



Rural snapshots

A look back at 2007
gives a glimpse of 2008



The stage is set in rural America for a profitable 2008—on and off the farm. Vibrant ethanol and export demand as well as a strong farm forecast are promising economic opportunities.

But, it's rising production costs that will determine how prosperous rural America will be this year, say Jason Henderson, an economist, and Maria Akers, an assistant economist, both at the Federal Reserve Bank of Kansas City's Omaha Branch. Henderson is also the Branch executive for the Omaha office.

Henderson and Akers examined the rural economy in 2007 and its prospects for 2008. They researched the booming farm economy, steady expansion on Main Street, and future opportunities and limitations.

"The rural economy appears poised to post another year of economic gains," Henderson says. "Ethanol demand and export activity likely will contribute to robust farm incomes. On Main Street, similar to the national economy, activity has slowed, but may rebound by the end of 2008."

2007

in review



“Rural America basked in a bright economic outlook in 2007,” Akers says.

Net farm incomes unexpectedly reached a record high—\$87.5 billion, according to the USDA. Producers used increased profits to strengthen their financial conditions, such as pay off debts. They also boosted investments in equipment and land, and values have increased as a result. Main Street businesses, too, reaped some of the benefit of this higher farm spending.

Crops

Increased crop profits in rural America last year were mostly the result of corn and wheat, according to Henderson and Akers’ research. Easing droughts led to increased production while heightened export and ethanol demand led to high selling prices. Crop inventories worldwide have been lean; ethanol demand alone accounted for 24 percent of the record U.S. corn crop and exports rose by 15 percent.

U.S. wheat exports surged nearly 30 percent, pushing inventories to a record low. And although U.S. soybean production and exports declined, total foreign trade projections increased 6 percent.

Meanwhile, subsidies are shrinking (at \$12.1 billion down from \$15.7 billion), which is “a big concern because of the cost of production,”

says farmer Dan Watermeier.

Expenses were way up for Watermeier’s large, family-owned farm in Syracuse, Neb., which includes corn, wheat, soybeans and alfalfa. “Fertilizer, machinery and anything petroleum” greatly affects the bottom line, he says. Still, 2007 was a good year and Watermeier predicts he’ll fare well this year, too.

Livestock

Thinking back on 2007, Neal Haverkamp marks it with an “F.” Not for failure by any means, but rather “feed, fuel and fertilizer.”

These rising costs significantly affect his family’s livestock business, Haverkamp Brothers Inc., just outside the small town of Bern, Kan. He oversees Nemaha Valley Angus Inc., the cattle operation of the business, while several of his 10 siblings run the row crop and swine components.

Last year “wasn’t bad” as far as profitability, but Haverkamp says he offsets soaring expenses by locking in low feed prices, mixing corn with cheaper components, cutting back on fertilizer and the like.

Across rural America, higher feed costs trimmed livestock producers’ profits, Akers says. Feed costs increased almost 23 percent, according to the USDA.

For the industry overall in 2007:

- cattle feedlots operated in the red for most of the year;
- hog profits declined significantly;
- price-cost margins for poultry producers fell sharply.



Haverkamp points to the increasing demand for corn-based ethanol as the primary factor driving the price hike.

Generally, growing livestock demand has helped offset rising production costs, Akers says. Gains were driven largely by export demand, with the biggest emerging in the dairy sector. Gross revenues increased 17 percent, but by the end of 2007, producers still were struggling to post profits.

For Nemaha Valley Angus, this may lead to a short-term increase in slaughter, and a long-term decrease in overall beef production, Haverkamp says. And expansion isn't likely any time soon.

"Once we see costs rise," he says, "we seldom see them go back down."

Business

While the nonfarm rural economy slowed along with the nation, rural areas still experienced steady economic growth last year, though the gains were not evenly distributed across geographic regions.

"Main Street activity was buoyed by strong activity in energy and high-skilled services," Henderson says.

The rural unemployment rate remained lower than metro unemployment rates. Rural businesses may have been challenged to find and retain high-skilled workers or find lower-skilled workers at existing wages. Overall, businesses added jobs at a modest pace last year.

"Natural resource industries, namely mining and energy, saw the largest nonfarm growth in employment and earnings for rural America," Henderson says. "Despite industry-specific lulls in employment, rural incomes rose and economic prospects remained positive for Main Street businesses as 2007 ended."

