FRB CHICAGO

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Continued farm pressures likely—USDA Outlook

The current situation in the agricultural sector and the outlook for the coming year were recently summarized at the USDA's 62nd Annual Outlook Conference held in Washington. The tone of the conference pointed to a continuation of the pressures that have faced the farm sector for the last several years. World crop production in 1985/86 is expected to surpass the year-earlier record. Much of the increased output is attributable to large feed grain, soybean, and cotton crops recently harvested in the United States. At the same time, growth in world demand is expected to remain sluggish, although economic growth rates in developing countries may show some improvement over the previous year. Overall, huge supplies are expected to hold crop prices relatively low in 1985/86, barring major production problems in Southern Hemisphere crops. While lower grain prices in the United States will contribute to improved operating margins for livestock producers, they are not expected to boost the level of U.S. agricultural export shipments in fiscal 1986.

World coarse grain production during 1985/86 is expected to total 844 million tons, up 4 percent from the year-earlier record output. Much of the gain in world output is attributable to the huge U.S. corn crop, the principal feed grain produced in this country. Among major exporting countries other than the United States, coarse grain production is projected to be up 3 percent from last year. The gain is accounted for by larger, or expected larger, crops in Canada, Thailand, and South Africa that will more than offset expected declines in Argentina and Australia. A substantial increase in coarse grain production in the Soviet Union is expected to largely offset declines in other major importing countries, leaving production among that group slightly below the year-ago level.

Record corn, sorghum, and barley crops in the U.S. boosted domestic feed grain production to 271 million tons in 1985, up about 14 percent from last year. About 81.5 percent of that total is accounted for by this year's record corn harvest. In addition, existing feed grain stocks boosted total domestic feed grain supplies to more than 321 million tons, almost 20 percent greater than available supplies in 1984/85.

Global use of coarse grains in 1985/86 is expected to approach 800 million tons, a 2 percent gain from a year earlier. About two-thirds of that total is expected to be used as animal feed. In the United States, where feed use of coarse grains accounts for 80 percent of the total, utilization is forecast to be up more than 4 percent from the 1984/85 level. Despite expected declines in livestock production, the availability of supplies and low prices are expected to provide a competitive edge to corn and coarse grain in the feeding mix, boosting overall use. Foreign coarse grain use in 1985/86 is forecast to show a year-to-year increase of about 1 percent as gains in livestock production moderate and abundant supplies of wheat, particularly in the European Community countries, encourage substitution of that grain for feeding livestock.

A sharply lower level of Soviet imports is expected to more than offset increases among other importing countries, reducing the volume of world coarse grain trade this year. Current USDA estimates point to a year-to-year drop of almost 5 percent in world coarse grain trade. Moreover, the level of domestic price supports in combination with the exchange value of the dollar and large competing supplies from abroad will contribute to another drop in the U.S. share of world coarse grain trade from the 1979/80 high of 72 percent. U.S. exports are forecast to fall about 12 percent from the low level of a year ago and account for less than half of world trade, while exports of feed grains from other exporting countries may rise 2.5 percent in 1985/86.

U.S. corn production this year is estimated at a record 8.7 billion bushels, up almost 14 percent from last year. Although domestic corn use is projected to be up 5 percent from last year, that gain will be offset by a sharp drop in exports, leaving total corn utilization virtually unchanged from a year ago. With utilization falling well short of production, ending stocks for the 1985/86 marketing year will likely exceed 3 billion bushels, more than double the year-earlier level and near the record high that triggerd the PIK program in 1983. With the huge supplies and expected carryover pressuring prices, the October-to-September marketing year average corn price is expected to range from \$2.35 to \$2.55 per bushel, down from the \$2.65 per bushel average for 1984/85.

