A Resurgent Rural Economy Spurs Farmland Values

By Jason Henderson and Nancy Novack

The rural economy broke free from the reins of recession in 2004 with an especially strong performance in the farm sector. Net farm income easily surpassed the record high of 2003. And the weakness that plagued the nonfarm rural economy in recent years appears to have been replaced with stronger job growth and higher incomes.

Strong performances in the farm and nonfarm sectors have led to soaring land values. Rising incomes are often capitalized into asset values, and the past year was no exception. Rising rural incomes quickly led to strong land value gains. Since real estate is rural America's most important asset, strong land values are often viewed as an indicator of a healthy rural economy.

Looking ahead to 2005, healthy rural incomes in agriculture and on Main Street will continue to underpin farmland value gains. While farm incomes are expected to remain strong, the industry must keep a close watch on trade developments and an emerging disease threat to the soybean crop. The nonfarm economy is expected to strengthen with the rest of the nation. Growth in jobs and wages in high-skilled industries is a welcome sign for rural America in its quest to build new economic engines in high-skilled activities.

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This article reviews the performance of the rural economy in 2004 and looks ahead to the prospects for 2005. The first section focuses on the booming farm economy in the past year. The second section discusses the recovery in the nonfarm rural economy. The third section examines the influence of stronger farm and nonfarm incomes on farmland values. And the final section looks at the issues facing the rural economy in the coming year.

I. A RECORD YEAR FOR FARM INCOME

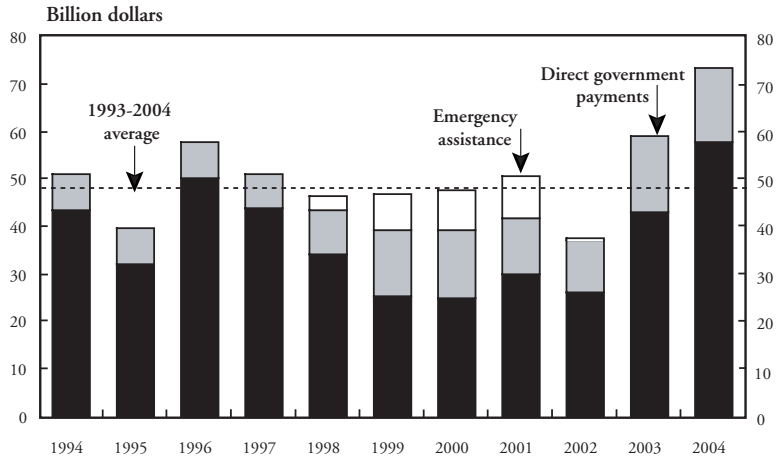
U.S. agriculture had a stellar year in 2004. Cattle producers started the year confronting markets in disorder after the outbreak of Mad Cow disease. But, overall, livestock producers enjoyed robust demand and strong prices. The nation's crop producers reaped bountiful harvests aided by widespread favorable growing conditions. As a result, net farm income soared to a record at $73.7 billion, shattering last year's record of $59.2 billion (Chart 1).

A healthy year for livestock

The U.S. livestock sector enjoyed a banner year in 2004, fueling the surge in U.S. farm income. Total livestock receipts increased an estimated $16 billion, or 15 percent above the previous year. Cattle producers survived the Mad Cow scare of late 2003 and posted another strong year. Profit opportunities leapt for hog and poultry producers as well, as demand for pork and poultry rose with trade bans against U.S. beef. Dairy producers enjoyed a profitable year as production was unable to keep up with demand.

The cattle industry began 2004 deeply concerned about the lingering effects of the Mad Cow incident that hit in December 2003. The discovery of the disease in a single U.S. dairy cow sent cattle prices tumbling 20 percent as countries around the globe banned U.S. beef imports. But by early spring, exports to Mexico resumed and prices began to strengthen. Borders of other major export markets remained closed to U.S. beef, but strong domestic demand and tight supplies allowed prices to rise. For the year, fed cattle prices averaged an estimated $84.60, in line with 2003 and well above the five-year average.

Chart 1
U.S. NET FARM INCOME

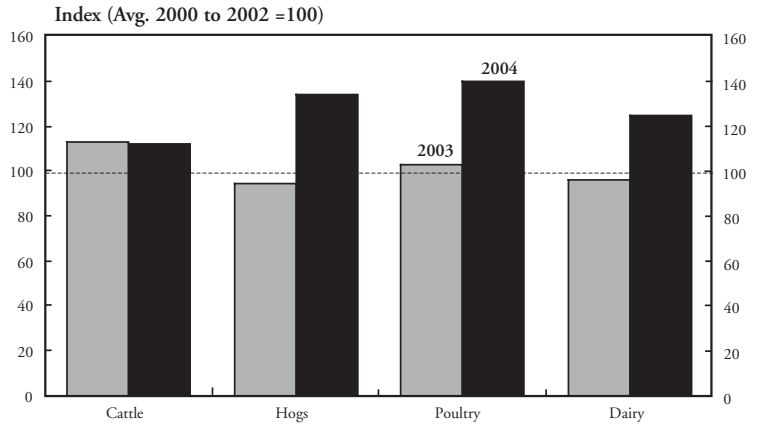


Source: USDA

While the Mad Cow impacts on fed cattle prices were fairly short lived, profits for some cattle feeders were trimmed by the record high feeder cattle prices. Supplies of feeder cattle remained tight throughout the year, partly because the U.S. border remained closed to Canadian imports. And, pasture conditions improved dramatically in some previously drought-ravaged areas, increasing demand for feeder cattle. By summer, prices topped $120 per hundredweight. Prices for feeders moderated late in the year and averaged an estimated $105 per hundredweight for 2004. As a result, cattle and calves receipts came in less than 1 percent below the 2003 record highs (Chart 2).

