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# *The* Main Street \_\_\_\_\_ Economist *Commentary on the rural economy*



## Will Rains and a National Recovery Spur a Rural Rebound?

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**D**rought and a jobless recovery battered the rural economy in 2002. The worst drought since the Dust Bowl gripped many parts of rural America, leading to forest fires, livestock liquidations, short crop supplies, and a plunge in farm incomes. After a solid start, a soft period for the national economy limited the ability of Main Street businesses to create new jobs.

As rural stakeholders looked at their new menu of economic options, many were left wondering about the year ahead. Will rains and a stronger national recovery be enough to lead rural America back to prosperity?

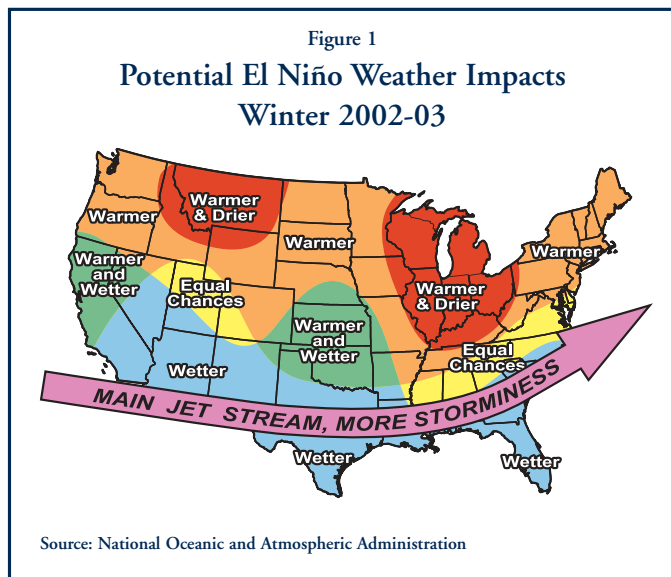
This article examines the rural outlook in the face of drought and a weak national recovery. While the return of rains and a stronger national economy will certainly not cure all of rural America's economic ills, the combination of two such factors should improve the prospects for rural areas in 2003.



in crop prices. History suggests the Corn Belt often suffers dry conditions in an El Niño pattern. Live-stock producers in these regions would face another year of poor pasture conditions and high feed costs that would delay the rebuilding of live-stock herds and possibly lead to continued herd liquidations. If U.S. weather patterns return to more normal trends to mitigate the drought, crop production would rebound but place some downward pressure on prices. Rains could have an even bigger impact on the cattle industry. Precipitation would help rejuvenate pastures, lower crop and feed prices, and encourage producers to begin rebuilding herds.

Despite weather uncertainty, the potential for some improvement in the farm economy appears promising. Lower red meat supplies and increased export demand are expected to boost livestock prices and profits.<sup>1</sup> In 2003, U.S. red meat and poultry production are expected to fall 2 percent, while U.S. meat and poultry exports are expected to rise more than 5 percent. With current projections, steer, hog, and poultry prices are expected to move above break-even levels by the second half of 2003.

If prices remain strong and production rebounds, crop cash receipts could rise in 2003. Based on current supply and demand expectations, USDA forecasts wheat, corn, and soybean prices to be more than 20 percent above year-ago levels during the current marketing year. Precipitation would boost U.S. crop production and cash receipts would rise if larger crop production does not cause a sharp downturn in crop prices. Overall, thirst-quenching rains would bring some relief to the drought-induced farm recession.



### A slow recovery on Main Street

As the farm economy fell into recession in 2002, Main Street businesses struggled with economic recovery. The rural economy picked up some momentum to start the year. But, as the summer drew to a close, a “soft spot” in the national economy produced an economic slowdown on rural Main Streets. Economic weakness limited the ability of businesses to add new jobs and boost wages.

At the beginning of 2002, a recovery appeared to be under way in rural America. The bright spot of this recovery was strong rural construction activity. By midyear, falling long-term interest rates pushed 30-year conventional mortgage rates to record lows. The low rates energized home refinancing and residential construction activity. Through October, the total value of rural building permits had risen 18.6 percent above 2001 levels.

