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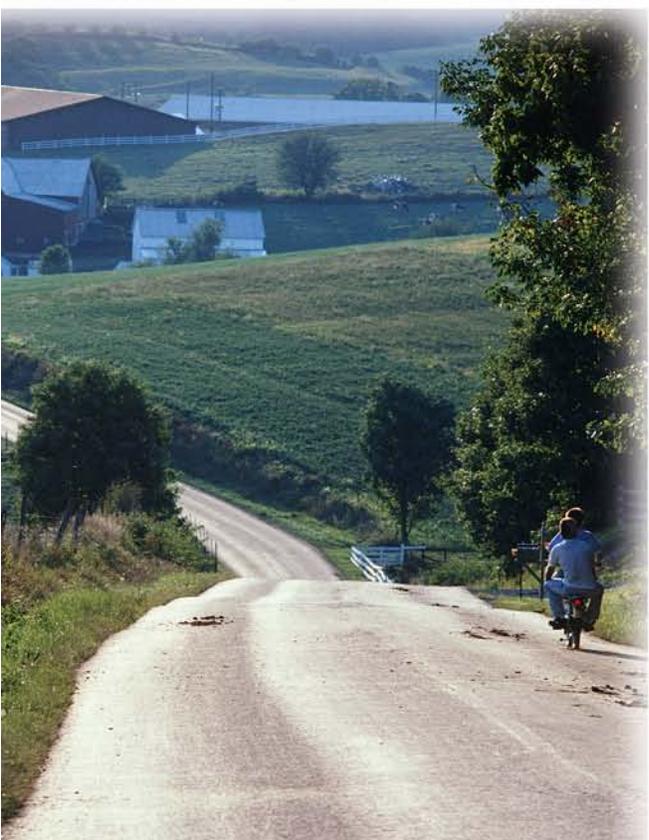
Commentary on the rural economy



The Outlook for U.S. Agricultural Exports

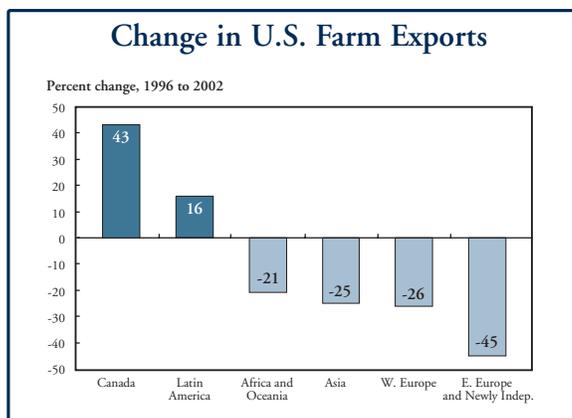
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U.S. agriculture is finally showing signs that it may be rebounding from its slump that began in 1996. One of the main culprits over the last few years has been weak agricultural exports, which are still 7% below their 1996 peak. Exports to Asia have never fully recovered from the Asian financial crisis, and exports to the EU have languished amid food safety concerns. Exports to Canada and Mexico, however, have been one bright spot. If U.S. agriculture is to escape its seven-year slump, healthier exports are a key.

There are two promising spots on the export horizon. The weaker dollar should support export activity over the next few years. And rising incomes in developing countries will spur more demand for high-value products, creating profitable niches for savvy U.S. producers. In the end, however, if export growth is to be sustained, two significant factors must change. International food-safety concerns must be allayed, and global trade barriers must continue to fall.



U.S. agriculture exports are recovering in several key markets

U.S. agricultural exports reached an all-time peak in 1996 and then collapsed a year later, taking down prices with them. The Asian financial crisis hit particularly hard, and ag exports to Asia are still 25% below 1996 levels (Chart 1). Food demand in Japan, one of our key trading partners, remains particularly sluggish. In contrast, strong economic growth is boosting other Asian markets, such as China, presenting new opportunities for U.S. producers. In the near term, trade with China may be limited by the strength of the dollar relative to the yuan. Still, Asia remains a huge potential market.

Europe remains a large market for U.S. agricultural products, but trade with the EU has been up and down since 1996. U.S. agricultural exports to the EU are down a fourth from 1996 levels. Concerns over food safety have created concerns for European consumers and may continue to hamper EU trade.

