CENTER FOR THE STUDY OF RURAL AMERICA
Federal Reserve Bank of Kansas City

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The Main Street Economist
Commentary on the rural economy

An Economic Resurgence in the Rural Economy

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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.

Looking ahead to 2005, healthy incomes in agriculture and on Main Street will propel strong economic activity in rural America. 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. 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.

A closer look at the 2004 rural economy and the challenges that lie ahead appears in the first quarter 2005 issue of the Federal Reserve Bank of Kansas City's ***Economic Review****.*

A farm income boom in 2004

During U.S. agriculture's stellar year in 2004, net farm income soared to a record $73.7 billion, shattering the 2003 record of $59.2 billion. U.S. livestock fueled the surge in U.S. farm income, while a strong spring price rally and bumper crop led to a sharp rise in crop receipts.

The cattle industry remained strong and cattle and calves receipts came in just below the 2003 record highs. Strong domestic demand and tight supplies underpinned cattle prices. Feeder cattle prices were especially strong and reached record levels.

Boosted by strong export demand, hog prices strengthened, boosting hog receipts 42%. Poultry and egg receipts were $5.7 billion higher, with much of the increase coming from higher broiler receipts. Dairy producers posted strong returns—milk prices were up 28% and dairy receipts surged 30%.

Crop production surged, aided by favorable growing conditions. U.S. corn and soybean producers led the charge by harvesting record crops. Wheat production fell but remained above the five-year average. Crop prices went on a roller coaster ride. By mid-March, soybean prices topped $10 per bushel, and corn and wheat prices followed the higher price path of soybeans. Prices remained resilient into early summer, but when the large fall crop production estimates started coming in, prices tumbled, eventually falling below the government loan rates.

Record farm incomes boosted farm finances. Federal Reserve agricultural credit surveys indicated that loan repayment rates strengthened and requests for loan renewals and extensions waned. Record farm incomes also fueled a jump in capital expenditures. As of November, the Association of Equipment Manufacturers reported that large tractor and combine sales were up about 40% and 49% for the year, respectively.

An upturn on Main Street

The rural nonfarm economy emerged from a jobless recovery in 2004. Rural economies had slowly begun to add jobs early in the year. By October, rural job levels were almost 2% above a year ago. In addition, growth in the rural economy outpaced metro areas. The stronger job growth led to a decline in the nonseasonally adjusted unemployment rate.

Job gains were spread across both service- and goods-producing sectors. By October, rural service-producing firm payrolls had risen 2% and were outpacing gains by metro firms. After declining 2% in 2003, rural goods-producing sector jobs were 2% above a year ago in October. Construction and mining activity was robust and rural factories added jobs.

A strengthening national economy also helped propel higher rural incomes. Rural workers enjoyed stronger incomes as average weekly nonfarm earnings in the first ten months of the year were up 3.3%, compared to 2.7% in metro areas. Earnings rose in both the rural goods- and service-producing sectors.

While growth embraced all sectors of the rural economy, it was especially strong in high-skilled industries. Job rolls and incomes were both stronger in rural high-skilled industries than in the previous year. Producer service industries employed a larger share of high-skilled workers and enjoyed the strongest increases in job rolls and wages. Gains in consumer services were led by education and healthcare, industries that employ more highly educated people.

The rural economy in 2005

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. And the Main Street economy is expected to strengthen with the national economy.

Farm incomes should fall from the record highs set in 2004 but remain relatively healthy. Despite edging down from 2004, livestock prices are expected to be underpinned by strong domestic and international demand for protein. Beef bans related to Mad Cow disease will remain an important issue. In contrast, crop revenues may not be as robust as crop prices, especially corn and soybeans, and are expected to fall sharply. Still, crop supplies remain relatively tight, and a small South American soybean crop could underpin a spring price rally.

Crop prices could also strengthen if soybean rust develops. Soybean rust is a fungus that can significantly trim soybean yields, as it did with the 2004 South American crop. In late 2004, soybean rust was detected in the U.S. in nine states, clouding prospects for the 2005 crop. Economic impacts will be highly variable given weather conditions and geographic spread. The USDA estimates that soybean incomes could fall by 20% with high geographic spread and a 10% yield loss. Threats of the disease could alter the 2005 crop mix as some soybean farmers may elect to plant alternative crops.

Trade will be a major factor affecting the outlook for the farm economy. For the first time since the 1950s, the ag trade surplus is expected to disappear. Rising U.S. incomes are boosting the demand for high-value consumer food imports, and falling crop prices are reducing the value of U.S. food exports.