U.S. hog producers were profitable for much of 2004 following two years of losses. Strong demand, especially from overseas, was the primary driver in the pork market. Pork exports received a boost from the bans placed on U.S. beef, surging 23 percent above the previous year. Even though pork production increased in 2004, the strong demand resulted in prices that actually strengthened throughout the year. Prices in the second half of the year were well above $50 per hundredweight. Hog prices averaged an estimated $52.79 in 2004, up more than $13 from the previous year. As a result, receipts for hog producers jumped 42 percent above the previous year.

Chart 2
U.S. LIVESTOCK RECEIPTS



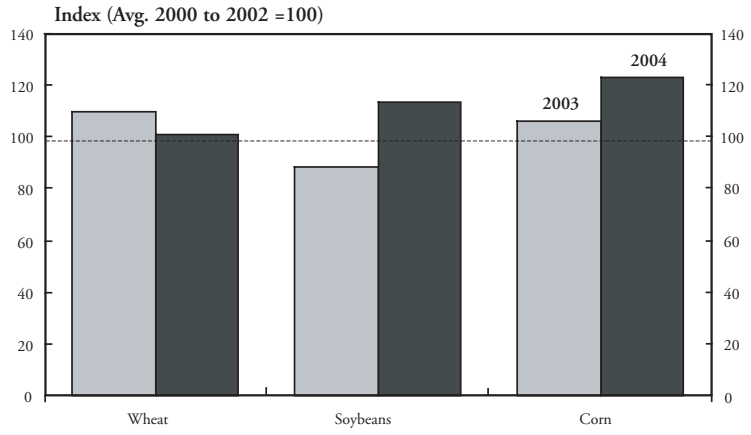
Source: USDA

Poultry and egg industries made a significant contribution to the rise in farm income. Poultry and egg receipts were $5.7 billion higher in 2004, with much of the increase coming from higher broiler receipts. Broiler production was up, but the production gains held off until the second half of the year. Thus, stocks were tight in the first half of 2004, allowing prices to move upward. In addition, strong prices for beef and pork boosted demand for chicken, and per capita broiler consumption increased about 3.5 pounds in 2004. Strong domestic demand and modest increases in production underpinned broiler prices. Broiler prices averaged 74.2 cents per pound in 2004, more than 12 cents higher than in 2003.

Dairy producers posted strong returns in 2004 due to limited production growth and strong prices. Milk cow numbers were down significantly in the first two quarters and finally reached year-ago levels in the fourth quarter. In addition, growth in milk cow efficiency, or the production per cow, was limited due in part to continued forage problems. Milk production for the year was up, but not enough to offset the rise in demand. On a milk-fat basis, commercial milk use exceeded production by an estimated 5.1 billion pounds. Milk prices for the year averaged a record $16 per hundredweight, up 28 percent from 2003. For the year, dairy receipts surged 30 percent.

Chart 3

U.S. CROP PRODUCTION



Source: USDA

Big crops boost crop receipts

Large crops and relatively strong prices also contributed to the income gains posted by the farm sector. Strong prices early in the year and large fall harvests boosted crop receipts. After a strong spring rally, prices dampened with expectations of large fall crops. Although bumper crops pushed commodity prices below the government loan rates in the fall, government payments are expected to remain at year-ago levels.

Crop production surged in 2004 as favorable growing conditions held for most of the year (Chart 3). U.S. corn producers led the charge by harvesting another bumper crop in 2004 with ideal growing conditions in many corn growing regions. Excessive moisture in the spring and an early frost caused concern in a few areas, but in the end the impact was minimal. Crop production estimates climbed throughout the growing season. The most recent estimate came in at more than 11.7 billion bushels, 16 percent above the record crop of 2003. Although more acres were planted to corn in 2004, the real driver was corn yields. The average corn yield exceeded 160 bushels per acre—nearly 20 bushels more than 2003.

U.S. soybean production in 2004 was also the largest on record. Wet conditions delayed spring planting in some areas, but a mild summer led to ideal growing conditions at the critical stages of the crop's development. As with corn, soybean yields were the main force behind the big crop. A new record average yield was set at just shy of 43 bushels per acre. The strong yields and slightly higher acreage led to production that topped 3 billion bushels, 9 percent larger than the previous record crop of 2001.

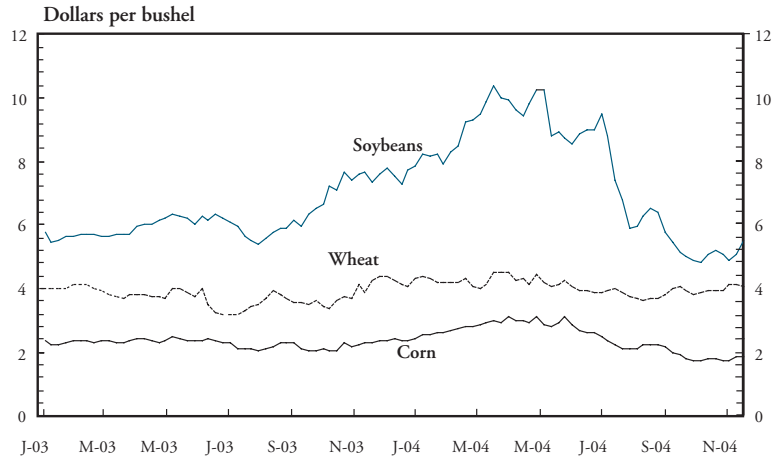
Wheat production fell below 2003 but remained above the five-year average. The decline was a result of both smaller acreage planted to wheat and lower yields. Lingering drought conditions in major winter wheat producing regions led the decline in production. The spring wheat crop was larger than in 2003, offsetting some of the winter wheat production declines. In the end, the total wheat crop was off 8 percent from a year ago but just above the five-year average.