Trade with our NAFTA partners, Canada and Mexico, has grown rapidly over the last few years. Since 1996, agricultural exports to Canada have jumped 43%. Exports to Latin American countries, mainly Mexico, are up 16%. These countries' proximity to the U.S., combined with their rising standard of living, should continue to boost demand.

The outlook: Food safety and trade talks

The outlook for U.S. agricultural

exports is promising, but gains would be helped by resolving food safety issues and reducing trade barriers. While exports are likely to grow overall, the outlook is quite different for bulk and high-value products. For high-value products, rising incomes in developing countries should spur demand. For bulk exports, however, exports are likely to remain stagnant as global competition continues to strengthen.

The weaker dollar should boost farm exports over the next few years. Since the beginning of the year, the value of the dollar has declined 6% versus other major currencies. Weighted against agricultural trading partners, the dollar is down 5%. The value of the dollar is somewhat weaker in high-value markets than in bulk markets. If the dollar continues to fall in key agricultural markets, exports would be poised for a significant recovery.

Still, the value of the dollar remains strong compared to some key Latin American competitors. Lower production costs and weaker currencies relative to the dollar have created stiff competition for U.S. bulk exports. According to the U.S. Department of Agriculture, China, Brazil, Argentina, India, and the former Soviet republics will capture 38% of world grain and soybean trade this year, up from 13% in 1995. Coincidentally, U.S. bulk exports have been stagnant over this period of time.

Many Latin American producers can sell bulk commodities cheaper than the U.S., mainly due to their lower land costs. For example, Brazil can produce soybeans for about 7 cents per bushel less than U.S. producers. Argentina's currency has depreciated 75% against the dollar, and they have ample soybean supplies, making them another strong competitor in bulk markets over the next few years.

With such stiff competition in bulk export markets, U.S. producers may shift to growing and marketing high-value products. Consumer demand for high-value

products has risen steadily, especially in developing countries. Consumers in developing countries tend to be highly responsive to changes in food prices and spend a large portion of their incomes on food. Rising incomes in developing countries should boost the demand for high-value products in the coming years.

In developed countries, consumer demand for value-added agricultural products has been strong, but food safety concerns could hamper trade in the period ahead. Europeans are still skittish about the outbreak of mad cow disease (BSE) several years ago. And in late May, several major beef-importing countries banned imports of Canadian beef and live-cattle when an Alberta cow tested positive for the disease. Food quality and safety issues will continue to evolve, and debate on them in developed countries will likely be heated.

Trade barriers will be another key factor shaping the outlook for U.S. agricultural exports. If countries use food labels to mark foreign products and thereby limit imports, agricultural prices may be artificially deflated. On the other hand, if domestic farm policies are used to limit imports, consumer prices may be artificially inflated. In both cases, farmers miss out on new opportunities to market their products.

Food labeling and farm policies will likely take center stage at the upcoming World Trade Organization (WTO) meeting in Cancun, Mexico, on September 10. If food labeling and farm policy issues are eventually resolved, U.S. exports could expand significantly.

Conclusion

U.S. agricultural exports have been slow to recover from the Asian crisis in 1996. While U.S. bulk exports have been notably weak, value-added exports have risen steadily. Expanded trade in high-value products presents new opportunities for producers, but they can only materialize as food safety issues are resolved. New progress on trade barriers could lift hopes for renewed growth in bulk exports.

