FRB CHICAGO

AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO
December 2, 1988 Number 1748

The agricultural outlook

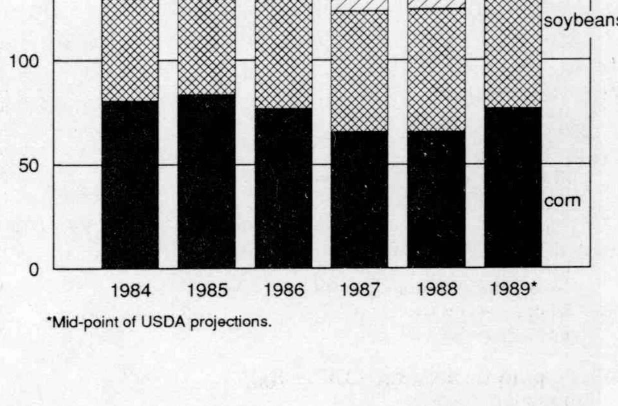
The 65th annual Agricultural Outlook Conference was recently hosted by the U.S. Department of Agriculture. The three-day conference focused on a number of critical issues with longer-term implications, including agricultural policy, the ongoing GATT negotiations, and marketing challenges and opportunities for the complex U.S. good and fiber system. But as always, considerable attention was also focused on recent and near-term prospective trends in production, consumption, and prices of major U.S. farm commodities. Other major presentations focused on recent and prospective 1989 trends in some of the broader measures of farm sector performance, such as trade, earnings, and asset values. While acknowledging some setbacks from the 1988 drought, the presentations foreshadowed a continuing recovery for the farm sector in the year ahead.

The index of all U.S. crop production fell an estimated 18 percent as a result of the 1988 drought. From an historical perspective, the 1988 crop harvest fell nominally below that of 1983 (which was also a year of major drought that coincided with a large acreage held out of production by government price support programs) and was the lowest since 1974. The drought effects were widespread. But among major field crops, corn production was hit the hardest, falling 34 percent from the year before. Soybean production fell 21 percent, while wheat production fell 14 percent as a result of extensive damage to spring wheat in the Northern Plains region.

The small harvest will sharply reduce carryover stocks of grains and oilseeds, cause modest reductions in grain usage, and necessitate a sizable reduction in soybean usage. In anticipation of these conditions, crop prices surged around mid year and, despite subsequent declines, are expected to remain at relatively high levels at least through the first half of next year. For the crop marketing year that will end next August, the USDA believes that monthly corn prices received by farmers will average somewhere between $2.40 and $2.80 a bushel, up from $1.94 last year and $1.50 in the 1986/87 marketing year. The 1988/89 price for soybeans is projected to average between $6.75 and $8.75 a bushel, up from $6.15 last year and $4.78 the year before.

For next year, expanded plantings and an assumption for more normal weather conditions point to a rebound in crop production. Acreage idling requirements and options for farmers that participate in price support programs have been lowered substantially for 1989. As a result, planted corn acreage is expected to rise 8 to 10 million acres above the 67.5 million acres planted in 1988. Harvested corn acreage could be up even more, perhaps 10 to 12 million from the 56.7 million acres of 1988, if better weather conditions reduce the amount of acres abandoned. Per acre corn yields are expected to improve markedly from the drought reduced out turn of 82.3 bushels of this year. While acknowledging the still short moisture reserves and the highly uncertain weather patterns that will emerge during the 1989 growing season, USDA analysts are currently assuming that per acre corn yields next year will rise to somewhere between 115 and 120 bushels per acre. These assumptions portend a possible 1989 corn harvest of some 7,700 to 8,300 million bushels. Production at the lower end of that range might foreshadow only a modest rebuilding of corn carryover stocks. Conversely, production at the upper end of the range might result in a sizable rebuilding of

Planted crop acreage expected to rise in 1989



*Mid-point of USDA projections.

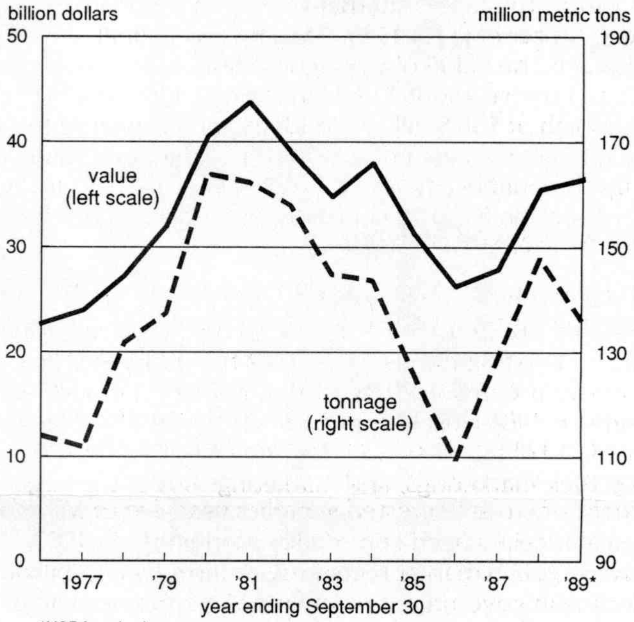
stocks and considerable downward pressure on corn prices by the later part of next year.

