	17.57	19.15
Demand										
Domestic	5,245	5,350	169.4	168.6	1,139	1,170	1,044	1,130	6.40	7.01
Export	1,241	1,125	36.6	35.2	740	760	915	975	1.96	6.75
Total	6,486	6,475	205.9	203.9	1,879	1,930	1,960	2,105	8.36	13.76
Ending Stocks	4,038	5,789	126.3	173.4	536	615	1,905	1,887	9.35	5.48

Source: U.S. Department of Agriculture

loss accounting will be implemented, how FCS borrowers, bond holders, and potential investors will respond to the accounting change, and how much pressure will be brought to bear on Congress to allow agricultural banks to use the same type of regulatory accounting.

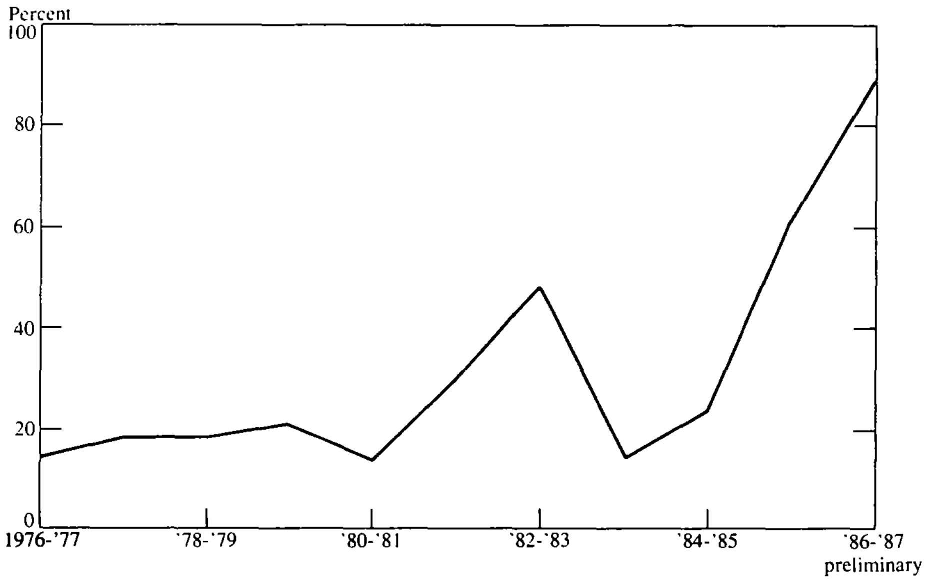
Crop outlook

The crop outlook is bearish for 1987. Total U.S. grain stocks will set another record next year, exceeding the 1983 levels that gave rise to the PIK program. A paid diversion program for feedgrains may prevent buildup in stocks, but stocks could be as huge at yearend as they are now. Domestic and foreign demand likely will remain weak. Crop prices, therefore, also promise to be weak. Any price strength is likely to be seasonal, the result of large government stocks and small free stocks. Overall, market grain prices probably will be well below the loan rate throughout the year.

Wheat supplies will be a near-record 4.0 billion bushels in 1987 (Table 3). The crop was relatively small in 1986, but lackluster domestic and foreign demand has kept surplus stocks at high levels. In addition, production by major foreign competitors increased an estimated 5 percent in 1986, leading to the second largest world wheat crop on record. U.S. wheat carryover stocks for the 1986-87 marketing year are expected to decline only slightly, to 1.9 billion bushels.

The domestic wheat market remains weak because of the abundant supplies and sluggish demand worldwide. A good Soviet crop will limit their imports. Low U.S. wheat prices will encourage some increase in the use of wheat as feed for livestock, but carryover stocks likely will still be at or near record levels at the end of 1987. Farm-level prices are expected to average $2.20 to $2.40 a bushel in the 1986-87 marketing year, down sharply from last year, and the lowest average price since 1977.

CHART 4
U.S. corn stocks to use ratio



Surplus stocks for feedgrains are even more burdensome. Feedgrain supplies will total 377 million metric tons in 1987, the largest ever. Corn supplies, the leading feedgrain, will swell to 12.3 billion bushels, another record. Corn carryover stocks are currently forecast at 5.8 billion bushels, a level that dwarfs the previous record of 3.4 billion bushels in 1983. Corn stocks will equal nearly 90 percent of annual use, a level not seen for 30 years (Chart 4).

Feedgrain demand remains anemic. Domestic use in 1987 will be little changed from the previous year. Feed use may increase slightly, but the increase will be limited by livestock inventories that are the lowest in more than ten years. Corn export volume is expected to decline from the already depressed level in 1986. The good Soviet grain crop will limit exports to that country, which had been relatively strong in 1986. Farm level corn prices may average $1.35 to $1.65 a bushel in the 1986-87 marketing year, again less than the loan rate, and down sharply from the year before. Grain sorghum prices are expected to average $1.30 to $1.50 a bushel in the 1986-87 marketing year, down from $2.15. Barley prices also will be down, to an expected range of $1.45 to $1.65 a bushel.

The soybean outlook is also clouded by record supplies. Total supplies will top 2.5 billion bushels in 1987, up from 1985's record supply. Ending carryover stocks are expected to climb to a record 615 million bushels. Prospects are brighter for soybean meal than for soy oil. A record world oilseed crop, including large output of Malaysian palm oil, is likely to depress U.S. soybean oil prices.