Crop prices went on a roller-coaster ride in 2004 (Chart 4). The year began with short crop supplies, particularly for soybeans, and strong export demand. By early 2004, soybean prices had already rallied above $7 per bushel after a short 2003 crop. Meanwhile, estimates for the South American crop were trimmed prior to the harvest. With smaller crops in both the United States and South America, world soybean supplies fell to near historical lows, driving prices to record highs. In mid-March, soybean prices topped $10 per bushel. Corn prices also followed the higher price path of soybeans. And wheat prices, on expectations of a smaller wheat crop, moved higher at the same time.

In the midst of dwindling production numbers, demand for U.S. soybean exports was on the rise. China had placed large orders for soybeans and followed through on the purchases in the early months of the year. However, the rising cost of soybeans began to put financial strain on the Chinese soybean crushing industry. As a result, in May China cancelled some contracts to purchase U.S. soybeans. Soybean prices fell from more than $10 to around $8.50 per bushel, and corn and wheat prices followed. Prices remained resilient in early summer, but when the large fall crop production estimates started coming in, soybean prices tumbled once again, eventually falling below the government loan rates. Although post-harvest lows were below a year ago, average prices for the entire calendar year were above 2003.

Chart 4

CROP PRICES



Source: *The Wall Street Journal*

Strong incomes lead to healthy farm finances

The strong farm income picture underpinned healthy farm finances in 2004. Farm credit conditions and financial ratios improved from the previous year, and led to strong capital expenditures for farm equipment.

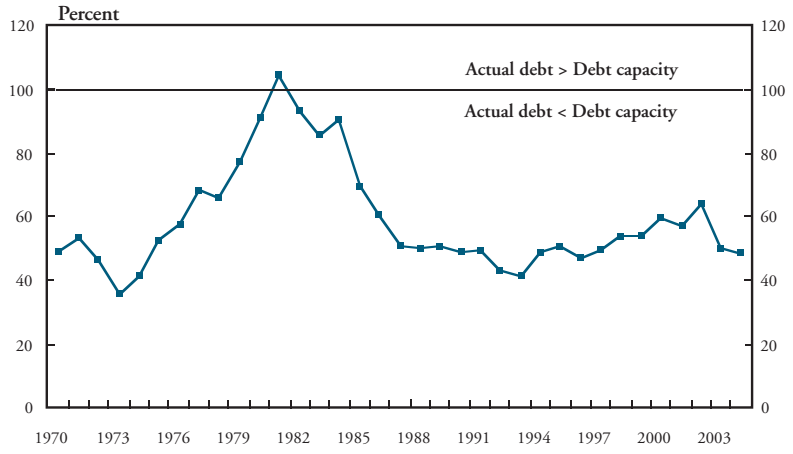
Record farm incomes boosted farm credit conditions. According to agricultural credit surveys conducted by Federal Reserve banks, loan repayment rates were strong in 2004. Through the first three quarters of the year, respondent bankers in the Kansas City and Minneapolis districts reported higher rates of loan repayments relative to the previous year. Renewals and extensions also suggested strength in farm loan portfolios. In the Dallas District, only 2 percent of respondents reported an increase from 2003 in requests for renewals and extensions.

Farm financial ratios illustrate the strength in the farm balance sheet. Both the farm debt-to-equity and debt-to-asset ratios continued to decline. Farm debt rose again in 2004, with the majority of the increase coming from real estate debt. However, rising farm asset values kept financial ratios in check. USDA's farm debt repayment capacity

Chart 5

U.S. FARM DEBT CAPACITY UTILIZATION

(Actual debt/debt that could be repaid with current income)



Source: USDA

utilization ratio, which measures farmers' ability to repay debt with current income, also declined in 2004 (Chart 5). Accordingly, farmers appeared to be in a good position to service their debt. Still, farmers with excessive debt burdens or those with production losses may have a difficult time meeting financial obligations.

Record farm incomes fueled a surge in capital expenditures in 2004. According to Federal Reserve surveys, bankers reported higher capital spending relative to a year ago. One-fourth of respondents in the Kansas City District and more than one-third of respondents in the Minneapolis District reported increases in capital spending. According to the Association of Equipment Manufacturers, farm equipment sales rose sharply in 2004. As of November, large tractor sales were up about 40 percent and combine sales were up 49 percent for the year.

II. AN UPTURN ON MAIN STREET

After two years of weak growth, the Main Street recovery gained steam in 2004. Both rural job and income growth rebounded in 2004. The growth was broad based as both service- and goods-producing

sectors led to rural job and income gains. Rural America appears to be planting seeds for a new economy, as many of the gains were in high-skilled occupations.