After a promising start to 2002, the recovery lost some steam as rural job and wage growth slowed. After gaining five percentage points in the first four

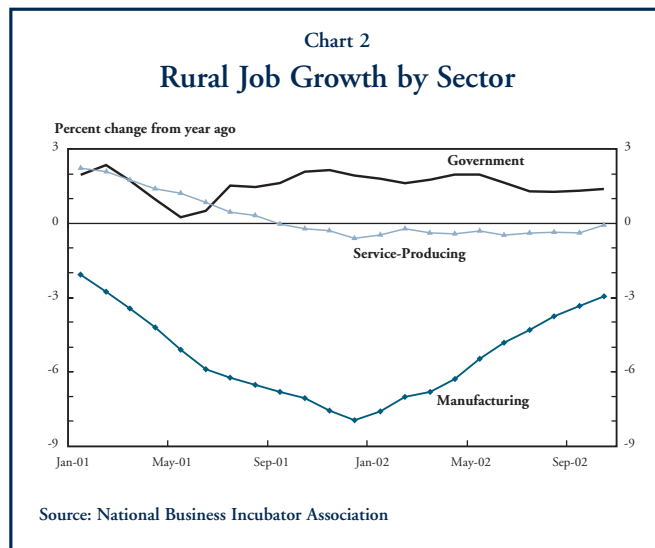
months of the year, rural job growth only advanced 0.2 percent in the next four months as weakness in the national economy intensified. It appears that the recovery has evolved into another jobless recovery, similar to that of the 1991 recession. During that recovery, it took more than two years before rural job levels reached pre-recessionary levels.

Weakness in the rural economy also translated into limited wage gains for rural workers. Despite the recession, rural workers enjoyed a 3.2 percent rise in wages in 2001. Strong wage gains carried over into 2002, but slowed as the rural economy stumbled. By November 2002, average weekly earnings for rural workers were only 1.0 percent above year ago levels.

### Weakness spreads on Main Street

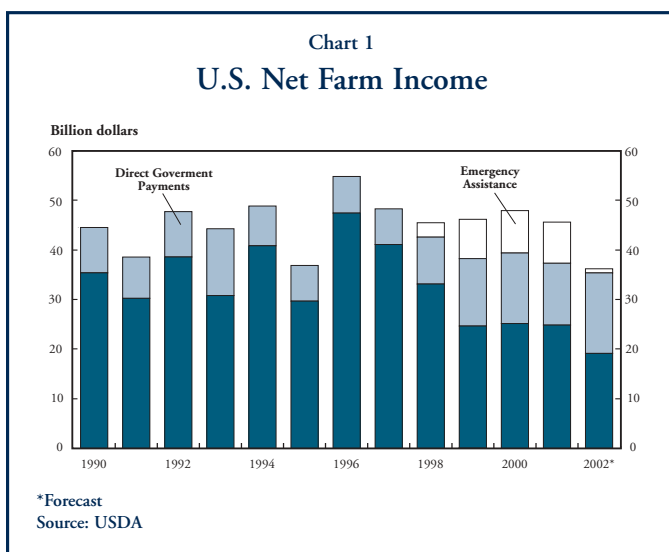
The summer slowdown in the rural recovery was driven mainly by weakness in the manufacturing sector that spread onto the rest of Main Street. Rural manufacturers felt the brunt of the recession and continued to post job losses. Economic weakness spread into other sectors as service-producing and government sector job growth slowed throughout the summer.

The recession took its toll on rural manufacturers and has left many factories struggling to remain open. Entering 2002, job levels at rural factories were 8 percent below a year ago (Chart 2). The job losses in rural manufacturers were associated



### Farm incomes shrivel in the drought

The drought of 2002 blanketed much of the country and will be remembered as one of the worst on record. The drought led to livestock liquidations and production losses that triggered a severe decline in U.S. net farm income. In 2002, U.S. net farm incomes dropped an estimated 21 percent to \$36 billion (Chart 1). In contrast to recent years, government payments failed to make up for the income shortfall.



Weakness in the livestock industry led the plunge in farm incomes. Entering 2002, livestock prices were already depressed as the industry struggled to overcome foreign food safety concerns and weak export markets. The drought only presented new problems for ranchers. Poor forage conditions forced many ranchers to search for greener pastures and other feed supplies. Many scaled back their operations and liquidated their herds. The increased supply of livestock sent to market boosted U.S. meat production. With abundant supplies and weak demand, live animal prices fell sharply, forcing livestock producers to operate in the red for most of the year. As a result, livestock cash receipts fell an estimated \$9 billion, the biggest drop on record.

Despite significant production losses, crop receipts edged up in 2002 due to higher crop prices and crop insurance payments. Drought plagued the Wheat Belt throughout the entire growing season and wheat production plummeted to just 1.6 billion bushels, the smallest crop since 1972. Timely rains kept the drought from spreading into the central Corn Belt but were not enough to prevent significant crop losses. As crop supplies tightened in the second half of the year, crop prices

surged. By November, wheat, corn, and soybean prices were well above year-ago levels. However, many farmers without a crop were unable to capitalize on the higher prices and were forced to fall back on crop insurance payments.

In contrast to recent years, the fall in U.S. farm income will not be offset by rising government

payments. Over the past three years, Congress sent to farmers an average of \$21.7 billion in direct and emergency payments. In the new farm bill, emergency payments were formalized into the counter cyclical program that helps producers most when crops are large and prices low. The drought resulted in just the opposite conditions and thus total government payments fell an estimated 18 percent to \$17 billion in 2002.