Soybean demand is expected to improve modestly in 1987, but not enough to prevent further build up in stocks. Domestic crushings are expected to increase slightly, encouraged by solid demand for feed. Foreign demand remains extremely sluggish, however, and exports may trend down slightly. A large crop in the Southern Hemisphere will put downward pressure on U.S. exports. Farm-level soybean prices may average \$4.50 to \$4.90 bushel in the 1986-87 marketing year, down 8 percent and the lowest price since the early 1970s.

The outlook for cotton is somewhat brighter. Cotton supplies are big going into the 1986-87 marketing year, but only because of the extraordinary fall in cotton exports last year. A sharp reduction in U.S. cotton production in 1986 and a return of more normal export levels promises declining stocks throughout 1987. Domestic and world consumption is expected to increase moderately, contributing to smaller stocks. Carryover stocks at the end of the 1986-87 marketing year are expected to be 5.5 million bales, a 40 percent decline from the previous year. Cotton prices may trade at or slightly above the 52.25 cent loan rate throughout the year.

On balance, the crop outlook is not bright for 1987. Crop markets are burdened with record surplus stocks as the new year begins. Export volume may improve somewhat, but only at lower prices. As in 1986, most producers will be looking to government programs to market their crops. There promises to be a wide divergence between market cash prices and government target prices.

Livestock outlook

Livestock producers expect good profits in 1987. Feed will be extremely cheap and consumer demand likely will be strong. The unknowns are how soon producers expand their herds to take advantage of the profits, and how much. Any increase in supplies will push down prices and erode profits. Expansion has not yet happened, despite sizable profit margins in the last half of 1986. Red meat supplies are expected to decline 5 percent in 1987, mainly due to cutbacks in beef production. Total meat production, however, is expected to fall only 1 percent as poultry producers continue their vigorous expansion. Meat prices may not be much higher than in 1986, but because of low feed prices, profit margins should be wider than any other recent year.

The beef industry should return to trend levels of output in 1987. With the principal impact of the Dairy Termination Program spent, total beef production is expected to decline 7 percent, following no change in 1986. Fed marketings are expected to decline at least through the first half of the year, but incentives will remain for producers to boost output. The biggest change in the beef supply in 1987 will be in nonfed marketings, now expected to fall nearly a fifth. The cutback results almost entirely from more normal slaughter after the sharp increase in 1986 nonfed marketings related to the Dairy Termination Program. The total number of cattle slaughtered, therefore, probably will decline throughout 1987, but heavy dressed weights will offset some of the decrease.

Cattle prices should be much stronger than in 1986. For the year, choice steers at Omaha may average \$64 to \$66 a hundredweight, a significant improvement over the \$58.50 average for 1986. Prices could be under some pressure in the last half if hog and poultry producers expand output more than now expected. Short supplies of calves and comfortable feeding margins for cattle finishers are expected to result in strong feeder cattle prices throughout most of 1987. Prices may average in the high \$60 a hundredweight range, with prices topping at more than \$70 at midyear.

Pork production in 1987 will be an important swing variable in the overall livestock output. Industry analysts expect pork production to decline 1 percent in 1987. But much depends on the ability and willingness of the industry to boost output and take advantage of record profit margins. Up to now, producers have been slow to expand and lenders have disciplined the expansion by lending cautiously. If expansion is delayed until late in the year, pork growers may have their most profitable year in a decade.

Prices for barrows and gilts at the seven regional markets may average about $55 a hundredweight, up from $51.50 in 1986. Significant reductions in pork and beef supplies in the first half will support prices, and prices could remain in the upper $50 range for the first six months of the year. The second half is less certain, depending much more on when expansion occurs.

Broiler producers expect another banner year in 1987. With feed cheap and consumer demand buoyant, producers may boost output 6 percent. Broiler and poultry growers continue to benefit from the excellent reception consumers afford their products. In 1987, per capita consumption of chicken may overtake pork for the first time in U.S. history. Broiler prices at the 12 city markets may average 53 cents a pound, off moderately from 1986.

Turkey producers have even bigger expansion plans in 1987. Encouraged by inexpensive feed and strong prices in 1986, turkey output may increase 16 percent, after a strong 12 percent increase in 1986. The larger supplies likely will put pressure on prices, which are expected to average 67 cents, about 10 percent less than 1986. Nevertheless, most growers will earn solid profits because of the low costs of production.

Dairy output should decline in 1987, now that the first round of herd reduction is over. As 1987 begins, dairy cow numbers are about 4 percent less than a year earlier. But even though the number of cows will be less, inexpensive feed will encourage high per-cow production. Thus, total dairy output may decline only 2 percent in 1987. With somewhat stronger U.S. consumption, government purchases may trend down somewhat, to about 6 billion pounds. Market dairy prices probably will remain close to the $11.35 a hundredweight loan support price that will take effect January 1, 1987.

Conclusions

U.S. agriculture had another difficult year in 1986, but signs mounted that the long, painful recession was starting to bottom out. The most encouraging sign was a marked slowdown in the decline of farmland values. Farm income also was fairly stable, though only due to record farm program payments. Farm lenders still had large loan losses, yet as the year progressed it became more evident that the wave of farm loan problems was beginning to crest. The major problem that agriculture still faces is the chronic crop surplus. Another large crop in 1986 and still lethargic exports only added to the huge mountain of grain the United States was already storing.

In the coming year, agriculture is likely to find itself on a plateau. Conditions in the industry may not improve much, due to the sorry state of export markets and the chronic crop surplus, but they may not decline much either, thanks to generous farm programs. The plateau rests firmly on government support. If that support is reduced, farm income and farmland values will adjust accordingly. Agriculture desperately seeks a significant rebound from its deep recession. Unfortunately, the road to recovery is long.

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