THE OUTLOOK FOR U.S. AGRICULTURE

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Welcome to USDA's 1996 Agricultural Outlook Forum. Today and tomorrow, a great variety of commodity, trade, weather, economic and other experts will assess the current state and future direction of U.S. and world agriculture. My remarks will present a general view of the U.S. agricultural economy, serving as an introduction to the many details to be discussed by the assembled experts. First, I will address a critical issue in shaping public interest in the food and farm outlook and that is the current prospects for the grain-livestock economy in light of this year's sharp rise in grain prices. Second, I will provide a brief assessment of the overall prospects for the agricultural economy, and third, I will comment on long-term adjustments to the current situation.

Critical Issue: Consequence of Low Grain Stocks for Producers and the American Public

Two years ago, in shifting the date of this Forum to early in the year and changing its format, we committed to reducing our discussion of near-term developments in favor of more medium- and long-term analysis. We pledged to regularly present a 10-year baseline. Despite the uncertainty of farm policy, we have stuck to that promise and made available our most recent 10-year projections, on which I will comment in a few minutes. Despite our desire to emphasize the longer term, several unprecedented developments compel focusing a good portion of these remarks on shorter-term issues.

<u>Low grain stocks and record-high grain prices</u>. To review, we expect record-high season-average farm prices for wheat in 1995/96 and near record for corn. For wheat, carryover stocks on June 1 are forecast at 346 million bushels. As a percent of total use, that is lower than the often-referenced 1973/74 season and the lowest since 1947/48. Domestic use is down a little from recent years but exports are expected to be the third highest in the 1990s. For corn, carryover stocks are forecast at only 457 million bushels, which as a percent of use is the lowest since 1937/38. Domestic feed and residual use is forecast to fall 17 percent from last season, while exports reach the highest level in the 1990s.

These once-in-50-years lows for stocks relative to use mean demand movements for the rest of this season and changing prospects for the 1996 crops make price movements highly uncertain. The low stocks have put feeders, processors, traders, and consumers at much greater risk if 1996 harvests are subpar.

Last year's cotton experience. As we watch the decline of grain stockpiles, there may be a lesson in last year's cotton market. Prices were the highest since the Civil War and leading cotton analysts were making headlines saying we will run out of cotton before the year is over. We did not, because both domestic and export use turned out lower than what was being forecast at the mid-year point. At last year's Outlook Forum, USDA forecast total 1994/95 cotton use to be 21.6 million bales with carryover stocks of only 1.6 million bales. However, total use turned out to be 20.6 million bales, with most of the drop coming in exports. Carryover stocks turned out to be a more comfortable 2.65 million bales. The lesson for grains is this: prices will ration demand to assure an adequate level of working stocks is carried over at year end. While we did not run out of stocks of cotton, we did see back-to-back high price years for cotton, something we have not seen for corn.

Prospects for the rest of this season. Focusing on corn, its price during a crop year normally is weakest during October and November when producers are harvesting the new crop (chart 1). Prices are usually 5-10 percent below the season-average then and peak the following June and July at 5-10 percent above the season-average. This pattern changes in a year when production is sharply cut back, causing low stocks and high prices. In supply-reduced years, the price peak has often come earlier with prices tailing off over a somewhat longer period. This year, stocks are being drawn down by a combination of reduced yield, but also strong foreign demand, so the bad-weather year pattern of early peak prices may not hold. Based on current futures prices, a slowdown in export sales, the onset of Southern Hemisphere production, and expected higher plantings, the corn price high appears likely to be a little earlier than normal, peaking perhaps during April-June at a monthly average farm price some 15 percent above the season-average price, or about $3.70 per bushel (chart 2). With average 1996-crop conditions, prices would decline thereafter into the fall.

