THE AGRICULTURAL OUTLOOK FOR 1986 . . . CONTINUED FINANCIAL WEAKNESS SEEN

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The agricultural sector is confronted with a number of problems as the year begins. Strong export demand for agricultural products, which raised farm incomes and attracted resources into agricultural commodity production in the 1970s, collapsed in the mid-1980s, leading to large stock buildups, low prices, and low income levels in the farm sector. It was against this backdrop that the Farm Bill was renewed in 1985. At the United States Department of Agriculture's (USDA) annual Outlook Conference held December 3-5, department analysts discussed agricultural problems and policies. Their forecasts are summarized below.

Financial Situation

After totaling $141.8 billion in 1984, farming cash receipts as shown in Table I will likely reach only $136$140 billion in 1985 and fall to the $132-$138 billion range in 1986. While receipts from crops are expected to fall throughout the year, cash receipts from livestock should strengthen in 1986 due to anticipated higher prices. Table I indicates that government payments are expected to add an equal $12-$19 billion to farm income in both 1985 and 1986. Predictions are for total gross income of the agricultural sector to range between $159 and $164 billion in 1985, down from $174 billion in 1984, but above the $154-$159 billion level expected in 1986.

Lower gross income levels will be tempered by lower production expenses in 1985 and 1986. Total expenses reached $139.5 billion in 1984, but should reach only $132-$136 billion in 1985 and $130-$134 billion in 1986, leaving the projected nominal net cash income estimates at $37-$41 billion in the latter two years. Net farm income-which includes farm household consumption, the rental value of farm dwellings, and inventory changes-is expected to fall from last year's $25-$29 billion to $22-$26 billion this year. The cash flow[1] for the farm sector as a whole should improve this year, increasing from a level of $34-$38 billion in 1985 to a level of $38-$42 billion in 1986. The largest contribution to this gain will be a smaller paydown of agricultural debt. In 1985 agricultural debt outstanding (excluding CCC loans) was reduced by $6-$10 billion, whereas a reduction of only $2-$6 billion is expected in 1986.

The farming sector balance sheet shown in Table II indicates that aggregate farm wealth will weaken through 1986, although at a slower rate than in the past few years. Real estate, comprising almost three-fourths of all assets, fell in value from $780 billion in 1981 to an estimated $575-$625 billion in 1985 with expectations of a further drop to $555$620 billion in 1986. By contrast, the value of nonreal estate assets, consisting primarily of farm equipment, remained relatively stable over the same period. Since the value of total assets fell from a level of over $1 trillion in 1981 to an estimated level of $770-$830 billion in 1986, it follows that real estate values are the chief contributor to that fall.

Farming sector liabilities are divided almost evenly between real estate and nonreal estate debt. After an upward trend through 1982, real estate debt decreased slightly in 1983 and is expected to continue falling. Nonreal estate debt will likely remain unchanged to slightly higher in 1986. The estimate for nonreal estate debt ranges from $98 to $102 billion in 1985 and $99 to $106 billion this year.

Total equity of the farm sector is expected to continue to decline. After totaling $816.3 billion in 1981, equity should range between $595-$635 billion in 1985 and $.570-$630 billion in 1986.

Agricultural Credit

The outlook for agricultural credit reflects the farm sector's economic outlook. Lower income levels and weakened balance sheet figures will translate into tighter credit conditions in 1986. Farmers will likely encounter greater difficulties obtaining loans from and servicing debt to financial institutions and government lending agencies struggling to maintain profit margins.

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[1] USDA defines cash flow as the sum of net cash income, net change in total loans outstanding to the farm sector, and rental income less capital expenditures.

Table I

FARM INCOME AND CASH FLOW STATEMENT

(Billion dollars)

