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

Will the farm rebound lead a rural recovery?

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Economic headlines in rural America were mostly positive in 2003, especially in the farm sector. Low global supplies, strong demand, and high prices underpinned strong gains in U.S. farm income. On Main Street, job losses and factory closures eased.

Still, it remains unclear whether the rural economy can build on the optimism of 2003 in the coming year. Demand for U.S. farm products remains uncertain, especially in light of the recent mad cow scare. Rural communities struggle to create the high-skill, high-wage jobs that currently pace U.S. economic growth. Despite these challenges, though, the prospect for a stronger rural economy this year looks promising.

The Farm Sector in 2003

The biggest headlines in the farm sector were written by the cattle industry. Overall, the industry enjoyed a boom year as comparatively low supplies and strong demand led to record-high prices and profits. U.S. cattle and beef supplies fell as the 2002 herd liquidations left fewer cattle for slaughter. In May, global supplies were trimmed as mad cow disease in Canada led to global bans on Canadian beef. And, domestic demand for beef strengthened as low-carb diets, such as the Atkins and South Beach diets, gained favor. The combination of short supplies and rising demand created record-high prices and profits for U.S. cattle producers.

But in December, when mad cow disease was discovered in the U.S., the nation's major trading partners banned U.S. beef imports. Cattle futures prices dropped 20 percent. Fortunately, domestic demand remained strong.

In the spring, much of the public's attention centered on drought conditions and prospects for bumper crops. By July, drought conditions had abated in most of the grain producing regions and U.S. grain production rebounded sharply. The wheat crop was 44 percent above year-ago levels. Corn yields reached record highs.

Despite a bumper U.S. crop, world grain supplies remained historically low and helped underpin strong U.S. grain prices. In contrast to the bin-busting U.S. grain crops, drought conditions in other countries limited world grain production. In addition, world demand for grain was strong, pushing world grain inventories to their lowest levels in over two decades and boosting wheat and corn crop receipts.

In August, though, the drought revisited many parts of the Farm Belt. The drought slashed soybean yields and helped boost prices; but it also created pockets of farm financial distress. According to bankers in drought regions of the Kansas City Federal Reserve District, loan repayment rates in were lower and rates of loan renewals and extensions were higher.[1]

The record-high prices were also driven by increased global demand. In beef markets, Canadian mad cow disease sparked a surge in U.S. beef exports to Japan. In soybean markets, strong demand from China, the world's largest importer of soybeans, underpinned a rally in soybean prices. And the decline in the value of the dollar helped boost the demand for U.S. exports as U.S. products became more affordable in foreign countries. In 2003, the value of the dollar dropped 20 percent against the currencies of major agricultural competitors, and agricultural exports jumped 5.3 percent.[2]

The year ended with uncertainty. In November, new U.S. import restrictions on various Chinese products triggered China's suspension and rescheduling of an agricultural trade visit, rocking prices in the soybean market. The collapse of trade talks at the ministerial meeting of the World Trade Organization in September, coupled with difficulties finalizing a Free Trade of the Americas agreement, created further trade uncertainty. Farm subsidy payments remained at center stage in both negotiations. The 2002 Farm Bill did little to ease tensions, with subsidy payments under the new bill jumping 70 percent to $19.7 billion.

The Main Street Economy in 2003

The farm sector rebounded sharply in 2003, but Main Street struggled to add jobs in a jobless recovery. By August rural job levels had dipped below levels of a year ago.[3]

In the third quarter, the national economy soared, leading to an uptick in rural jobs. By November, rural job levels had eclipsed year-ago levels, with economic strength spreading throughout most sectors of the rural economy. In the fourth quarter, the service-producing sector produced strong job gains after weakening for most of the year. Improving state and local tax revenues helped turn government sector job loses into job gains. While rural factories shed another 2.0 percent of their jobs in 2003, the losses paled in comparison to 2002.

The Rural Economy in 2004

Despite some uncertainties, the 2004 outlook for the rural economy looks promising. Strong farm finances and low supplies could sustain the farm recovery in 2004. Heading into the year, the farm sector's debt-to-asset ratio remained low, and loan repayment rates continued to improve. Small world crop inventories have led to bullish commodity markets. And beef production is expected to fall as the industry prepares to launch a new cattle cycle with more herd rebuilding. This move should cut the number of cattle sent to slaughter and lower beef production.