Survey of Agricultural Credit Conditions

Federal Reserve Bank of Kansas City

March 31, 2003

Highlights from the first quarter survey.*

- District farmland values posted solid gains in the first quarter of 2003. Expectations of higher farm income and strong nonfarm demand underpinned farmland values in most district states. In the first quarter, annual gains in farmland values were 7.2% for nonirrigated cropland, 6.5% for irrigated cropland, and 4.5% for rangeland. The largest gains occurred in Missouri and parts of Oklahoma, Kansas, and Nebraska. Gains were somewhat weaker in western portions of the district, where drought was severe.
- Farm credit conditions showed some lingering effects of the drought. Cash flow shortages led to lower loan repayment rates and higher renewals or extensions relative to a year ago. District bankers reported that an average of 20% of their farm borrowers had an increase in carryover debt this year versus last year. And more than half of bankers have tightened their credit standards at least somewhat on farm loans. Nonetheless, low interest rates and a more positive outlook for farm income this year led to a pick-up in demand for new farm loans in the first quarter.
- The district farm commodity price index moved higher in the first quarter. Prices for all commodities, except wheat, were up from the previous quarter. Relative to a year ago, crop and slaughter cattle prices were significantly higher, while prices for feeder cattle and hogs softened. Since March, both crop and livestock prices have posted further gains with particular strength in the soybean market. Higher prices and better crop prospects have boosted USDA farm income projections for 2003.
- Interest rates on new farm loans moved lower in the first quarter. At the end of the quarter, interest rates on new farm loans averaged 7.43% for operating loans, 7.48% for machinery and intermediate-term loans, and 6.98% for real estate loans. Since March, interest rates in national money markets have held steady.

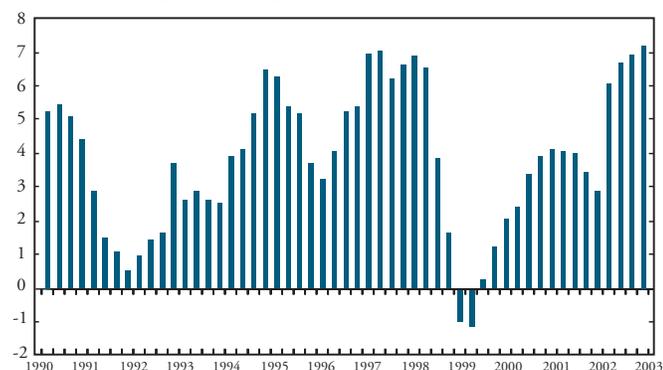
Note: 292 banks responded to the first quarter survey.

*Please refer questions to Nancy Novack, associate economist, at 816-881-2423 or nancy.l.novack@kc.frb.org.

Nonirrigated Cropland Values

Tenth District

Sample percent change from a year ago*

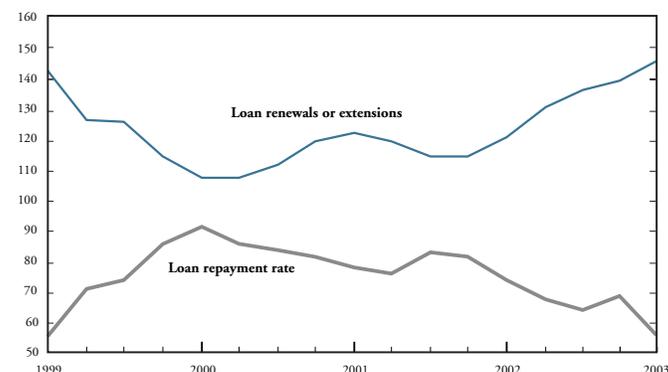


*Percent changes are calculated using responses only from those banks reporting in both the past and the current quarter.

Farm Credit Conditions

Tenth District

Diffusion index*

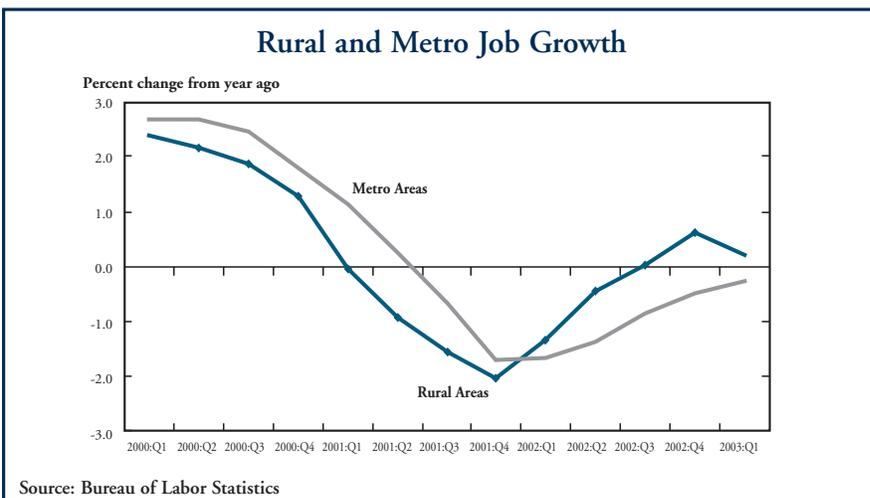


*Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and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