Soybean acreage is also expected to rise next year. But the rise may be comparatively modest since the uncertainty about prospective soybean prices, relative to the more certain returns offered by the $2.84 a bushel target price for 1989 corn program participants, is not expected to induce much switching from corn to soybeans. On balance, soybean acreage was projected to rise 1 to 3 million acres above the 58.8 million planted in 1988. Based on per acre yields in non-drought years of the recent past, such plantings might foreshadow a 1989 soybean harvest of some 1.85 to 1.98 billion bushels. While the fortunes of U.S. soybean farmers continue to be undermined by expanding production elsewhere in the world, such levels of domestic production in 1989 probably imply only a modest rebuilding in soybean carryover stocks.

Meat and milk production are both headed to new highs in 1988. Current estimates indicate milk production rose 1.5 to 2 percent in 1988, reflecting continued gains in output per cow that more than offset another slight decline in dairy cow numbers. A more even balance of these contrasting trends is expected for next year, resulting in an unchanged level of milk production. Milk prices, despite a marked increase since mid year, averaged slightly lower in 1988 than was the case the year before. Prices may average slightly lower again next year, despite a temporary 50 cent rise in the support price during the spring quarter. Flat to somewhat lower prices and relatively high feed costs imply that dairy farmers will experience somewhat lower returns again in 1989.

Paced by gains in pork and poultry, total meat production rose about 3.5 percent to another new high in 1988. For next year, an expected large decline for beef will likely result in a slight decline in meat production. Hog farmers have been expanding farrowings since late 1986. That expansion culminated in an 8 percent year-over-year rise in pork production in 1988. The lower hog prices that coincided with the rise in production, coupled with sharply higher feed costs, led to sizable negative returns for many hog farmers during recent months. USDA analysts believe that the stressed margins will result in a downturn in farrowings beginning this winter or spring. Because of existing pipeline supplies of slaughter hogs, however, pork production is likely to remain above year-earlier levels through the first half of 1989 before turning down in the fall. For all of next year, pork production is expected to be unchanged from the 1988 level. Hog prices next year are forecast to average about $45 per hundredweight, with quarterly averages ranging from the low to mid $40s in the first quarter to the mid to upper $40s in the third quarter. In 1988, hog prices averaged about $43.15 per hundredweight, down from $51.59 in 1987 and the lowest in eight years.

U.S. agricultural exports



*USDA projection.

Beef production declined nominally in 1988 and remained well below the cyclical peak of 1976 despite a near record number of cattle that went to slaughter from commercial feedlots. For next year, beef production is projected to decline 5 to 7 percent. Returns to feedlot operators have tightened considerably in recent months as higher costs for feed and feeder cattle have more than offset the rise in fed cattle prices. As a result, the movement of cattle from feedlots to slaughter is expected to decline markedly next year, augmenting the continued declines expected in the slaughter of cows and grass-fed steers and heifers. Returns to cow/calf operators are projected to remain favorable for the fourth consecutive year in 1989. If that is the case, the cyclical decline that has pulled the inventory of all cattle and calves to the lowest level since the early 1960s may end in the next year or two. Choice steer prices at Omaha averaged about $69.40 per hundredweight during the past year, up from $64.60 the year before and a new high. For next year, analysts expected cattle prices at Omaha to average near the mid $70s.

Projections for several of the broader measures of farm sector performance point to favorable trends next year. However, this year's drought will contribute to a projected decline of 8 percent in the tonnage of U.S. agricultural exports in fiscal 1989. The downturn will reverse the strong gains of the past two years that pushed export tonnage to a six-year high. Among major Seventh District crops, soybeans will likely account for a proportionately large share of the decline in export tonnage. Alternatively, corn exports may edge higher in fiscal 1989. Despite less overall tonnage, the value of U.S. agricultural exports is expected to rise about $1 billion in fiscal 1989 to a five-year high of $36.5 billion. With imports expected to be unchanged again next year, the agricultural trade surplus could rise to about $15.5 billion, about halfway between the fiscal 1981 peak of $26.6 billion and the fiscal 1986 low of $5.4 billion.