The strength of the farm recovery may well depend on the weather and exports. Drought conditions have intensified since last fall. Livestock prices will probably remain under pressure from global bans of U.S. beef. And, while grain exports are expected to strengthen, recent trade conflicts with China and the resulting soybean price swings underscore the volatility of U.S. export activity.

On Main Street, optimism appears to be rising. A stronger national economy should produce job gains. If the rural nonfarm economy continues to track the national economy, rural job levels should gain momentum. The challenge for rural communities will be to capture more of the high-skill jobs that have propelled U.S. economic growth. In 2003, less than a quarter of the rural service-producing job gains came from the producer services sector, which employs many high-skilled workers.

On balance, hopes for a stronger rural recovery were boosted in 2003, as the farm sector enjoyed a banner year and signs of optimism began to emerge on rural Main Streets. Mad cow disease and a persistent drought could limit the farm recovery. And on Main Streets, rural job gains have not been concentrated in the high-skilled industries with the best chance to boost rural incomes. Still, rural America starts this year cautiously optimistic that a stronger economic recovery can emerge at the farm gate ***and*** on Main Street.

References

[1]The Kansas City District includes Colorado, Kansas, Missouri, Nebraska, Oklahoma, Wyoming, western Missouri, and northern New Mexico.

[2]Calculations based on USDA's real trade-weighted index of U.S. agricultural competitors.

[3]Rural is defined as nonmetro for statistical purposes.

Survey of Agricultural Credit Conditions

Federal Reserve Bank of Kansas City
September 30, 2003

Highlights from the third quarter survey*

- Farmland values continued to post solid gains and provide stability for farm balance sheets. In the third quarter, annual gains in farmland values were 5.1% for nonirrigated cropland, 4.3% for irrigated cropland, and 5.9% for ranchland. A rebound in crop production and higher government payments have boosted incomes and helped support cropland values. Gains in ranchland values outpaced cropland value gains due to the strong cattle market and recreational demand for land.

- District farm credit conditions improved again in the third quarter supported by a rebound in farm income. The index of farm loan repayment rates moved to its highest third quarter level in six years, while renewals and extensions eased from the high levels of a year ago. Two-thirds of district bankers expect total farm income in 2003 to rise above last year. More than 90 percent expect higher livestock income. However, less than half of bankers expect crop incomes to rise, as drought reduced crop production in some parts of the district.

- The district farm commodity price index moved higher in the third quarter. Strong cattle prices have supported gains in the index, as the cattle industry accounts for the majority of district farm cash receipts. Cattle and wheat prices were higher than the previous quarter, but hog and corn prices fell. Livestock and soybean prices were well above year-ago levels, but prices of all remaining crops were significantly lower than in 2002.

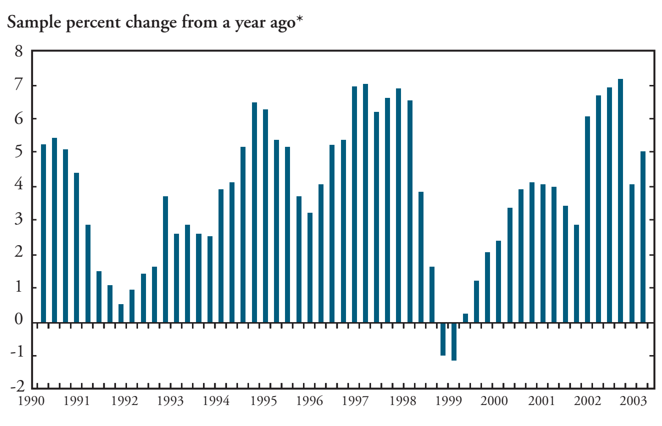
- Interest rates on new farm loans edged down in the third quarter. At the end of the quarter, interest rates on new farm loans averaged 7.22% for operating loans, 7.28% for machinery and intermediate-term loans, and 6.82% for real estate loans. Since September, interest rates in national money markets have moved up.

*Note: 298 banks responded to the third quarter survey.