An end to the jobless recovery

The rural nonfarm economy emerged from a jobless recovery in 2004 by posting job gains. Since the end of the recession in November 2001, rural areas faced a jobless recovery, where renewed economic growth failed to produce new jobs. At the start of 2004, rural economies slowly began to add jobs. By October, rural job levels were almost 2 percent above a year ago. Growth in the rural economy outpaced metro growth during the year as rural businesses were adding jobs at a faster clip than the 1.0 percent gains posted by their metro counterparts. Stronger job growth led to a decline in the non-seasonally adjusted unemployment rate to 5.2 percent, down from 5.6 percent in 2003.[1]

Jobs gains were broad based as both service- and goods-producing sectors posted stronger growth (Chart 6). By October, rural service-producing firm payrolls had risen 2.0 percent above a year ago and outpaced gains in metro firms. Rural service-producing job gains were led by strong growth in professional and business services, transportation, wholesale trade, and utilities jobs.

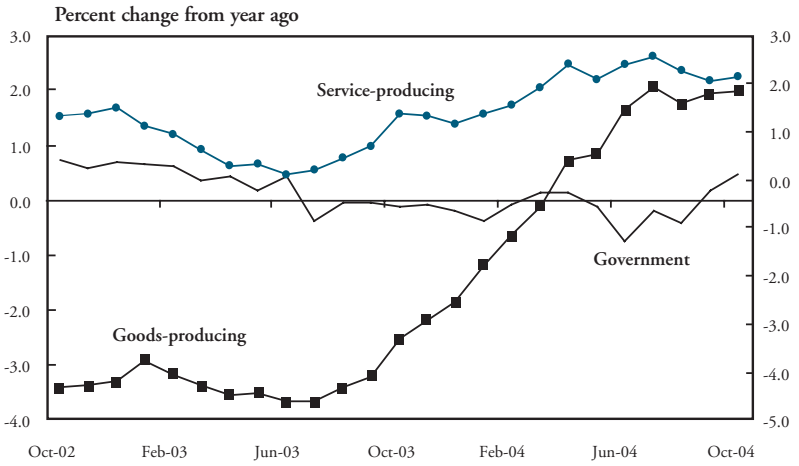
Goods-producing sectors rebounded sharply in 2004. After posting 2.0 percent declines in 2003, rural goods-producing sector jobs were 2.0 percent above a year ago in October. Despite a recovery, job growth in rural goods-producing firms still trails metro growth.

Pacing the growth in the goods-producing sector were construction and mining. In October, jobs in those industries climbed to 6 percent above a year ago. Strong energy prices supported an expansion in mining and oil and gas extraction. Construction also posted strong gains as the value of rural building permits rose above the record levels posted in 2003.

Manufacturing appears to have stopped hemorrhaging jobs in 2004. Rural factories posted 0.3 percent job gains in the year ending in October, after declining 4 percent in 2003. The number of rural factory closures fell well below the 2003 level.[2]

Chart 6

U.S. RURAL BUSINESS JOB GROWTH



Source: Calculations based on Bureau of Labor Statistics data

A stronger recovery boosts rural incomes

A strengthening national economy also helped propel higher rural incomes. In 2004, rural workers enjoyed strengthening incomes as average weekly nonfarm earnings in the first ten months of the year were up 3.3 percent from a year ago. Rural earnings growth was stronger than the 2.7 percent average in metro areas during the year.

Income gains were broad based as workers in government and the service- and goods-producing sectors reported higher average earnings. Despite lower job levels, government workers reported the strongest income gains, as earnings rose 12 percent above a year ago in October and remained stronger than the gains in metro areas.

Earnings in the goods-producing sector rose 2.5 percent in rural places. Strong wage gains in construction and mining more than offset weaker earnings in manufacturing. A contraction in rural manufacturing earnings, coupled with gains in metro manufacturing earnings, resulted in lower goods-producing earnings for rural firms.

Earnings in rural services industries rose 1.6 percent, led by strong gains in information, education and health, and professional and business services. These industries posted stronger earnings growth than in metro areas. As a result, growth in the rural service-producing sector was stronger on average than for their metro counterparts.

High-skilled growth propels the rural recovery

While growth embraced all sectors of the rural economy, it was especially strong in the high-skilled industries. Indeed, industries that employ high-skilled workers led rural job growth. In addition, high-skilled occupations in rural areas posted stronger income gains than in metro areas.

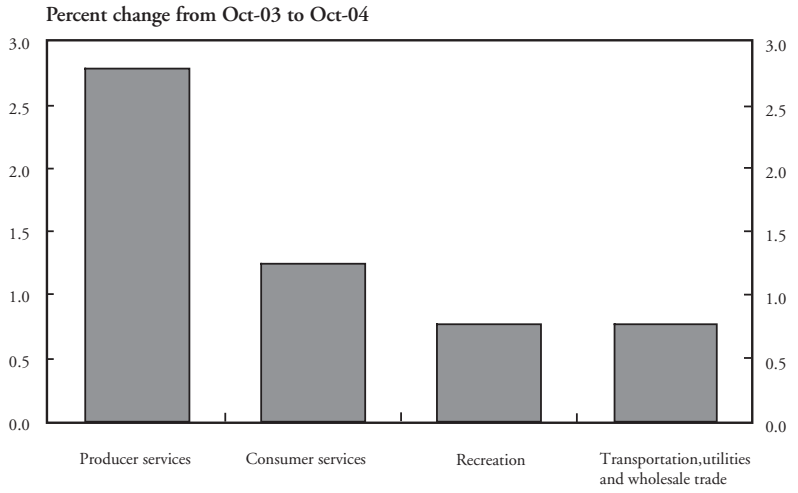
High-skilled industries in rural America posted stronger job and income gains in 2004 than during the previous year. The producer service industries—professional and business services, financial, and information services—expanded job rolls 3.8 percent in the year ending in October, up from 2.8 percent in 2003 (Chart 7). Producer service industries account for roughly 13 percent of all rural jobs and tend to employ a larger share of people with higher levels of education. In contrast, jobs in consumer services—education, health care, and retail trade—rose just 1.6 percent, with the strongest gains in the higher-skilled education and healthcare industries. Education and health service industries account for another 12 percent of rural jobs. Meanwhile, recreation firms, which have the smallest share of jobs filled by people with higher educations levels, rose 0.9 percent.[3]

Workers in high-skilled industries also enjoyed stronger increases in pay. In October, average earnings in producer services rose 6 percent above a year ago. While earnings in consumer services rose 1.8 percent overall, stronger gains were posted in the education and healthcare industries, which employ more highly educated people. Earnings in recreation industries edged down in 2004.