Trends in the broader measures of farm sector earnings are expected to be mixed next year, reversing the contrasting trends evident for the past year. Preliminary projections suggest that net cash farm income in 1988 closely approximated the 1987 record of $57.1 billion. Higher commodity prices, increased livestock marketings, and marketings out of the large stocks of crops harvested in earlier years led to a sharp rise in receipts from commodity marketings in 1988. But the rise in market receipts was offset by a $3 billion decline in government payments to farmers and an 8 percent increase in cash operating expenses. While net cash farm income held steady last year, the so-called measure of total net farm income declined sharply because of the large drought-related reduction in the value of the change in farm inventories. Current estimates indicate that total net farm income in 1988 fell to about $39 billion from the year-earlier level of $46 billion. For the year ahead, an anticipated rebuilding of farm commodity inventories is expected to boost total net farm income back up to about the record high of 1987. But net cash income could decline, perhaps 10 to 15 percent, reflecting further gains in operating expenses, a further decline in government payments to farmers, and little, or no, gain in receipts from farm commodity marketings.

The balance sheet of the farm sector recorded further gains in both asset and equity values this past year and the trend is expected to continue in 1989. Farm debt, after declining over the past five years, however, may also turn up in the year ahead. Current estimates indicate asset values in the farm sector rose about 4.5 percent this year to more than $740 billion, lead by a 6 percent rise in land values.

Conversely, outstanding farm debt is believed to have declined about 3 percent to approximately $140 billion. At that level, farm debt would be down some 28 percent from the ending 1983 peak. The contrasting trends over the past year in assets and debt helped boost farm sector equity to more than $600 billion, up 12 percent from the cyclical low of two years ago. For the year ahead, continued gains in land values, which account for nearly three-fourths of all farm sector assets, are expected to increase asset values 2 to 3 percent. Although debt is expected to turn up, equity values may rise modestly again next year. Adjusted for inflation, however, farm sector equity at the end of next year may only be marginally above the low of two years earlier.

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AGRICULTURAL LETTER (ISSN 0002-1512) is published bi-weekly by the Research Department of the Federal Reserve Bank of Chicago. It is prepared by Gary L. Benjamin, economic adviser and vice-president, Peter J. Heffernan, economist, and members of the Bank's Research Department, and is distributed free of charge by the Bank's Public Information Center. The information used in the preparation of this publication is obtained from sources considered reliable, but its use does not constitute an endorsement of its accuracy or intent by the Federal Reserve Bank of Chicago.

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Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from: Prior period	Year ago	Two years ago
Prices received by farmers *(1977=100)*	November	142	-0.7	8	15
Crops *(1977=100)*	November	133	0.0	11	33
Corn *($per bu.)*	November	2.46	-4.7	52	67
Oats *($per bu.)*	November	2.40	-6.3	48	82
Soybeans *($per bu.)*	November	7.27	-3.5	36	57
Wheat *($per bu.)*	November	3.90	1.6	45	60
Livestock and products *(1977=100)*	November	151	-0.7	6	4
Barrows and gilts *($per cwt.)*	November	36.80	-6.8	-10	-31
Steers and heifers *($per cwt.)*	November	72.60	0.0	9	21
Milk *($per cwt.)*	November	13.20	1.5	2	-1
Eggs *(¢per doz.)*	November	59.4	1.2	11	-11
Prices paid by farmers *(1977=100)*	October	174	1.2†	5	10
Production items	October	162	1.3†	8	14
Feed	October	142	-3.4†	35	43
Feeder livestock	October	196	8.9†	3	23
Fuels and energy	October	162	-2.4†	-4	8
Producer Prices *(1982=100)*	October	109	0.6	3	6
Agricultural machinery and equipment	October	113	0.1	3	3
Fertilizer materials	October	100	2.1	15	23
Agricultural chemicals	October	108	0.4	2	6
Consumer prices *(1982-84=100)*	October	120	0.3	4	9
Food	October	120	0.1	5	9
Production or stocks					
Corn stocks *(mil. bu.)*	September 1	4,260	N.A.	-13	5
Soybean stocks *(mil. bu.)*	September 1	303	N.A.	-31	-43
Beef production *(bil. lbs.)*	October	2.01	-1.8	-4	-7
Pork production *(bil. lbs.)*	October	1.44	6.1	6	12
Milk production *(bil. lbs.)*††	October	10.1	2.3	2	5

N.A. Not applicable
†Prior period is three months earlier.
††21 selected states.

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