Loren Kucera, director of the Nebraska Business Center at Wayne State College, says the rural business sector was profitable last year, especially in ethanol, manufacturing and farm equipment industries.

Some sectors, however, such as convenience stores and non-chain restaurants, have seen a drop-off in business.

For Myrna and Jerry Higgins, owners of Higgins Hardware in Plattsmouth, Neb., 2007 was average compared to the other 30 or so years that they've owned the shop. The couple says profitability seems to mirror that of other sectors in rural America.

They can pinpoint certain factors that will affect business, such as prolonged bad weather, which keeps people away, or the current housing slump, which prompts homeowners to tackle improvement projects around the house rather than move into a new one. So far this year, they've seen both scenarios.



Sectors of rural employment

increases include:

- education
- health care
- professional and business services (accounting, architecture, engineering)
- tourism
- financial activities and information
- distribution and transportation

decreases include:

- retail
- government
- manufacturing

Rural prosperity in 2008

Large fall harvests have strained both storage capacities and transportation, which, coupled with high fuel costs, has led to increased expenses this year. Higher crop prices have led to significant increases in feed and seed costs as well. Additionally, rising production costs, such as the increase in the price of equipment, may limit profit in various sectors. Rising commodity price and input costs are also straining the financial position of some grain elevators as they meet margin requirements on futures contracts and hold inventories of farm inputs.

“Both farm and nonfarm businesses are facing higher input costs, which could take some of the luster off emerging opportunities,” Henderson says. “But stronger export activity and rising ethanol mandates could offset these expenses and greatly benefit the rural economy in 2008.”

The private sector and the Federal Reserve both forecast national economic growth to soften this year. The forecasts, however, anticipate renewed strength in the second half of 2008. If the rural

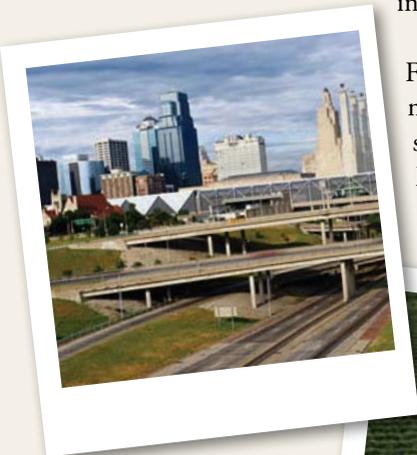
economy continues to track the national economy, Main Street activity could experience a rebound at this time.