Stronger income growth in high-skilled industries was driven in large part by stronger income growth in high-skilled occupations. In October, the average weekly earnings in professional occupations were up 8.1 percent from year-ago levels, outpacing metro growth.[4,5] Rural earnings were up 5.4 percent from a year ago in management,

Chart 7

RURAL SERVICE-PRODUCING JOB GROWTH



Source: Calculations based on Bureau of Labor Statistics data

financial, and business occupations, compared to a slight decline in metro earnings. While lower-skilled occupations—production and installation, maintenance, and repair occupations—posted income gains, the growth in the average rural weekly earnings lagged growth in metro earnings.

III. LAND VALUES SOAR IN 2004

Stronger incomes on the farm and on Main Street boosted rural land values. Soaring farm incomes were quickly capitalized into farmland prices, while robust nonfarm activity supported both residential and commercial demand—and thus the price of land. Further, higher incomes allow people to enjoy more leisure time, thus boosting the recreational demand for land.

Record farm incomes underpin land values

Boosted by record-high farm incomes in 2004, farmland values soared. Farmland values derive from the capitalized value of future farm income streams (Burt, Moss, Phipps). In other words, rising farm incomes and the expectation of future income gains lead to higher land values.

While farmland values rose sharply nationwide in 2004, the strongest gains appeared to emerge on the East and West coasts. According to agricultural credit surveys conducted by various Federal Reserve banks, farmland values rose 15 percent in the Richmond District and 33 percent in the San Francisco District. Strong double-digit gains were also posted in the Chicago, Kansas City, and Minnesota districts.[6]

Evidence is mounting that government payments are being capitalized into farmland values. Government payments are an additional income stream that is factored into the capitalization formula. In 2000, USDA estimated that government payments accounted for 30 percent of the capitalized value of farmland on average—and over 70 percent in some regions (Ryan and others). More recently, some analysts estimate that 45 percent of the capitalized value of Iowa farmland derives from government payments (Barnard, Duffy and Holste).

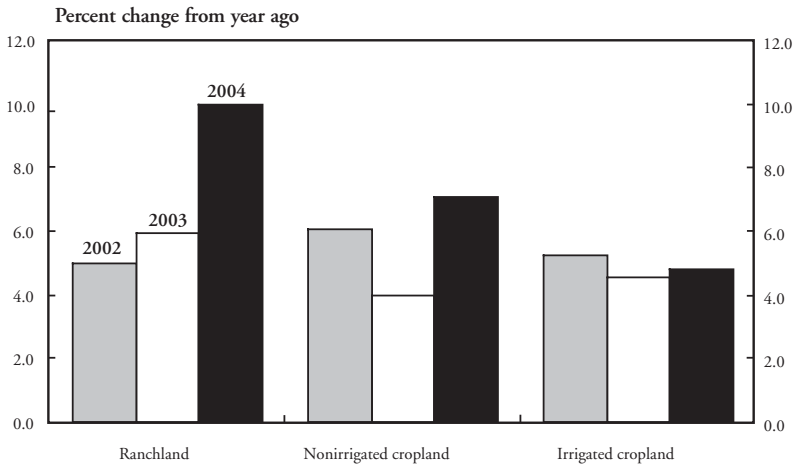
Federal Reserve agricultural credit surveys also reveal that gains vary by land type. For example, in the Kansas City District, gains in the value of irrigated cropland lagged gains in nonirrigated cropland, as high energy costs boost irrigation costs and limit profits on irrigated land (Chart 8). Ranchland values posted the strongest gains, 10 percent above a year ago in 2004. The surge in ranchland values coincided with the persistence of record high feeder cattle prices, but ranchland also is being converted more rapidly to urban use. Ranchland is often cheaper than other rural land, while it often offers scenic attraction.

Nonfarm demand fuels land value gains

Even with record farm incomes, farmland value gains appear to be driven in large part by the rising tide of nonfarm demand. The surge in

Chart 8

KANSAS CITY FEDERAL RESERVE DISTRICT LAND VALUE GAINS (SECOND QUARTER)



Source: Federal Reserve Bank of Kansas City

farmland values along the densely populated East and West coasts is one clear indicator of the nonfarm impact on farmland values. Another indicator of the increasing importance of nonfarm demand is the mounting gap between farmland values and cash rents.

Farmland values should reflect the capitalized value of future cash rent payments. Yet, farmland values are rising faster than the revenue stream from agricultural production (cash rents). Since 1998, cropland cash rents have risen just 15 percent, compared to a 32 percent rise in cropland values.[7]

Several nonfarm demand factors appear to be contributing to strong land value gains.[8] The relatively weak performance of the stock market fuels the demand for land as an alternative asset. The continued expansion of urban areas boosts the demand for land in commercial and residential use. And rising recreational demand is underpinning strong farmland value gains.