Would such a price pattern set in motion disruption of exports or feed use and cause livestock production cutbacks that have serious implications for future food prices? The short answer is: we don't think so. This year's price pattern has thus far caused no sign of curtailment in export sales or major trimming of livestock herds, and that is of course why we forecast such historically low stocks. Corn export sales in early February are 82 percent of the current crop year forecast, even though only half the year has expired. On the domestic side, 1996 beef production is expected to rise 2-3 percent. Even though fed cattle prices are lower than a year ago and feed prices up, fed cattle prices have still been above the average breakeven level, as lower feeder cattle prices have offset much of the higher feed costs. Lower feeder prices, will increase cow slaughter as we move through the year, but the pace has not yet been rapid, and by yearend, the beef cow inventory is likely to be down slightly. This would be the first year-over-year drop since 1990. It appears that forage supplies are adequate enough to let cow/calf operators wait for development of the 1996 feed crop before making major breeding cow liquidation decisions.

For hog producers, the current expected pattern of feed prices will cause some higher cost operators to reduce breeding herds this spring. However, most producers likely will still cover cash costs. Pork producers increased herds last fall, consequently production this year is expected to rise 3 percent, with most of the production increase and price pressure in the fall, a time when a normal 1996 corn crop would mean lower feed costs. For poultry, broilers had strong net returns in 1995, supporting expansion which is expected to raise production 6 percent in 1996. High feed prices are reducing returns but cash costs are expected to be covered for much of the rest of this corn marketing year. Milk producers appear to be cutting back; milk production in 1995/96 is expected to be up less than 1 percent, compared with 2.5 percent last year.

So the livestock, poultry and dairy industries are making adjustments, although not major, in response to the higher feed prices. These moderate adjustments should help maintain a stable food CPI. If 1996-crop corn prices were to move into the $4.00 plus per bushel range due to reduced yield prospects, hog and poultry producers would reduce animal numbers first with cow/calf operators making their big reductions in the fall. The result would be higher meat prices in late 1996 and into 1997 and, for beef, into 1998 and beyond.

Prospects for the Overall Farm Economy in 1996

Building on the possible grain-livestock developments just outlined, a picture of the 1996 farm economy may be crafted starting with the prospects for the 1996 crops. Although legislative authority is not yet in place, we can expect no acreage reduction requirements for 1996 crops, which is consistent with the Secretary's stated intentions and the pending Senate and House bills.

<u>1996 crop plantings</u>. With higher prices, no acreage reduction program and better planting-time weather, corn acreage may rise nearly 15 percent to over 80 million acres, up from 71 million in 1995. Winter wheat acreage was up 7 percent, and total wheat acreage could rise by 4 million to 73 million. Sorghum, barley and oats acres may all rise as well. With trend yields, these area increases would raise production above prospective use in 1996/97, as grain exports may drop a little reflecting increased foreign production. Stocks would rise; however, the increase would be quite modest. Wheat stocks would be in the range of 400-450 million bushels and corn, 700-750 million. Wheat farm prices would drop back a little but still be near $4.00 per bushel, and corn farm prices would decline to near $2.75 target.

For cotton, this year's grain prices have increased relative to cotton and about a 10 percent decline in planted area is expected. With a return to average yields and total use expected to be about unchanged, carryover stocks would rise about 2 million bales to nearly 5 million, and prices would weaken. Soybeans will face increased competition from corn. The last couple of years at planting time the ratio of soybean-to-corn prices has been about 2.4 to 2.5 to 1. With the runup in corn prices, it has been running 2.1 to 1 this winter which should cause some corn to be planted on traditional soybean land. However, the incentive to switch based on futures prices is less. For 1996, we forecast at most a 1.5- to 2-million-acre decline in soybean area. Even with a small reduction expected in exports, carryover stocks would decline, maintaining 1996 crop soybean prices at about this year's level.

