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Commentary on the rural economy



The Farm Slump Eases

Alan D. Barkema
Vice President & Economist
Center for the Study of Rural America

Nancy Novack
Research Associate

Another big package of government financial aid cushioned the farm slump in 2000 but did little to lift agriculture's spirit. Overall, the industry's major financial indicators stayed remarkably healthy. Farmers delivered more red meat and poultry to supermarkets than ever before, and strong consumer demand in the robust U.S. economy boosted livestock prices and profits. But another big crop swamped still sluggish global markets, and weak crop prices held down farm incomes. In the end, help from Washington propped up the industry's financial indicators for the third consecutive year.

Some signs of improvement have emerged, but like the year before, the industry's outlook for 2001 hinges on the weather and Washington. Global food consumption has caught up with agriculture's recent production surge, tightening world grain supplies and brightening prospects for farm exports. Nevertheless, normal weather and another big crop could keep U.S. granaries full and crop prices low. Livestock producers are likely to have another good year, but weak crop

prices could hold down farm income. As in the past three years, agriculture's prospects in 2001 may rest on financial assistance from Washington.

The farm slump continued in 2000

Farm financial conditions stayed on a remarkably even keel in 2000. Farm incomes and asset values edged up despite weak crop prices, which lingered as the sole reminder of agriculture's continued slump. Despite an early warning of widespread drought, crop producers turned out the nation's fifth consecutive bumper harvest. The big crop swelled crop inventories and held down crop prices, but generous assistance from Washington lifted incomes. Livestock producers notched solid profits, with cheap feed holding down costs and robust consumer demand buoying livestock prices.

When all the numbers are in, the nation's farm income for 2000 compared to 1999 is expected to be up slightly. The U.S. Department of Agriculture pegs net cash farm income, a cash flow gauge that measures the difference between receipts and expenditures, at \$56.4 billion, up more than 3 percent from the year before. Net farm income, a broader measure that takes into account inventory swings and depreciation, could total \$45.4 billion, up more than 4 percent from the year before and slightly above the decade average (Chart 1).¹

Livestock producers generally fared well in 2000, with profits fueled by cheap feed and strong livestock prices. The strong prices and big production boosted livestock receipts to a record \$99.5 billion, up more than 4 percent from 1999. Hog producers earned strong profits through the year, in a welcome turnaround from two years of substantial losses. Profits for cattle feeders seasawed through the year, solidly in the black at the beginning of the year, deeply in the red by summer, and back in black in the fall. Despite the swing in feedlot profits, high feeder cattle prices kept profits steady for ranchers.

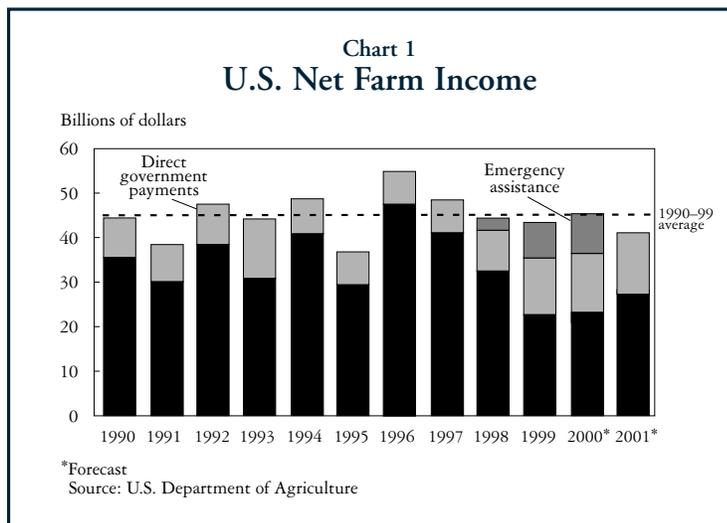
Crop producers had a brief opportu-

nity to market their crops at better than break-even prices, when an early spring warning of widespread drought rallied the markets. The price surge was short-lived, however. The summer weather in the southern Great Plains was dry and harsh, but many other areas dodged the drought. By midsummer, prices plunged to the lowest levels since the mid-1970s for soybeans and since the mid-1980s for corn and wheat. The low prices held crop sales at a relatively low \$96.6 billion, up about 4 percent from 1999.

As in the year before, financial assistance from Washington anchored farm incomes in 2000. Government payments to farmers are expected to total a record \$22.1 billion, adding up to roughly half of net farm income. Underscoring Washington's concern with the industry's lingering slump, nearly 25 percent of the year's big farm subsidy came from emergency assistance authorized by Congress and signed by the Clinton administration in midsummer. Another 14 percent was spillover from similar emergency assistance authorized in 1998 and 1999.