U.S. soybean production this year is estimated at more than 2.1 billion bushels, up about 14 percent from last year. However, a year-to-year increase in carryover stocks at the beginning of the current marketing year boosted total supplies more than 20 percent above last year. Increases in domestic crushings and exports of about 4 and 13 percent, respectively, are projected to boost soybean utilization 6.6 percent for the current marketing year. Although still tentative, USDA projections of Southern Hemisphere soybean production point to a slight decline from last year. Much of the anticipated gain in U.S. soybean exports is expected to occur during the first half of the marketing year with relatively tight supplies limiting shipments from South American countries until the new crop is harvested this spring. Nevertheless, large supplies in the face of only a moderate increase in utilization are expected to hold soybean prices in the \$5.00 to \$5.30 per bushel range compared to the \$5.85 per bushel average price of the last marketing year.

Domestic wheat supplies for the 1985/86 marketing year that began on June 1 totaled almost 3.9 billion bushels, down about 3.8 percent from the previous year. With beginning stocks up almost 2 percent, the drop is attributable to the 6.8 percent year-to-year decline in production. With domestic use expected to be down about 4 percent and exports off almost 30 percent from a year earlier, total utilization of wheat may drop 18 percent, pushing ending stocks more than 22 percent above the 1984/85 level. The apparent weak demand is expected to hold wheat prices for the 1985/86 year in the \$3.00 to \$3.20 per bushel range, down from \$3.38 last year and the lowest level since 1978/79.

The drop in U.S. wheat exports is attributable to another large world crop and a continued competitive disadvantage due to the level of U.S. price supports and the value of the dollar. Although down slightly from last year's record, the 506.3 million ton world wheat crop assures ample supplies and stiff competition. Moreover, substantial drops in import needs in the Soviet Union and China as well as other importing countries that are major U.S. customers are projected to limit exports. In an attempt to overcome the U.S. price disadvantage and to offset export subsidies paid by competitors, the United States has implemented an Export Enhancement Program. Under the program, an estimated 35 to 75 million bushels of wheat owned by the Commodity Credit Corporation will be awarded in bonuses to exporters to lower effective grain export prices during the 1985/86 marketing year in an attempt to regain specific markets thought to have been lost to competitors using unfair trade practices. The export enhancement program can be beneficial if it increases the quantity of grain demanded by the targeted importing countries. However, if the subsidy program only encourages a substitution of U.S. grain for that of other countries with no net gain in trade volume, the displaced exports will likely result in greater competition and a potential loss of U.S. market share in trade with other importing countries.

U.S. red meat production, expected to total more than 39 billion pounds in 1985, is projected to drop about 4 percent in the coming year. Much of the decline is accounted for by an expected 5 percent to 6 percent cut in beef production. Pork production in 1986 is expected to register only a slight year-to-year decline, with most of the drop occurring in the spring and summer quarters. The drop in red meat production in 1986, however, is expected to be partially offset by a 4.5 percent increase in poultry production.

The inventory of all cattle and calves on January 1 will likely show another year-to-year decline. Although down from the high level of a year earlier, cow slaughter during the first half of 1985 continued to reduce the size of the herd. Moreover, a sharp cutback in the retention of replacement heifers through mid-year signaled a further reduction in the productive capacity of the U.S. cattle industry. As a result of the cutback, USDA's initial estimate of the 1985 calf crop points to a 3 percent decline from the previous year, marking the fifth consecutive annual decline. With a smaller cow herd likely at the beginning of 1986, further reductions in the calf crop can be expected next year. Cattle slaughter in 1986 is expected to drop 3 to 5 percent, with fed cattle slaughter down 2 to 4 percent and forage-fed cattle slaughter 9 to 11 percent below a year earlier. Choice steer prices at Omaha are projected to average in the low-to mid-\$60-per-hundredweight range for all of next year compared to \$58 to \$59 per hundredweight estimated for 1985.

Although pork production may decline 1 percent in 1986, an expansion is expected to be underway by yearend. USDA estimates point to a slight drop in pork production this winter followed by a 1 to 3 percent year-to-year decline in the spring. During the third quarter, pork production is projected to fall 3 to 5 percent from the high level of this year. During the final three months of 1986, however, pork production is projected to expand 3 to 5 percent from the year-earlier level, with the expansion expected to continue into 1987. Hog prices in 1986 are expected to average in the upper-\$40 per-hundredweight range, perhaps reaching \$50, compared to an expected average of about \$45 per hundredweight for all of this year.