Farmland values and other real estate prices are influenced by changes in other asset values. During the recession, declines in the stock market enticed investors to search for alternative investment opportuni-

ties. With 30 percent declines in the stock market from 2001 to 2003, an average annual 5 percent gain in farmland values became an attractive investment opportunity.[9] Also, when housing values rise, investors often purchase farmland for future development in locations close to a city or in areas with stronger economic growth.

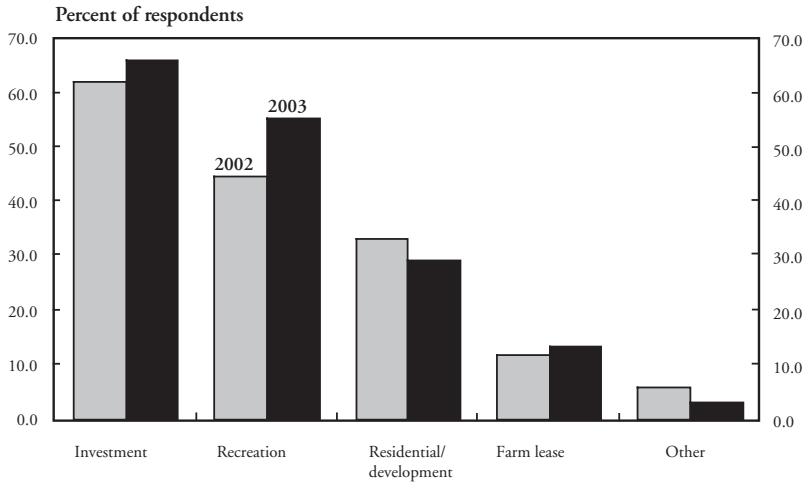
Urban expansion continues to boost land values as farmland is converted from agricultural to urban use. The conversion of land to urban use intensified during the economic expansion of the 1990s. From 1992 to 1997, roughly 1.4 million acres of land annually were converted to urban use—a figure that is 40 percent higher than the historical average. Land in urban use typically generates higher income streams and creates higher values for farmland that is transitioning out of agricultural production. In Indiana, the value of farmland moving out of agriculture was $6,000 per acre, compared to $3,278 per acre for top quality cropland in agriculture (Dobbins and Cook). Since farmland next to existing urbanized areas has a higher probability for future conversion, land next to urban areas typically has higher values. For example, the average price of farmland sold in counties adjacent to the Minneapolis/St. Paul metro area was 24 percent higher than farmland sold in out-state counties.[10]

The impacts are now spilling well beyond metro areas with 1031 tax exchanges. The 1031 tax exchanges allow sellers of land to limit capital gains taxes by purchasing similar types of land in alternative locations. Now farmers close to metro areas, like Kansas City, have a tax incentive to sell their farmland and purchase land in western Kansas. The tax exchanges have emerged as a mechanism that transforms the rising demand for land near urban centers into a rise in demand for land in more remote areas.

Land purchases for investment as an asset or for urban use also appears to be driving nonfarm demand for land. Since 2002, agricultural bankers responding to the agricultural credit survey in the Kansas City District revealed that investment purchases have become the biggest nonfarm demand influence on farmland values. Over 70 percent of the bankers revealed that farmland purchases were driven by investment decisions (Chart 9).

Chart 9

REASONS FOR FARMLAND PURCHASES BY NON-FARMERS



Source: Federal Reserve Bank of Kansas City

Note: Respondents were asked the most common reasons for farmland purchases by individuals other than farmers. Respondents could choose more than one response and therefore percentages will not sum to 100.

The survey also revealed that recreation is an increasingly important influence on farmland demand. In 2003, over 55 percent of the bankers reported that recreational demand was a reason for farmland purchases, up from 45 percent in 2002. Wildlife recreation—hunting, fishing, and wildlife watching—has not only been a significant contributor to growth in rural businesses, such as Cabela's and Bass Pro Shop, but also a contributor to land value gains. In 2001, wildlife recreationers spent $12 billion on land leasing and ownership, up from $7 billion in 1996. The bulk of the land expenditures were spent on land ownership. In comparison, $11 billion was received in government payments by farmers. In 2002, 28,000 farmers reported earning $202 million from recreation services. While recreational services were an income supplement for most farmers, 7 percent earned more from recreational services than the average per capita income of $23,362 in rural counties.

IV. THE RURAL ECONOMY IN 2005

Looking ahead, the foundation is set for another solid year in the rural economy, although some challenges shade the horizon. Farm incomes are expected to remain robust in 2005, despite several factors: the disappearance of the agricultural trade surplus, a new disease threat to the soybean crop, and the persistence of drought in some areas. The Main Street economy is also expected to strengthen in 2005. Overall, robust farm and nonfarm economies should underpin healthy land value gains in the year ahead.

Can a strong livestock sector produce a healthy farm economy?

Farm incomes in the year ahead will likely fall from the record highs set in 2004 but remain healthy by historical standards. Livestock prices are expected to remain strong, and increased government payments should offset declining crop revenues from lower prices. The final outcome for farm income will rest heavily on the persistence of drought, the prospects for agricultural trade, and whether a nascent soybean disease gains a hold over the 2005 crop.

Historically high prices could produce broad gains in the livestock sector and underpin a healthy farm economy. Despite edging down from 2004 highs, livestock prices are expected to remain above their historical average in 2005 (Table 1). Strong domestic and international demand for protein will underpin high livestock prices.