With Washington's help underpinning farm incomes, the industry's balance sheet remained solid. The value of farmland, which accounts for about four-fifths of the nation's farm assets, firmed and started climbing again after softening the previous year. A quarterly survey of farm bankers in the Kansas City Federal Reserve District (Colorado, Kansas, western Missouri, Nebraska, northern New Mexico, Oklahoma, and Wyoming) indicated an average gain of more than 3 percent in district farmland values during the year

ending September 30. A similar survey reported a 7 percent gain in the Chicago Federal Reserve District (Iowa and parts of Indiana, Illinois, Michigan, and Wisconsin). Ranchland values in the mountain states climbed the most, influenced more by nonfarm investors' demand



for scenic mountain views than by ranchers' demand for additional grazing land.

Farm debt edged up just over 2 percent to \$180.6 billion, as farm borrowers and their lenders hunkered down to await better financial times. With farm assets nearly steady and farm debt up slightly, the industry's debt-asset ratio inched up to a still solid 16.1 percent. Farm borrowing costs climbed, with the average interest rate on farm operating loans rising about 75 basis points during the year ending September 30. But big government payments and healthy livestock profits enabled most borrowers to repay operating loans and keep payments up to date on machinery and farm real estate loans. Nevertheless, farm borrowers and their lenders remained uncomfortable with the notion that government assistance was at the root of agriculture's financial stability.

Modest improvement likely in 2001

Agriculture enters the new year in generally solid financial health, thanks mainly

to the large doses of government financial aid received over the last three years. The industry's 2001 outlook points to more of the same. Only modest financial gains are in prospect, with farm income still heavily reliant on government assistance.

Crop producers face another challenging year in 2001, although prospects for crop prices are brightening. A tighter balance of global crop supplies and prospective demand points to big swings in crop prices, as crop prospects shift with changing weather patterns during the year. But with U.S. granaries already filled to the brim by the 2000 crop, normal weather and prospects for another big harvest in 2001 could limit gains in crop prices. Crop receipts are expected to climb to \$100.2 billion, up almost 4 percent compared to 2000.

Livestock producers may have another good year in 2001, but probably not as solid as in 2000. The outlook points to mixed outcomes—stronger profits for beef producers but weaker profits for pork and poultry producers. Bigger meat supplies are likely, with expanding pork and poultry supplies outpacing a cutback in beef production. But with slower growth expected in the nation's economy, consumer demand may ease a notch from the record levels of recent years. As in the year before, livestock receipts may fall just short of the \$100 billion benchmark.

As in recent years, help from Washington will be a big part of farm income in 2001. How big a part remains an open question, however. Current projections suggest net farm income could total \$41.3 billion, down 9 percent from the year before. Stronger crop receipts and steady livestock receipts would boost the market-based portion of the total to \$27.2 billion, a welcome improvement over the previous two years. Nevertheless, the total also includes \$14.1 billion in government payments expected under current legislation. Moreover, during the past three years Washington provided add-on payments totaling nearly \$20 billion, setting a strong precedent for additional aid that would limit the drop now foreseen in farm income.

How much government aid the industry will receive in 2001 is an open question. But the industry's continued reliance on government support is almost certain to fuel a vigorous debate on the farm policy that will replace the current legislation, which expires in 2002. The central theme of the current farm law, the Federal Agricultural Improvement and Reform Act (FAIR), is a seven-year phase-out of the industry's government support in exchange for fewer government controls on farm production decisions. Farmers have quickly embraced the additional flexibility in deciding what crops to produce, and backtracking to government production controls seems unlikely. Still, the industry's slump has put the bold spirit of FAIR to a critical test, and the result is the recent surge in farm subsidies. The experience suggests that the transition to a market-based agriculture is more than a seven-year undertaking and that Washington may consider a stronger safety net for the industry in the meantime.

Little change is likely in the farm balance sheet in 2001. The value of farmland, by far the industry's biggest asset component, will probably continue its gradual climb. Weak crop prices could hold down returns on farmland investments, triggering some erosion in farmland values, but a significant slide in farmland values seems unlikely. Big government payments have supported farmland values the past three years, and in some areas demand for land with scenic mountain views and recreational uses continues to push up farmland values. Still, prospective gains in farmland values will be limited by the sobering recognition that the size of future government payments remains uncertain.

Farm debt may edge up slightly in 2001. Entering the year, farm lenders attribute the generally good health of farm loan portfolios to the large government payments many of their borrowers received in recent years. Both borrowers and lenders remain concerned, however, that subsidies are a poor substitute for market-based earnings, especially since future subsidies could be trimmed in the scheduled 2002 rewrite

of U.S. farm programs. As a result, little expansion is likely in farm debt, as farmers and their lenders wait for better times to expand farm businesses.