Milk production in 1985, following a first quarter drop as the paid diversion program ended, exhibited increasingly large year-to-year gains during the next three quarters. For the year, it is now estimated that milk production rose 5.8 percent to more than 143 billion pounds. Prospects for 1986 point to further gains, but the magnitude of the rise will hinge largely on pending legislation for the dairy support program. Assuming no diversion or whole herd buyout programs for dairy producers and a support price of \$11.60 per hundredweight, USDA estimates point to gains of 2 to 5 percent in milk production in 1986. Commercial disappearance is expected to register another year-to-year increase during the coming year, but by only 1 to 3 percent. As a result, net removals of manufactured dairy products by the Commodity Credit Corporation, the mechanism by which the milk support price is maintained, are expected to be equivalent to between 13 billion and 20 billion pounds of milk, compared to about 13.5 billion pounds this year. The average price received by farmers for all milk next year is expected to range from \$12.15 to \$12.65 per hundredweight, between 10 and 60 cents lower than 1985.

Retail food prices, as measured by the consumer price index, are expected to rise slightly more than 2 percent in 1985. Ample supplies of most food commodities and only a slight rise in marketing costs account for the moderate rise in retail food prices this past year. For the year ahead, food prices may show a somewhat larger gain, with the current forecast pointing to a rise of between 2 and 4 percent. Food marketing cost increases are expected to remain moderate in 1986, rising between 1 and 2 percent from this year's level. However, somewhat tighter food supplies, principally meats, may exert some pressure on raw food costs. USDA estimates suggest that the farm value of food may rise 2 to 4 percent from this year. Retail prices for meats and eggs are forecast to rise 3 to 5 percent next year, registering the largest increases among major food groups. Their rise, however, is expected to be tempered by poultry and dairy product prices holding steady or perhaps declining slightly. Once again in 1986, much of the gain in the consumer price index for all food will be attributable to food consumed away from home, which is expected to be up 3 to 5 percent from 1985. The index of prices for food at home, an indication of prices that consumers pay in grocery stores is projected to rise only 1 to 3 percent in 1986.

The financial outlook for the agricultural sector is for relatively stable to somewhat lower income and further erosion of equity. The current USDA estimate of net cash income in 1985 indicates a range of $37 to $41 billion, up about $3 billion from earlier forecasts. The estimate suggests that net cash income, a measure of the income available to service debt and meet family living expenses, will be near the 1984 level of $39.2 billion. The estimate of 1985 total net farm income, a conceptual measure of the income generated from farm production in a given year whether it is sold, fed or placed in inventory, was raised as well. At $25 to $29 billion, however, net farm income in 1985 will still be well below the 1984 record of $34.5 billion.

Net cash income of the farm sector in 1986 is forecast to hold in the same range as this year. A drop in cash receipts, primarily for crops, is projected to be offset by a second consecutive annual decline in cash expenses. However, total net farm income may decline in 1986, particularly if smaller crop production results in a large negative inventory adjustment to gross income. The current USDA forecast calls for total net farm income to range between $22 and $26 billion in 1986.

The farm sector balance sheet deteriorated this year and the trend is expected to continue in 1986. The current USDA estimate values the assets of the farm sector, excluding operator household assets, between $790 and $840 billion, down from about $856 billion at the end of 1984. Virtually all of decline stems from an estimated 4 to 8 percent decline in the value of real estate assets, with nonreal estate assets holding near the year-earlier level. Total farm debt is expected to remain near the ending 1984 level as a sharp increase in Commodity Credit Corporation loans offsets declines in other loans outstanding. CCC debt is expected to range from $14 to $18 billion compared to $8.7 billion in 1984. Excluding CCC loans, nonreal estate farm debt is expected to range from $82 to $86 billion on December 31, down from the $87.3 billion of a year earlier. Outstanding farm real estate debt is forecast between $96 and $101 billion compared to the ending 1984 level of $102.9 billion, pointing to the possibility of the largest year-to-year decline recorded since 1944.