Plantings under Congressional bills. These forecasts are based on extension of current law. If the commodity provisions for 1996 reflect the current House and Senate farm bill provisions, these forecasts are not expected to change much. The Congressional bills allow essentially complete planting flexibility, including the planting of corn in excess of base onto soybean area. Other things equal, the Congressional bills could mean a little more corn and less soybeans than our current-law forecasts. However, because the price incentives to switch are not that great and because any enacted farm bill will come so close to planting, it is likely that corn and soybean acreage would be little different than under current law. Likewise cotton may differ little. There would be some incentive to use the greater flexibility provisions to reduce cotton and raise feed grains in the Southern Plains but some producers could elect to plant cotton on soybean land. Rice faces the biggest potential adjustment as there is no minimum planting requirement under the Congressional bills. Rice acreage could be up to 0.5 million lower than under current law. If so, rice farm prices in 1996/97 would likely average at or above this season's forecast of $8.75 per cwt, rather than drop 15 percent as expected with a continuation of current law.

Livestock, poultry and milk summary. Turning to 1996 livestock, poultry, and dairy prospects, I have already described the adjustments we expect this year in reaction to grain prices. Overall, a 4-percent increase in meat production is expected, lowering prices across the meat counter. Although the increase in beef production is expected to be below last year's, it maybe enough to reduce farm level beef prices 2-3 percent. The relatively larger pork production increase may result in an 8 percent pork price drop, with prices particularly weak in the second half of 1996. Broiler prices may decline 4 percent. Milk is a different story. Dairy product surpluses will be the lowest since the mid-1970s. Removals on a total solids basis will be the equivalent of an extraordinarily low 2 billion pounds of milk. Milk prices for 1996 are expected to be 4-5 percent above 1995.

Food prices. The CPI for food rose 2.8 percent in 1995, up slightly from 1994, with much of the rise due to higher prices for fruits and vegetables. In 1996, the highlight for the American consumer will be food price increases below the overall inflation rate, as the strong increase in meat production lowers meat prices slightly. Red meat and poultry represent 24 percent of the at-home food CPI. Per capita meat consumption should reach a record 216.5 lbs. in 1996. With meat prices down, the increase in the 1996 overall food CPI is likely to be toward the lower end of a forecast range of 2-4 percent. With average weather, consumers should see smaller price increases for fresh fruits and vegetables than last year. Cereal and bakery product prices will rise reflecting higher grain prices, but the increase at retail is likely to be 3-5 percent as farm-level grain prices represent only about one-tenth of the retail prices of these products. Beyond 1996, meat prices will likely increase and raise the food CPI to nearer the overall inflation rate.

Indicators of Financial Performance

The overall state of U.S. agriculture is generally positive, but economic indicators suggest rising concern in a couple of areas. Compared to 1990-94, farm receipts, assets, and equity were up in 1995 and further increases are expected this year (table 1). Although agricultural debt is increasing, the debt-to-asset ratio is stable at about 15.8 percent. Farm real estate values continue to increase, reflecting higher crop receipts, lower interest rates, and low probability that the farm bill will hurt incomes in the near term. Land values were up 6.4 percent on January 1, 1995, compared to an average of 3.5 percent during the first half of the 1990s.

The value of agricultural exports were up 31 percent in fiscal year 1995 compared to 1990-94, and 1996 exports are projected at a record $60 billion. Net cash farm income in 1996 is expected to again be about the same as in 1995 and 1994. Commodity program outlays in fiscal year 1995 were $6 billion, 43 percent below the average for 1990-94, and are projected at $2.7 billion in fiscal year 1996 under current law. This means our current calendar year estimate of deficiency payments to producers in 1996 under current law is below $2 billion. However, under the Congressional bills, transition payments could rise as high as $8 billion, adding more than $6 billion to our forecast of net farm income for 1996.

We know that aggregate indicators mask varying performance of individual sectors. Examining net returns for specific sectors reveals corn, wheat, and soybean per acre returns are up significantly in 1995 compared to 1990-94 (table 2). The tight supplies and strong prices that characterize grain and oilseed markets, while expected to moderate in 1996/97, will likely keep net cash returns above earlier levels. Returns to cotton producers in 1995, while below earlier levels due to reduced yields, are expected to improve with better yields in 1996.