Overall, the 2001 outlook points to still modest financial gains, although a bit stronger than in 2000. With farm income heavily dependent on government assistance, only small changes are likely in asset and debt levels. But gains in farm assets may outpace farm debt, opening the door to a modest increase in farm equity.

Summary

The biggest package of government financial assistance in history cushioned the nation's farm slump in 2000. As a result, agriculture's major financial indicators remained remarkably stable. Farm income edged above the average of the past decade, farmland values resumed their gradual climb, and farm loan portfolios stayed healthy.

Welcome signs emerged during the year that the industry could be gradually working its way out of its long slump. A stronger global economy enabled world food consumption to catch up with the industry's recent production surge. U.S. farm exports turned up. Global grain inventories were whittled down.

Nevertheless, farm income prospects may depend on additional aid from Washington, following the precedent of the past three years. With normal weather and another big crop, weak crop prices could hold down incomes for crop producers. For livestock producers, low feed costs and strong meat demand point to another good year, although probably not as strong as in 2000. As the debate begins on the next generation of farm policy, the industry will grapple with the notion that the industry's recent financial stability rests on government support.

¹ Farm finance and commodity projections in this article are based on data from the U.S. Department of Agriculture.

A more detailed assessment of the farm economy appears in the fourth quarter 2000 issue of the bank's *Economic Review*.

Survey of Agricultural Credit Conditions

Federal Reserve Bank of Kansas City

September 30, 2000

Highlights from the second quarter survey.

- Gains in district farmland values averaged 1.1 percent during the third quarter of 2000, but the gains were not evenly shared. Dry conditions limited gains in Oklahoma and Nebraska cropland values, while Missouri and the Mountain states posted strong gains. Ranchland values continued to climb, approaching record levels in Kansas and Nebraska.
- The district index of farm commodity prices fell nearly 7 percent in the third quarter but remained above year-ago levels. Declining prices for corn, soybeans, hogs, and cattle more than offset a post-harvest rebound in winter wheat prices. Since the end of the third quarter, corn and cattle prices have recovered somewhat, but prices for hogs and soybeans remain weak.
- Farm credit conditions weakened in the third quarter. Despite big government payments to farmers, demand for farm loans edged down, loan repayment rates slowed, and loan renewals or extensions edged up. District bankers remain concerned that producers would have difficulty repaying farm loans without government aid.
- After rising for five straight quarters, farm interest rates held steady in the third quarter. At the end of the third quarter, average interest rates on new farm loans averaged 10.52 percent for operating loans, 10.36 percent for feeder cattle loans, 10.29 percent for intermediate-term loans, and 9.73 percent for real estate loans.

Note: 292 bankers responded to the third quarter survey.

Kendall McDaniel, associate economist with the Center, can respond to questions at 816-881-2291, or kendall.l.mcdaniel@kc.frb.org.

Farm Real Estate Values

September 30, 2000
(Average value per acre by reporting banks)

	Nonirrigated	Irrigated	Ranchland
Kansas	\$640	\$1,041	\$369
Missouri	957	1,161	636
Nebraska	862	1,420	359
Oklahoma	519	753	371
Mountain states*	349	1,122	220
Tenth District	\$687	\$1,172	\$375
Percent change from:			
Last quarter+	0.92	1.24	1.21
Year ago+	3.38	3.23	6.98
Market high	-18.65	-18.65	-7.57
Market low	73.38	72.28	124.70

* Colorado, New Mexico, and Wyoming combined.

+ Percentage changes are calculated using responses only from those banks reporting in both the past and the current quarter.

Source: Federal Reserve Bank of Kansas City

Selected Measures of Credit Conditions at Tenth District Agricultural Banks

	Loan demand (index)+	Loan Fund availability (index)+	Loan repayment rates (index)+	Average renewals or extensions (index)+	Loan-to-deposit ratio* (percent)	District farm commodity price index (1980=100)
1998						
Jan.-Mar.	120	108	93	109	65.9	94.3
Apr.-June	123	100	78	118	68.0	92.2
July-Sept.	112	99	58	136	68.4	78.7
Oct.-Dec.	107	108	55	138	66.9	80.7
1999						
Jan.-Mar.	105	113	56	143	65.7	86.0
Apr.-June	107	107	71	127	66.5	87.8
July-Sept.	103	90	74	126	67.7	87.0
Oct.-Dec.	100	99	86	115	67.7	91.2
2000						
Jan.-Mar.	107	95	92	108	67.1	97.9
Apr.-June	112	78	86	108	70.4	97.0
July-Sept.	103	85	84	112	70.8	90.3

* At end of period.

+ Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100.

Source: Federal Reserve Bank of Kansas City