Housing effects

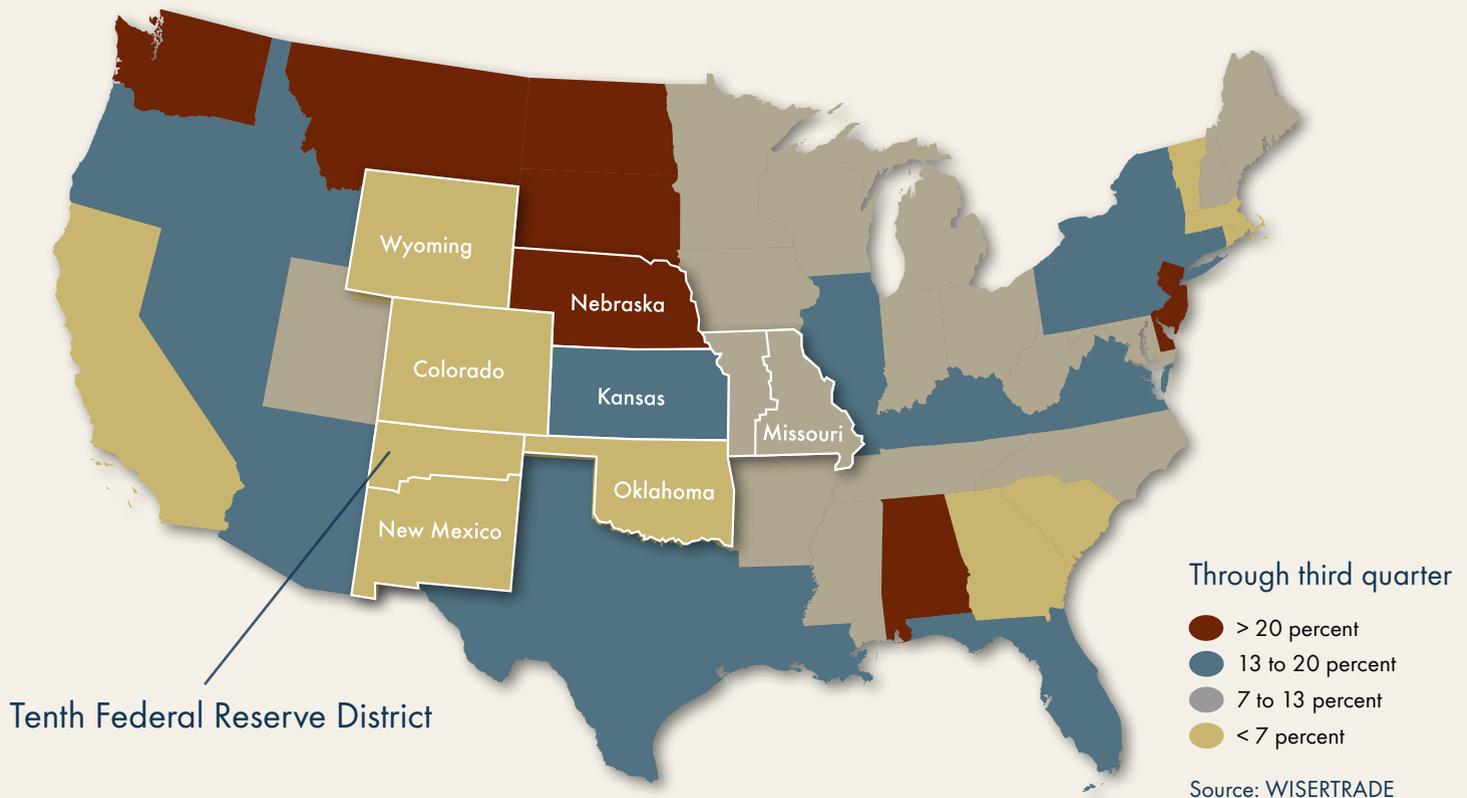
Nationwide, the combination of declining home values, resetting interest rates on adjustable rate mortgages and more loans issued to higher-risk applicants resulted in a dramatic increase in foreclosure rates beginning in 2006. As of mid-2007, the share of mortgages entering into foreclosure reached an all-time high. Some estimates predict 3 million homeowners will default on their mortgages by mid-2009 with two-thirds of those resulting in foreclosure.

National housing market woes spread to rural communities, but didn't affect residents as negatively as in urban communities.

Through most of last year, rural building



Annual Export Growth 2005-07



permits fell sharply, although these declines were less than the nearly 50 percent decline in metro housing permits. The demand for affordable new home construction brings new home buyers and developers to rural communities, but in a weak housing market this demand decreases.

For Myrna and Jerry Higgins, a drop in construction means less business from both commercial and private contractors who come to their Nebraska hardware shop for supplies.

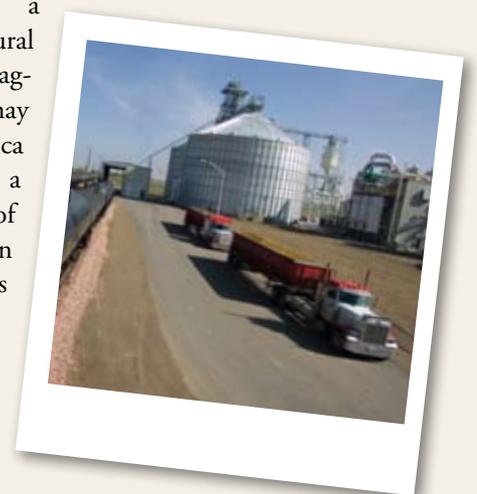
Despite initial job cutbacks, the rural construction industry rebounded and even added jobs as 2007 progressed. Much of the demand seemed to be in commercial construction rather than homes.

Research shows higher energy costs have a disproportionately larger impact on rural households than urban households, with

gasoline especially—rural households spent nearly 22 percent more in 2006 than urban households. With higher gas prices and longer commutes, rural communities that surround metro areas could face more limited housing demand that could be a potential economic drag this year, Akers says.

Export activity

Exports play a large role in the rural economy, especially agriculture, which may give rural America a boost. Although a decline in the value of the dollar can mean higher import prices





on goods purchased by rural customers, a weaker dollar can spur exports as it did last year.