A stronger national economy should help propel rural growth. The lower value of the dollar should support U.S. exports and help underpin job growth at rural factories in the year ahead. In nonmanufacturing sectors, revenues and job gains are also expected to be strong in industries employing more high-skilled people. Government sector jobs, however, could be limited by continued pressures to keep a lid on government spending.

Survey of Agricultural Credit Conditions

Federal Reserve Bank of Kansas City
September 30, 2004

Highlights from the third quarter survey*

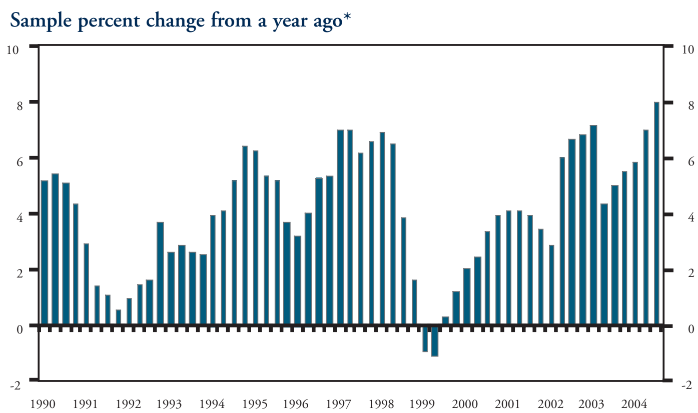
- District farmland values remained healthy in the third quarter of 2004. Ranchland values again posted double digit gains of 10.5% over the previous year. The strongest ranchland value gains were in Kansas, Missouri, and Nebraska. District cropland values were also strong. Nonirrigated cropland values increased 8.1% over a year ago, and irrigated values increased 5.8%.
- District farm credit conditions remained strong in the third quarter. The index of farm loan repayment rates moved up and was well above a year ago. Requests for renewals and extensions were sharply lower after edging up last quarter. Only 8% of respondents reported an increase in renewals or extensions. The district farm income index edged down from the previous quarter, but district bankers' assessment of farm income remained well above a year ago. Although the most recent USDA estimate of U.S. net farm income was up substantially, the lower index relative to last quarter likely reflects district bankers' concerns about the impacts of high energy prices and the high price for feeder cattle.
- The district farm commodity price index fell in the third quarter but remained above a year ago. Relative to the previous quarter, all crop and livestock prices, except feeder cattle, were lower. At the end of the quarter, fall crop prices were approaching seasonal lows and fell well below a year ago. Prices for feeder cattle and hogs remained especially strong, while fed cattle prices were below the highs posted last fall.
- Interest rates on new farm loans moved higher in the third quarter. At the end of the quarter, interest rates on new farm loans averaged 7.29% for operating loans, 7.36% for machinery and intermediate-term loans, and 6.99% for real estate loans. Since the end of September, interest rates in national money markets have moved higher.

*Note: 296 banks responded to the third quarter Survey of Agricultural Credit Conditions in the Tenth Federal Reserve District—an area that includes Colorado, Kansas, Nebraska, Oklahoma, Wyoming, the northern half of New Mexico, and the western third of Missouri.

*Please refer questions to Nancy Novack, associate economist, at 816-881-2423 or nancy.l.novack@kc.frb.org.

Nonirrigated Cropland Values

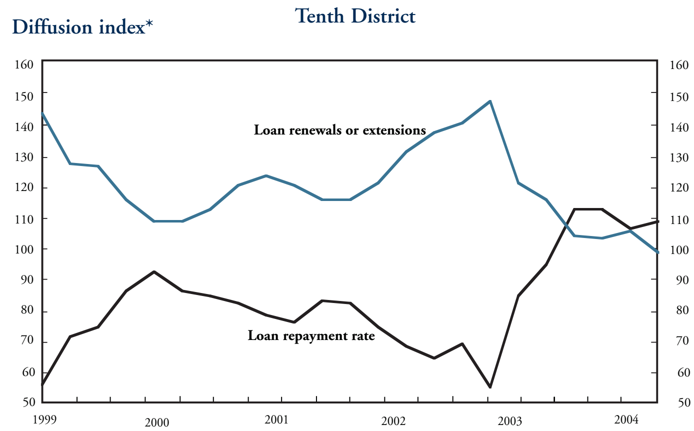
Tenth District



*Percent changes are calculated using responses only from those banks reporting in both the past and the current quarter.

Farm Credit Conditions

Tenth District



*Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100.