In contrast, crop revenues in 2005 may not be as robust. Crop prices are expected to fall well below the levels posted last year but remain above the lows of 1998 to 2001. Wheat prices are expected to fall 3 percent.[11] Corn and soybean prices are expected to drop 20 to 30 percent below last year but remain above the 1998-2001 levels.

Potential farm income losses from lower crop prices could be offset, at least in part, by increased government payments. Under the most recent farm bill, lower prices will trigger higher payments under the loan deficiency and countercyclical programs. Over the past two years, government payments have averaged $15.8 billion. High crop prices over the past two years have kept government payments below expected levels in 2002, when the farm bill was passed.

Table 1

USDA PRICE PROJECTIONS

Livestock prices

	2005	2004	Average 2001 to 2003
	Dollars per cwt.		
Choice steers	86.00	84.22	74.81
Feeder steers	97.00	104.46	86.03
Hogs (barrows and gilts)	49.00	51.67	40.06
Broilers	72.50	74.60	58.90
Milk	13.35	15.95	13.20

Crop prices

	2004/05	2003/04	Average 1998 to 2001
	Dollars per bushel		
Corn	1.90	2.42	1.90
Wheat	3.35	3.40	2.63
Soybeans	4.95	7.34	4.46

Source: Livestock, Dairy, and Poultry Report and World Agricultural Supply and Demand Estimates, USDA, December 2004

Will weather, disease, and trade limit farm incomes?

Crop prices could strengthen in the marketplace if weather and disease problems develop. Weather problems are an annual source of uncertainty for crop producers. In 2004, drought conditions eased across the country. This year, subsoil moisture remains low, and a lack of moisture over the winter and into the spring could rekindle drought concerns.

Soybean rust has raised concerns for the 2005 crop. Soybean rust is a fungus that can significantly trim soybean yields. In 2004, soybean rust significantly cut the South American harvest and led to record high prices last spring. The fall hurricane season appears to have brought soybean rust from South America to U.S. soil. In November and December, soybean rust was detected in nine states, spreading from the South to Missouri and Tennessee. Fungicide treatments are expected to raise production costs $25 per acre. USDA estimates that losses could range from $164 million to $1.2 billion, depending on the geographic spread of the disease and associated yield losses (Livingston and others). Economic impacts will be highly variable given weather conditions and

geographic spread. Soybean prices rose 12 percent after the discovery of soybean rust. The USDA estimates that soybean incomes could fall by 20 percent with high geographic spread and a 10 percent yield loss. Threats of the disease could alter the 2005 crop mix as some soybean farmers may elect to plant alternative crops.

Another factor affecting the outlook for the farm economy in 2005 will be agricultural exports. The future of farm exports is uncertain. For the first time since the 1950s, the value of U.S. imports is expected to equal the value of U.S. exports. U.S. agricultural imports are expected to rise with increased imports of consumer and intermediate products. Import prices are rising due to rising prices for processed foods, higher transportation costs associated with high energy costs, and a decline in the value of the dollar. Despite the higher import prices, rising U.S. consumer income is boosting overall import demand.

In contrast to rising imports, the value of U.S. ag exports is expected to fall 10 percent in 2005. Bulk commodity exports should account for all of this loss. Bumper harvests in the United States and South America are driving prices so low that, even with a larger quantity of U.S. bulk commodity exports, their total value is expected to fall 21 percent.

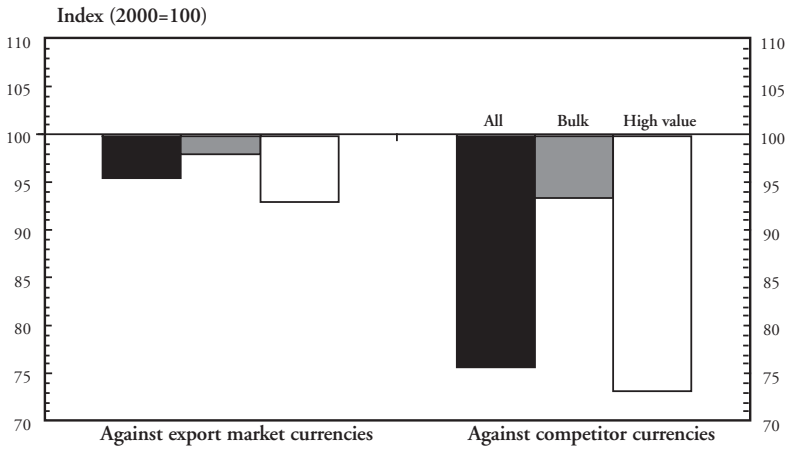
The devaluation of the dollar may not lead to a sharp boost in U.S. farm exports. The dollar has fallen sharply against world currencies in 2004. However, China and other Asian markets that account for the majority of U.S. agricultural exports peg their currencies to the U.S. dollar. As a result, the agricultural trade-weighted value of the U.S. dollar has dropped only 4.4 percent against the currencies in our export markets (Chart 10). The falling dollar will not make U.S. agricultural goods cheaper in these markets and will limit the boost in demand expected from a falling dollar.

The impacts of a weaker dollar could vary by type of product exported. The dollar has fallen roughly 25 percent against the currencies of our major agricultural competitors, making goods from other countries more expensive (Chart 10). The strongest declines have occurred against competitors in high-valued consumer and intermediate agricultural products—mainly Canada, Australia, and the European Union. In contrast, the dollar has fallen only 6 percent against competitors in

Chart 10

REAL TRADE-WEIGHTED EXCHANGE RATES

(September 2004)



Source: USDA

bulk-commodity markets, mainly Brazil and Argentina. Thus, the devaluation of the dollar is expected to drive bigger impacts on consumer and intermediate products than bulk commodities.