Since 2003, the dollar has fallen 30 percent against the Euro and the Canadian dollar. Like manufactured exports, agricultural exports also strengthened, accelerating as 2008 neared. This was driven by increases in both the price of exported goods and the quantity shipped. Low global crop inventories are also supporting U.S. exports this year.

“Future agricultural export growth will

and Japan in particular, have accounted for a large share of the multibillion dollar U.S. beef export industry.

“China is a big factor as well,” Haverkamp says. “Maybe this year the pace (of exports) will pick up.”

Ethanol

Perhaps most telling of its expectations, Renova Energy is making modifications to increase production at its 15-year-old Wyoming Ethanol facility, and building another that’s twice as large in neighboring Idaho.

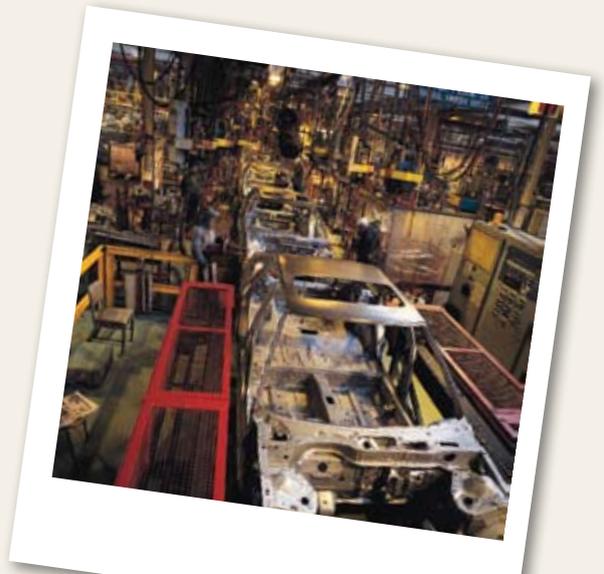
“Demand for ethanol is good. . . . There will definitely be a market” throughout 2008 and beyond, says Jim Glancey, senior vice president

“ One lesson from 2007 is that ethanol is still a policy-driven industry. ”

not only be supported by a weaker dollar that makes U.S. goods more competitive in foreign markets, but also by income gains in foreign countries that buy U.S. products,” Henderson says.

Haverkamp, of Nemaha Valley Angus Inc., is optimistic his exports will grow in Japan specifically. After years of intermittent bans first prompted in 2003 by a mad cow disease risk, American beef is once again allowed into the country. With the ban lifted, U.S. beef exports soared last year. In the past, Asian countries,

of Renova, the parent company of Wyoming Ethanol, which produces annually 10 million



gallons of corn-based ethanol and a byproduct for livestock feed in the small town of Torrington.

But that's not to say there aren't concerns in the industry. On the heels of a successful 2007—overall ethanol production surged 32 percent above the previous year—profit opportunities in 2008 might be affected by higher production costs and lower selling prices, Akers says.

"Corn prices are a challenge at all times," Glancey acknowledges.

Other obstacles may include building market-based demand (rather than demand emerging from government mandates alone), transportation issues and a potential restructuring of the ethanol industry, Akers says. As ethanol reached mandatory levels, production has slowed and several plants under construction were put on hold.

But, a recently established mandate could spark another cycle of expansion in ethanol production. The Renewable Fuels Standard requires 9 billion gallons of renewable fuels (not limited to just ethanol) to be produced this year, with a progressive increase to 36 billion gallons by 2022. Ethanol production would, however, taper as mandated levels are reached.

"One lesson from 2007 is that ethanol is still a policy-driven industry," Henderson says, "and government policy, in the form of mandates and subsidies, will drive profitability going forward."

Rural profits

Several key sectors to the rural economy posted solid gains heading into 2008, Henderson and Akers say, including mining, rural construction, high-skilled services, tourism and manufacturing.

Kucera, of the Nebraska Business Development Center, says the facets of rural America are often dependent on each other. If one sector has a good year, others very well may too.



"If farmers make money, they're going to spend it. They're going to buy farm implements or that new truck or go out to eat," Kucera says. "I think everything looks positive for '08."

Henderson and Akers agree.

"Although, ethanol demand and export activity may support robust farm incomes and profits on Main Street," Henderson says, "it's these rising production costs that will determine rural America's 2008 prosperity."



BY BRYE STEEVES, SENIOR WRITER

FURTHER RESOURCES

"WILL RURAL PROSPERITY PREVAIL IN 2008?"

By Jason Henderson and Maria Akers
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