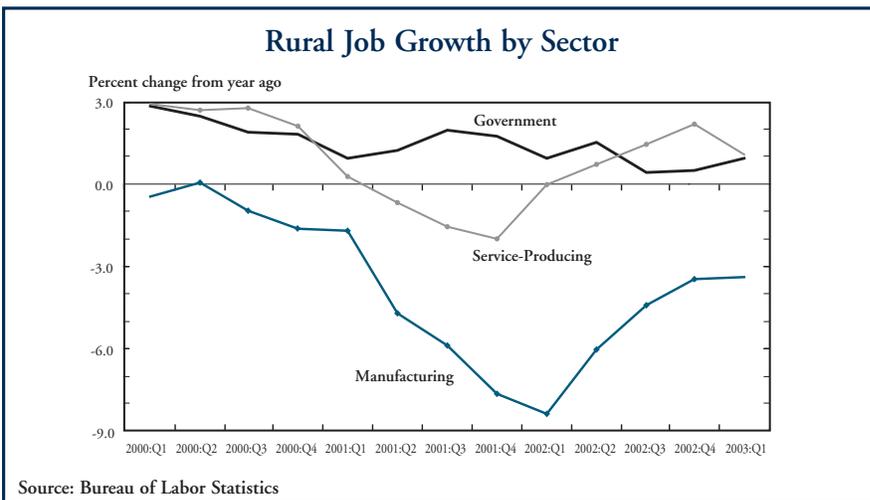
Summary of Economic Conditions

Highlights from the first quarter*

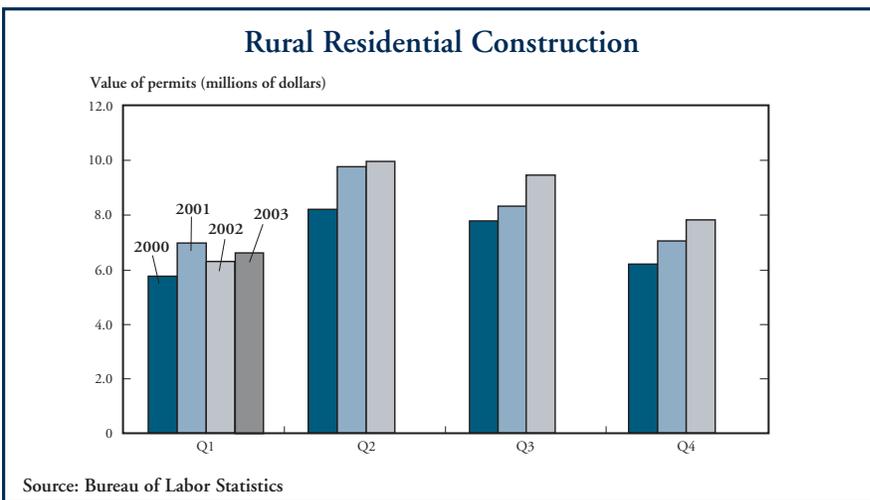
- The recovery under way in the rural nonfarm economy slowed in the first quarter of 2003. Job growth in rural areas pulled back, and at the end of the quarter the number of rural jobs stood at just 0.2% above the previous year. Nevertheless, rural job growth continued to outpace metro areas in the first quarter, as it has since the end of the recession.



- Government and service-producing industries posted small job gains of roughly 1% above a year ago in the first quarter, contributing to the slightly positive job growth in rural areas. Rural factories, however, continued to face job losses. Limited improvement in manufacturing combined with minimal job gains in services and led to the stagnant job growth overall.



- Rural construction activity slowed seasonally to start the first quarter but made a strong rebound in March with more favorable weather. On the whole, rural building permits edged down 0.8% from the previous year. Nevertheless, the value of rural building permits continued to rise and in the first quarter edged above year-ago levels.



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For more current analysis on the state of the rural farm and nonfarm economies, visit our website at www.kc.frb.org.

Notes: Data for all tables are not seasonally adjusted. Job data were revised and reclassified in January 2003.