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

Nonirrigated Cropland Values

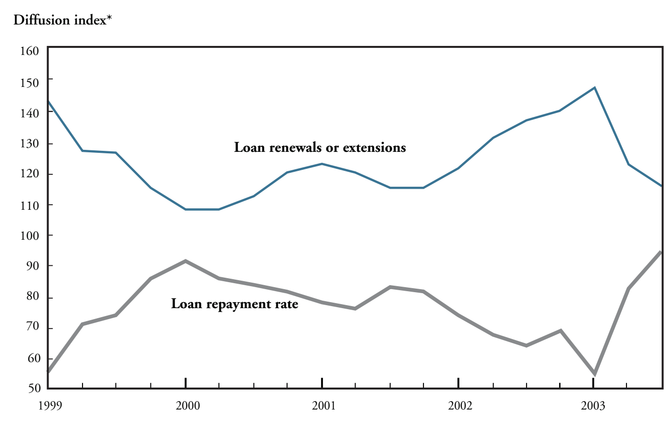
Tenth District



*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

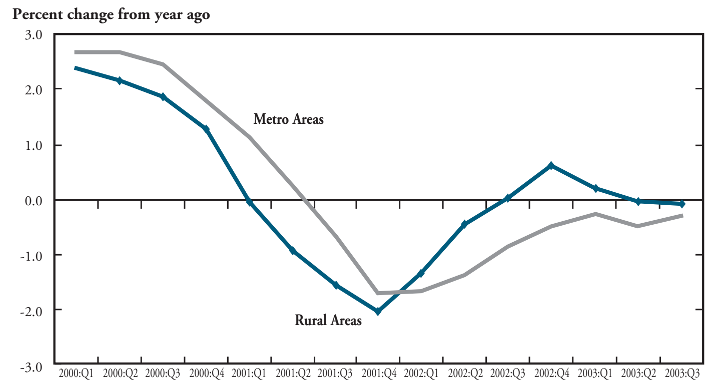
Highlights from the third quarter.*

- The rural nonfarm economic recovery continued to weaken in the third quarter of 2003. Rural job levels remained below a year ago for the second straight quarter. A third-quarter surge in the national economy led to improvements in metro job levels, narrowing the gap between rural and metro growth.

- Contraction in government employment and continued weakness in goods-producing employment led to weak business job growth. Government employment dipped below year-ago levels as various government entities struggled with budget crises. Despite improvement, goods-producing employment remained well below year-ago levels as rural factories struggled to add jobs. Gains in service-producing sectors were unable to offset the losses in government and goods-producing sectors.

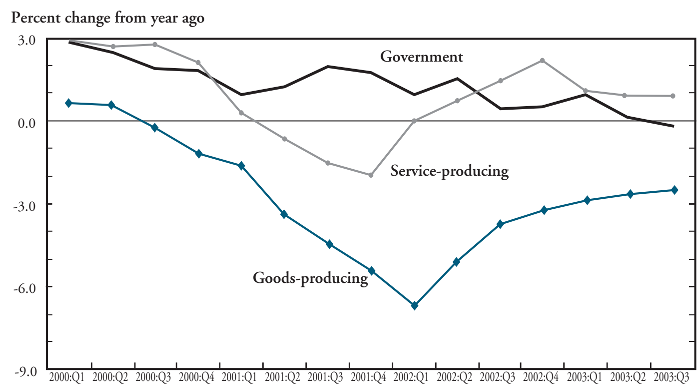
- The construction sector continued to be the highlight of the rural economy in the third quarter as low interest rates boosted construction activity. The value of rural building permits jumped well above year-ago levels. The number of rural building permits rose more than 6 percent above a year ago, led by strong single-unit construction activity.

Rural and Metro Job Growth



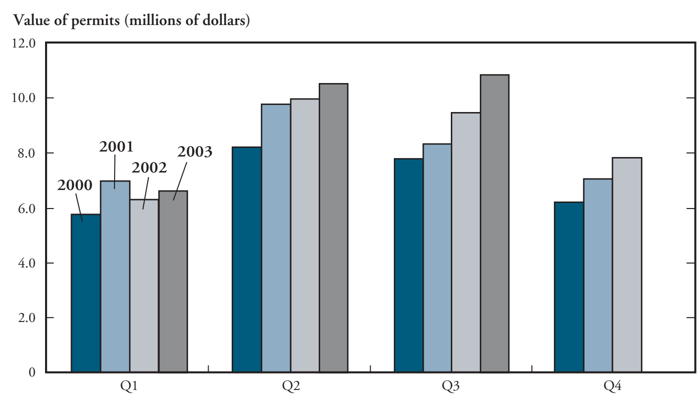
Source: Bureau of Labor Statistics

Rural Job Growth by Sector



Source: Bureau of Labor Statistics

Rural Residential Construction



Source: Bureau of Labor Statistics

*Please refer questions to Nancy Novack, associate economist, at 816-881-2423.

For more current analysis on the state of the rural farm and nonfarm economies, visit our web site at ***www.kc.frb.org***.

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