### Land values buoy farm finances

While farm incomes deteriorated severely, farm financial conditions remained mixed. Agricultural bankers reported weakening credit conditions throughout the year. Still, land values continued to rise and stabilize farm balance sheets.

Bankers reported eroding farm credit conditions as farm incomes fell. Loan repayment rates on farm loan accounts moved lower. Loan demand in the first half of the year was down relative to previous years as farmers took a more cautious approach to new debt. But as cash flows tightened, demand for new funds picked up and the rate of loan renewals and extensions accelerated. Some bankers began requiring more collateral to secure farm loans, suggesting they perceived more risk in agriculture.

Even as farm credit conditions weakened, farmland values remained remarkably resilient. Expectations of bigger government subsidies to farmers continued to be capitalized into farmland values, boosting prices paid by all buyers. Demand from off-farm investors also was a source of strength for farmland values. Investors appear to want farmland for many purposes, including recreation and development. Still, most farmland is being purchased by farmers. Many farm sales cannot be justified by cash flow projections alone, so many purchases are likely being financed with off-farm income. Three-fourths of Tenth District bankers reported that the majority of their farm borrowers supported their operations with off-farm income.

### Will the farm economy rebound in 2003?

Agriculture's prospects going forward depend largely on the weather. The drought certainly has not broken and only time will tell if sufficient moisture will fall to replenish parched soils. Forecasters indicate a moderate El Niño is expected to bring mixed weather patterns across the country (Figure 1). But, given current conditions, prices are expected to remain solid in the year ahead to spur a modest rebound in 2003.

El Niño raises uncertainty in the outlook for U.S. weather and agriculture. If El Niño persists, U.S. wheat, corn, and soybean production could again be hampered, leading to continued strength



with a large number of factory closings and mass layoffs. In the first three quarters of 2002, rural manufacturers reported 405 incidences of mass layoffs and 139 plant closures.<sup>2</sup> As the year progressed, rural factory closings and job losses moderated and the gap between rural and metro job growth closed. Still, the year ended with rural factories posting severe job losses.

As the year progressed, the strength of the *service-producing* sectors eroded. A capital overhang in telecommunications companies contributed to sharp job losses in rural transportation, communications, and utilities industries. Wholesale and retail trade and finance, insurance, and real estate industries also reported a contraction in jobs. Throughout the year, business, health, and personal service industries posted job gains that barely offset job losses in other service-producing industries.

Private sector weakness quickly translated into fiscal problems for state and local governments. State revenues fell short in 2002. As states balanced their budgets and trimmed programs, *government* job growth slowed.<sup>3</sup> States are again faced with the daunting task of closing the budget gaps. Recent projections peg total state budget shortfalls in fiscal year 2004 at \$60 to \$85 billion.

### Will Main Street recover in 2002?

As in the rest of the nation, the rural economic recovery is expected to strengthen in the year ahead. The rural economy tends to move in the same direction as the national economy. Renewed strength in the national economy could boost the rural economy. As 2002 comes to a close, signals of a pick-up in rural job growth point to a brighter outlook for the rural economy in the year ahead.

While national economic indicators are mixed as 2002 ends, leading indicators of national economic activity suggest the rural economy should strengthen. Indicators of manufacturing and

nonmanufacturing activity continued to improve during the fourth quarter of the year. The Conference Board's index of leading economic indicators also continued to advance, suggesting that a stronger recovery lies ahead. Moreover, many economic forecasters expect U.S. GDP growth to improve throughout 2003.<sup>4</sup>

As 2002 came to a close, signs of renewed strength in the rural recovery indicate the potential for stronger rural growth in the year ahead. At the start of the fourth quarter, rural housing activity remained robust as the value of rural building permits was 7 percent above a year ago. Moreover, improvements in rural job growth indicate renewed vigor in the rural economy. At the start of the fourth quarter, annual job growth in rural factories improved, while government and service-producing industries began to add jobs at a faster pace.

The rural economy appears to be working through the challenges of 2002. During the year, drought pushed the farm economy into recession. Meanwhile, weakness in the national economic recovery limited the ability of rural businesses to add jobs and raise wages. If rains return and the economic recovery strengthens, the prospects for rural America appear brighter in 2003.

<sup>1</sup>Price and production forecasts are based on various USDA estimates.

<sup>2</sup>A mass layoff is identified when 50 or more unemployment insurance benefit claims are made in a single establishment in a given month.

<sup>3</sup>The fiscal year for most states runs from July 1 of the preceding year through June 30 of the current year. For example, the 2003 fiscal year began on July 1, 2002 and ends June 30, 2003.

<sup>4</sup>Hilsenrath, Jon and Constance Mitchell Ford, "Economists Expect Spending by Business to Lead Recovery," *Wall Street Journal*, January 2, 2003, page A1.

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