In the livestock sector, the average net cash return for hog producers in 1995 is similar to 1990-94 levels, but returns in 1996 are expected to decline, and perhaps turn negative. A key area of concern is among cow/calf operators who are already experiencing negative returns and are expected to become more negative in 1996. Broiler producers benefited from higher average returns in 1995 than earlier as strong demand and rising prices offset higher feed costs. Returns to broiler production are expected to fall in 1996, but remain near average 1990-94 levels.

Last year, reduced production and higher grower prices boosted farm value, encouraged imports, and slowed exports of fresh-market fruits and vegetables. The horticulture industry is expected to export about 16 percent more in 1996 with exports rising to over $10 billion and imports rising slightly. With expected sales value similar to last year, net cash income to the sector may decline. Larger supplies and smaller consumer price increases are expected to increase per capita-consumption of fresh fruits and vegetables.

Longer term adjustments

We are providing Forum registrants with copies of our most recent 10-year baseline projections for U.S. agriculture. This morning Rip Landes and other staff of the Economic Research Service led a workshop on projected foreign developments and the factors underlying the export projections. I want to close by making a few comments on these projections.

The projections are based on provisions of the 1990 Farm Bill, trend yields and specific assumptions about other U.S. and foreign policies and variables. The projections are only as good as these assumptions which, in many cases, will not hold. Nevertheless, the projections are useful to indicate the potential market adjustment from the current situation and to peg, at least for now, the emerging trends in the markets of the future.

The baseline sheds light on questions about future prospects. One key issue is what will economic growth be like? Despite a slower 1996 U.S. economy, we continue to see positive trends in the world economy which will support U.S. export expansion. Developed country GDP is projected to average a moderate and sustainable 2.5 percent over the next decade. Developing country growth may average about 5.5 percent, slightly above the first half of the 1990s. To no one's surprise, key growth regions include East Asia and Latin America. Russia's economic decline is forecast to bottom this year with the entire FSU turning positive by 1998. Mexico's 7 percent decline in 1995 is expected to turn marginally positive in 1996 and, over the next 5 years, average near the pre-devaluation projected growth rate.

A second key question underlying the outlook is how will the economic prospects translate into foreign demand? Last year, we projected U.S. agricultural exports would reach $68 billion by 2005. That projection is now raised to $80 billion. Much of the increase reflects growth in high-value exports, such as meats and horticultural products, but there is also a stronger outlook for bulk commodities and higher projected commodity prices. China with its increased grain imports, dominates this year's adjustments. A year ago, we pegged China to still be a net coarse grain exporter in the year 2000. Now, China is projected to be a net importer of 7-8 million tons, more than offsetting lower expected FSU imports.

A third key question is how will stronger demand play against land availability and use? The outlook is for increased utilization of the agricultural land base for farm production. Stronger exports combined with domestic demand growing slightly faster than population offset yield increases and pull more land into production. The land comes from acreage reduction programs which, used liberally in the past, are projected to be used for only a few years and only for cotton. Higher prices also mean less land is enrolled in the 0-50/85-92 provision. Finally, our baseline assumes that the CRP contains 28 million acres in 2000, down from the current 36.4 million. The drop is based on an estimate of contract extension and virtually no new enrollments. The future size and composition of the CRP will ultimately depend on contract extension policy, funding, enrollment authority, and environmental targeting.

A fourth interesting question is how normal is the return-to-normal from the current tight market situation? The answer is it is a little different than recent history. Under current farm policy, commodity markets are shown to recover to a little tighter supply/demand balance than recent trends. For example, the average stocks-to-use ratio for corn over the next decade is projected at 8-9 percent which, in the past, has often been considered "normal" at 12-13 percent. The tighter markets do not reflect a food scarcity problem. Economists measure scarcity and crisis with relative prices, and although the tighter market balance means a little higher major crop prices than previously expected, inflation-adjusted prices are still projected to decline over the next decade, but not as fast as the long-term trend.