Summary of Economic Conditions

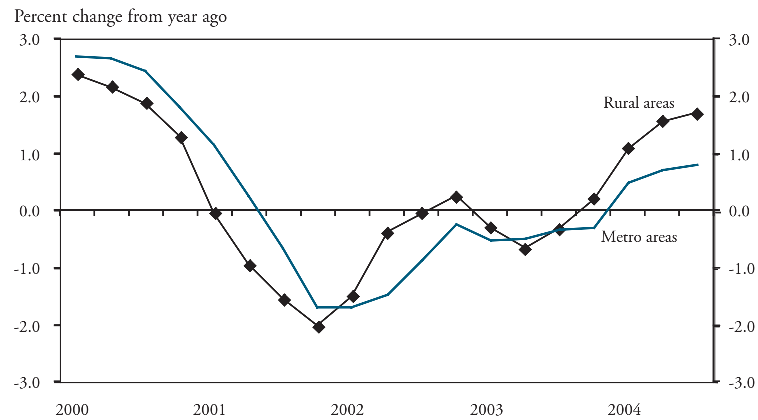
Highlights from the third quarter*

- The rural nonfarm economy continued to grow in the third quarter of 2004 with job increases of 1.7% above a year ago. The rapid acceleration in the rate of growth that began at the start of the year slowed, but the pace of growth remains strong. Job growth in metro areas was more moderate with growth of less than half the rate of rural areas.

- Service-sector growth slowed somewhat from the third quarter but remains strong at 2.1%. Job growth in the goods-producing sector climbed higher to 1.9% and was fueled in part by 6% growth in the construction sector. Manufacturing growth has been sluggish but positive for the last two quarters. Although job growth was stronger in the third quarter, the government sector continues to be a weak spot in the rural economy as governments remain cautious about new spending.

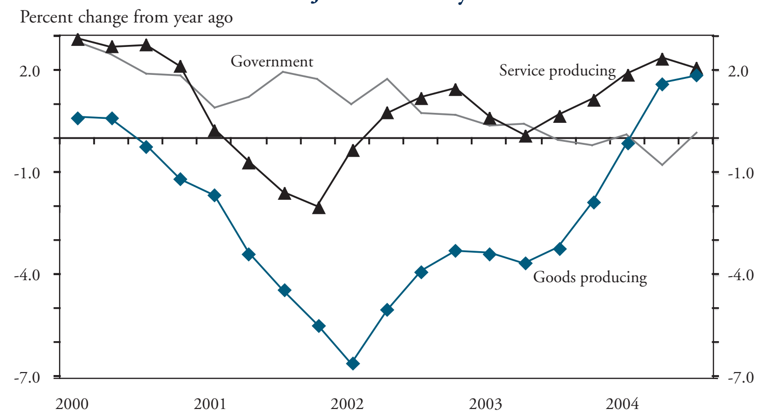
- Rural construction activity was relatively strong in the third quarter. The total number of newly issued multiunit permits was flat, while single-unit permits edged down. Downward revisions in the construction data put the total value of new building permits below year-ago levels for each of the last three quarters. The average value of permits, however, reached a new high in the third quarter.

Rural and Metro Job Growth



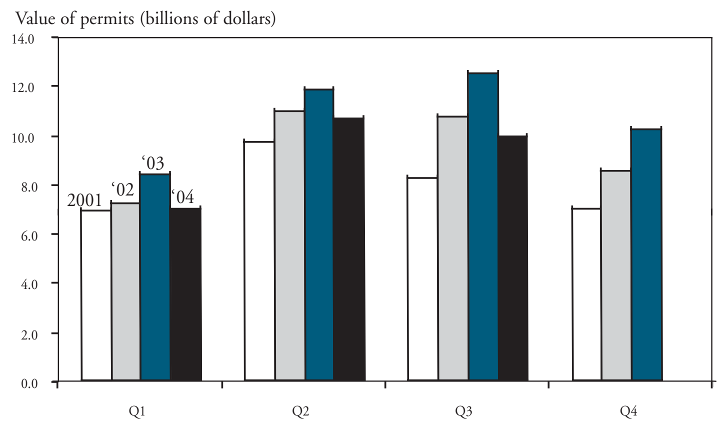
Source: Bureau of Labor Statistics

Rural Job Growth by Sector



Source: Bureau of Labor Statistics

Rural Residential Construction



Source: Bureau of Labor Statistics

Notes: Data for all tables are not seasonally adjusted. Job data were revised and reclassified in January 2003.

*Please refer questions to Sean Moore, research associate, at 816-881-4766 or sean.moore@kc.frb.org.

For more current analysis on the state of the rural farm and nonfarm economies, visit our website at *www.kansascityfed.org/ruralcenter.*