Will rural job growth continue?

Healthy farm incomes are expected to coincide with strong Main Street activity in the year ahead. Continued strength in the national economy should help propel rural growth. Rural areas appear to be forging a beachhead into a new high-skilled economy. However, the ability of the government sector to post job gains may be limited due to rising federal deficits and tight state budgets.

Private sector forecasters expect another relatively strong year for the national economy in 2005. Economic growth could be broad based, as both manufacturing and nonmanufacturing sectors are expected to strengthen. According to the ISM survey of purchasing managers, manufacturing revenues are expected to rise 7.8 percent and employment

1.6 percent. In the nonmanufacturing sectors, revenues are expected to rise 5.9 percent, leading to 3.1 percent gains in employment. Job gains are expected to be strong in industries employing more high-skilled people.

Rural areas should continue to enjoy the renewed strength of the national economy. Rural job growth continued to strengthen heading into 2005, with growth strongest in the second half of 2004. Goods-producing sectors posted the strongest gains. The lower value of the dollar should support U.S. exports and help underpin job growth at rural factories in the year ahead.

However, the lack of government sector job gains could limit rural growth. Federal deficits remain large. And with a continued Iraq War, pressure to limit domestic spending has intensified. While state and local government revenues have stopped their freefall, the rebound may not be strong enough to both replenish rainy day funds and support increased spending and job creation.

Will farmland values continue to rise?

Solid farm incomes and stronger nonfarm growth in the year ahead should continue to underpin land value gains. Market-based farm revenue is expected to be healthy in 2005, but policymakers face increased pressure to change government subsidy programs. A stronger economy and renewed strength in business confidence are expected to boost business investment and spur increased demand for land in urban use.

Farm income will fuel additional farmland value gains if it remains above its historical average. Commodity prices that are expected to be at or above historical levels will underpin healthy farm income and support some gains in farmland values. However, federal policymakers are feeling increased pressure to control federal spending and reduce agricultural subsidies to restart and complete the Doha Round of the World Trade Organization negotiations. These pressures may not lead to lower government payments, but they could lead to different programs to distribute the payments. New distribution mechanisms, in turn, could change the way government payments are capitalized into land values.

A stronger national economy that boosts commercial and business development will also spur demand for land. During the recession, business investment fell sharply and for the past two years has been slow to strengthen. While business investments in computers and equipment have strengthened recently, business spending on physical structures remains slow by historical standards. A stronger economy that boosts business confidence is expected to help bolster new investments in physical infrastructure. By contrast, housing activity is expected to slow in 2005 with higher interest rates. The expected slowdown from higher interest rates could be offset in part by rising incomes due to increased employment.

The rural economy strengthened in 2004. Record high farm incomes have solidified a farm recovery. Stronger nonfarm activity solidified job gains on Main Street. Rising prosperity at the farm gate and on Main Street is leading to soaring farmland values. The stage is set for another year of healthy farm incomes, robust Main Street activity, and rising land values in many rural regions.

ENDNOTES

[1]Job growth comes from the BLS payroll survey. Unemployment rates come from the BLS household survey.

[2]Factory closures are based on BLS mass layoff statistics and include only the factory closures reporting layoffs of 50 or more people.

[3]Over 36 percent of producer service jobs were filled by people with a college education in 2000, while 26.4 and 8.3 percent of consumer and recreation jobs were filled by people with a college education (Henderson 2004).

[4]Professional occupations account for roughly 12 percent of the nonmetro occupations. Management, financial, and business occupations account for roughly 4 percent of the nonmetro occupations. Production accounts for 12 percent of nonmetro occupations, while installation, maintenance, and repair accounts for 3.3 percent of nonmetro occupations (Calculations based on the Current Population Survey data from the Bureau of Labor Statistics).

[5]Roughly 70 percent of professional occupations are filled by people with at least a bachelor's degree compared with 46 percent of management, business, and financial occupations, and 6 percent of production and installation, maintenance and repair occupations. (Calculations are based on the 2000 Census of Population and Housing, Equal Employment Opportunity file.)

[6]The San Francisco Federal Reserve District covers the states of Arizona, California, Idaho, Oregon, Utah, Washington, Hawaii, and Alaska. The Richmond District covers the states of South Carolina, North Carolina, Virginia, West Virginia, and Maryland. The Chicago District covers the states of Iowa, Michigan, northern Illinois, northern Indiana, and southern Wisconsin. The Minneapolis District covers the states of Minnesota, South Dakota, North Dakota, Montana, and northern Wisconsin. The Kansas City District covers Nebraska, Kansas, Oklahoma, Colorado, Wyoming, western Missouri, and northern New Mexico.

[7]The gap could be driven by changes in the capitalization rate used to capitalize cash rents into farmland values.

[8]Lower interest rates can also boost farmland values. Some have argued that the historically low mortgage rates have, in part, driven the recent gains in home values. The same holds true for farmland values. Lower interest rates boost the affordability and lower the cost of mortgage for all types of uses–agricultural, commercial, and residential.

[9]From May 2001 to February 2003, the Dow Jones Industrial Average fell 28 percent and the S&P 500 fell 34 percent.

[10]Calculations are based on data from actual sales prices of farmland parcels in Minnesota. Data are available from the University of Minnesota (*http://www.cffm.umn.edu/landeconomics/landdata/*).

[11]Price forecasts were obtained from the World Agricultural Supply and Demand Estimates (WASDE) published by the USDA. The year references the final crop year. For example, 2004 references the 2003-04 crop year.

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