The fifth and last question I want to address is what does all this mean for prospects for overall financial performance of U.S. agriculture? The picture is one of overall stability, with net cash income changing little from recent levels. Based on current programs and our CRP assumptions, future crop prices now look a little stronger and livestock and products a little weaker than our previous thinking. The role of government would continue to shrink with direct government payments amounting to only 1 percent of gross cash income by the year 2000.

Overall, U.S. agriculture is described by generally favorable economic indicators, but as always, these indicators mask some segments which are financially vulnerable. U.S. agriculture in the mid-1990s is dominated by tight grain supplies and strong prices, and solid domestic and global demand, which is likely to prevail for the next couple of years, but reduced profitability in the livestock sector that may reduce the growth in meat production in future years.

TABLE 1. ECONOMIC INDICATORS FOR U.S. AGRICULTURE (billion $)

Item	Avg. 1990-94	1995e	% change	1996f 1/
Farm receipts 2/	181.7	193.5	6.5	193-203
Assets	879.5	956.6	8.8	985-995
Liabilities	140.6	150.7	7.2	153-157
Equity	738.9	805.9	9.1	830-840
Farm real estate ($/acre)	723.0	832.0	15.0	na
Exports	41.3	54.2	31.2	60.0 3/
CCC outlays (fiscal year)	10.6	6.0	-42.9	2.6
Government payments	9.6	6.2	-35.4	3-5

e=estimated; f=forecast

1/ From "Long-term Agricultural Projections to 2005," USDA/WAOB, Feb. 1996.

2/ Includes farm-related income.

3/ From "Outloook for U.S. Agricultural Exports," February 21, 1996.

TABLE 2. RETURNS ($/unit) 1/

Item	Avg. 1990-94	1995e	1996f 2/
Corn (acre)	167.18	193.95	192.78
Wheat (acre)	89.34	101.72	92.51
Soybeans (acre)	134.12	168.65	178.44
Cotton (acre)	224.56	159.69	210.29
Hogs (100 lbs)	6.90	6.83	-5.12
Cow/calf (per cow)	86.95	-8.56	-26.59
Chickens (100 lbs)	4.87	6.40	3.30
Dairy (100 lbs of milk)	2.33	0.76	0.97

e=estimated; f=forecast.

1/ Crops--return over variable costs for program participants for crop years; cow/calf, dairy and hogs (farrow to finish)--returns over cash costs with dairy on marketing years; chickens--returns over total costs.

2/ From "Long-term Agricultural Projections to 2005," USDA/WAOB, Feb. 1996.