The reductions in these debt categories are largely attributable to the price and income protection afforded by the increased CCC non-recourse lending and the deficiency payments provided to participants in government programs. With the huge harvests this year and the high level of participation in government programs, the cash flows of many crop producers were enhanced, allowing them to partially pay down their outstanding debt. However, part of the debt decline is accounted for by loan losses incurred by farm lenders and writedowns on nonperforming loans. With the decline in assets likely to far outstrip any drop in liabilities, farm equity is expected to fall to $595 to $635 billion at the end of 1985, well below the $657.2 billion of a year ago and the 1980 peak of $832.8 billion.

The balance sheet of the farm sector is expected to show further deterioration*

	December 31				
	1982	1983	1984	1985F	1986F
	(billion dollars)				
Assets					
Real estate	745.6	736.1	639.6	575-625	555-620
Nonreal estate	232.2	220.4	216.5	200-230	190-235
Total assets	977.8	956.5	856.1	790-840	770-830
Liabilities					
Real estate	101.2	103.7	102.9	96-101	93-99
Nonreal estate					
CCC loans	15.4	10.8	8.7	14-18	17-21
Other	87.0	88.0	87.3	82-86	80-86
Total nonreal estate	102.4	98.8	96.0	98-106	99-105
Total liabilities	203.7	202.5	198.9	195-202	194-201
Farm equity	774.2	754.0	657.2	595-635	570-630

*Excludes operator households.

F Forecast range.

SOURCE: USDA

The adjustment of the farm sector's balance sheet is expected to continue in 1986. Asset values are projected to fall again, but by a somewhat smaller magnitude. Year-end 1986 may see a drop of up to 4 percent, putting asset values between $770 and $830 billion. Again, much of the decline is expected to be in real estate assets. On the liability side of the balance sheet, outstanding farm debt is expected to drop to between $194 and $201 billion as farmers continue to pay down real estate debt and lenders continue to recognize losses. Another increase in CCC loans outstanding, however, will likely temper the decline in total farm debt. As a result, farm sector equity is projected to fall to $570 to $630 billion by the end of 1986. While this adjustment process will likely place additional pressure on many highly leveraged farm borrowers during the coming year, it can also raise the potential return on new investment in the agricultural sector to a level that is more competitive with other investment opportunities.

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Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from: Prior period	Year ago	Two years ago
Receipts from farm marketings *($ millions)*	N/A*				
Crops	N/A*				
Livestock	N/A*				
Government payments	N/A*				
Real estate farm debt outstanding *($ billions)*					
Commercial banks	September 30	11.0	4.1†	8	21
Federal Land Banks	September 30	46.4	-3.5†	-6	-5
Life insurance companies	August 31	12.0	-0.2†	-5	-5
Farmers Home Administration	September 30	10.7	0.6†	6	11
Nonreal estate farm debt outstanding *($ billions)*					
Commercial banks	September	39.3	-1.6†	-6	1
Production Credit Associations	September	16.0	-4.0†	-19	-22
Farmers Home Administration	September	18.8	1.3†	12	18
Commodity Credit Corporation	September	10.0	14.9†	54	-18
Farm loans made *($ millions)*					
Life insurance companies	August	65	-10.5	-64	-62
Interest rates on farm loans *(percent)*					
7th District agricultural banks					
Operating loans	October 1	12.81	-0.9†	-11	-7
Real estate loans	October 1	12.48	-1.0†	-11	-7
Commodity Credit Corporation	December	7.88	-1.6	-22	-20
Agricultural exports *($ millions)*	Ocotber	2,344	24.3	-18	-26
Corn *(mil. bu.)*	October	126	55.9	-19	-19
Soybeans *(mil. bu.)*	October	55	75.9	35	-18
Wheat *(mil. bu.)*	October	89	14.3	-37	-28
Farm machinery sales[p] *(units)*					
Tractors, over 40 HP	November	3,782	-25.0	-27	-27
40 to 139 HP	November	2,663	-33.9	-24	-19
140 HP or more	November	1,119	10.0	-35	-42
Combines	November	1,139	-21.1	-36	-10

*Monthly data no longer available.
†Prior period is three months earlier.
[p]Preliminary

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