CHART 1. SEASONAL FARM PRICE PATTERNS FOR CORN

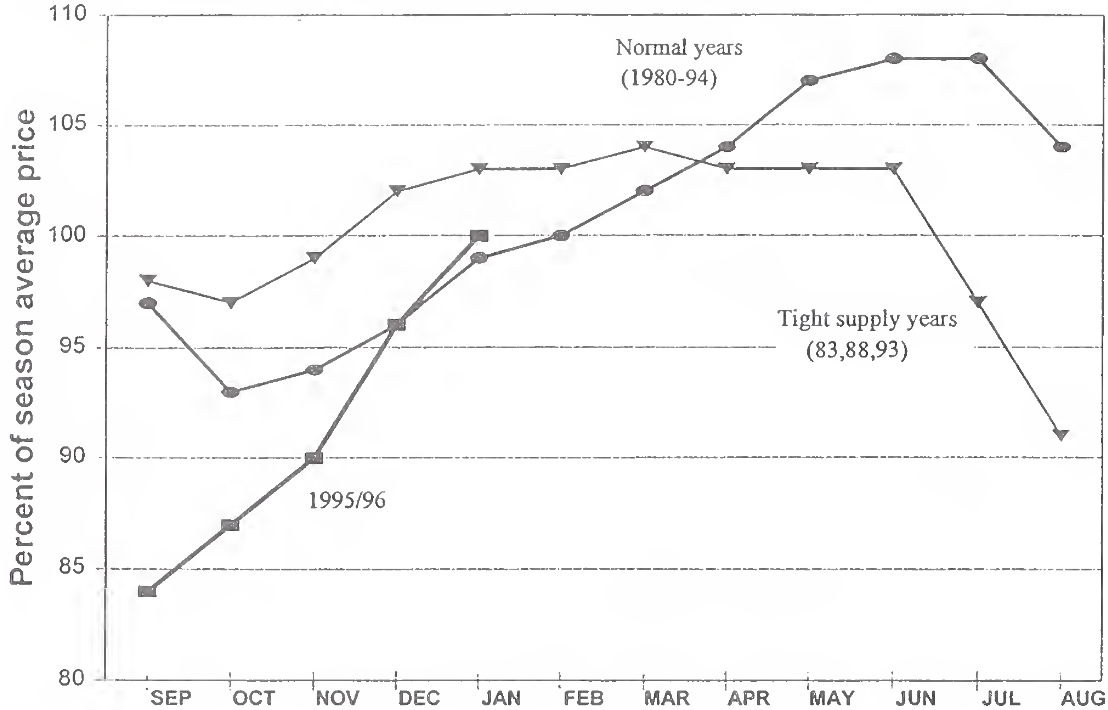
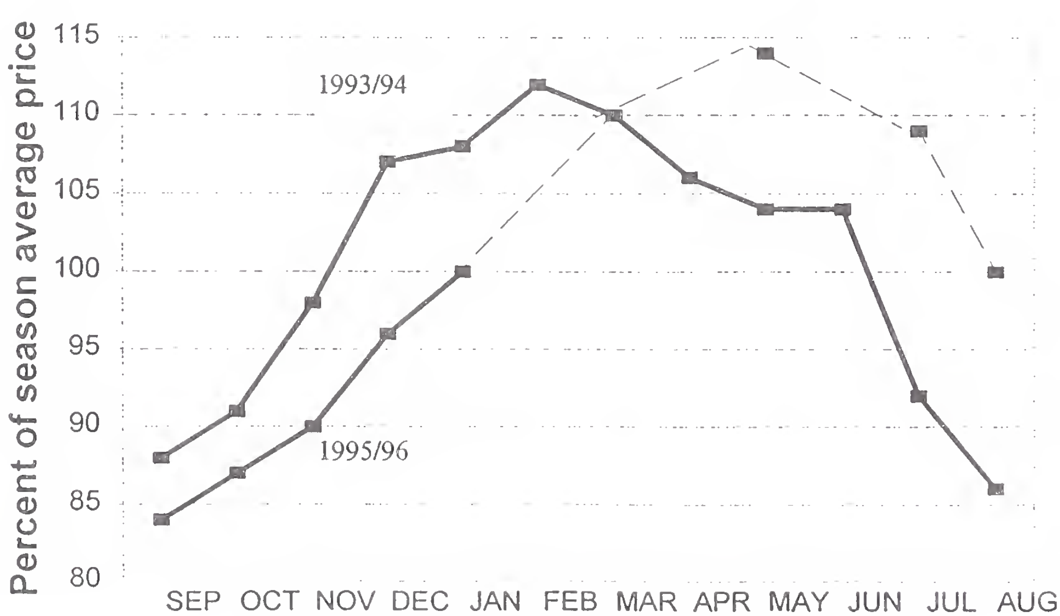


CHART 2. SEASONAL FARM PRICE PATTERNS FOR CORN



Note: Projections are mid-February CBOT Futures Prices for delivery month adjusted to farm level.