Item	1982	1983	1984	1985F	1986F
Farm income sources:					
1. Cash receipts	142.9	136.3	141.8	136-140	134-138
Crops[1]	72.7	66.8	69.1	66-70	64-68
Livestock	70.3	69.4	72.7	67-71	69-73
2. Direct Government payments.....	3.5	9.3	8.4	6-9	6-10
Cash Government payments	3.5	4.1	4.0	6-9	6-10
Value of PIK commodities	0.0	5.2	4.5	0	0
3. Farm related income[2].....................	2.6	2.5	3.0	2-4	2-4
4. Gross cash income (1 + 2 + 3)[3]	149.0	148.1	153.3	147-152	145-150
5. Nonmoney income[4]......................	14.0	13.1	12.9	11-13	10-12
6. Realized gross income (4 + 5)	163.0	161.2	66.2	58-163	156-161
7. Value of inventory change	- 1.4	- 10.6	7.8	- 1-3	- 4-0
8. Total gross income (6 + 7)	161.6	150.6	174.0	59-164	154-159
production expenses:					
9. Cash expenses[5,6]..................	110.7	109.8	114.1	108-112	107-111
10. Total expenses.	136.9	135.6	139.5	132-136	130-134
Income statement:					
11. Net cash income:[1,6]					
Nominal (4- 9).	38.3	38.3	39.2	37-41	37-41
Deflated (1972$)[7].	18.5	17.8	17.5	16-18	14-17
12. Net farm income:[1]					
Nominal total net (8 - 10). . .	24.6	15.0	34.5	25-29	22-26
Deflated total net (1972$)[7]. . . .	11.9	7.0	15.5	11-13	9-11
Deflated total net (1967$)[8]. . . .	8.5	5.0	11.1	8-10	6-8
13. Off-farm income	37.9	38.8	40.0	39-43	40-44
Other sources and uses of funds:					
14. Change in loans outstanding[6]	7.3	3.5	- 1.5	-10--6	-6--2
Real estate.	4.0	2.5	- 0.8	-6--3	-5--1
Nonreal estate[9]	3.3	1.0	- 0.7	-4--2	-3-1
15. Rental income.	5.7	4.6	5.4	4-6	3-6
16. Gross cash flow (11 + 14 + 15)	51.3	46.3	43.1	34-38	38-42
17. Capital expenditures[6].	13.7	13.0	12.5	10-14	9-13
18. Net cash flow[1,6] (16 - 17).	37.6	33.3	30.7	22-26	26-30

F = Forecast as of 11/19/85.

[1] Includes net CCC loans.

[2] Income from custom work, machine hire, farm and recreational activity, and forest products.

[3] Numbers in parentheses indicate the combination of items required to calculate a given item.

[4] Value of home consumption of farm products and imputed rental value of farm dwellings.

[5] Excludes depreciation and perquisites to hired labor.

[6] Excludes farm households.

[7] Deflated by the GNP implicit price deflator.

[8] Deflated by the CPI-U.

[9] Excludes CCC loans.

Source: U. S. Department of Agriculture, Economic Research Service.

Total farm debt is expected to fall in 1985 and 1986 as is total equity. The latter, however, is expected to decline even more than the former. As farm income is not expected to improve in 1986, further debt service pressure will be placed on farms. On the positive side, however, the recent fall of interest rates may offer some relief.

The rate of delinquent farm loans at commercial banks has been trending upward for the three years that banks have been reporting delinquencies. According to data compiled by the staff of the Federal Reserve Board, 9.2 percent of all farm production loans outstanding as of September 30, 1985 were nonperforming or past due 30 days or more. The comparable figure for a year earlier was 6.5 percent. Government and government-sponsored credit agencies have experienced similar increases. Although the payment schedule for Farmers Home Administration (FmHA) loans makes it difficult to compare delinquent loan figures with those of banks, FmHA held a substantial amount of delinquent loans in 1985. FmHA will end a two-year moratorium on farm foreclosures beginning in 1986. Although the agency expects to restructure debt or develop other solutions for the majority of its delinquent borrowers, some loans will be called in this year. In mid-1985 the Cooperative Farm Credit System (FCS) revealed that delinquent and nonperforming loans were threatening its liquidity. The FCS experienced a net operating loss of $426 million through the first three quarters of 1985, with expected year-end losses of approximately $600 million. As a result, it sought and received federal help in the form of legislation authorizing an emergency line of credit should one become necessary.

USDA studies conclude that farmers most likely to experience financial stress are either highly leveraged or dependent upon export-sensitive commodities for their income. This conclusion is supported by data from the Federal Reserve Board showing that while net income before interest payments has been positive and stable in the eighties, net income after interest payments has declined to an average level close to zero. The implication is that producers earning average incomes and bearing average debt service requirements have been breaking even while those with below-average incomes or above-average debt service have not.

Table II

BALANCE SHEET OF THE FARMING SECTOR, EXCLUDING OPERATOR HOUSEHOLDS, DECEMBER 31

Item	1981[1]	1982	1983	1984	1985F	1986F
			(Billion dollars)			
Assets:						
Real estate	780.2	745.6	736.1	639.6	575-625	555-620
Nonreal estate	225.0	232.2	220.4	216.5	200-230	190-235
Total assets	1,005.2	977.8	956.5	856.1	790-840	770-830
Liabilities:						
Real estate	97.3	101.2	103.7	102.9	96-101	93-99
Nonreal estate:						
CCC loans	8.0	15.4	10.8	8.7	14-18	17-21
Other nonreal estate	83.7	87.0	88.0	87.3	82-86	80-86
Total nonreal estate	91.7	102.4	98.8	96.0	98-102	99-105
Total liabilities	189.0	203.7	202.5	198.9	195-202	194-201
Total farm equity	816.3	774.2	754.0	657.2	595-635	570-630
			Ratios			
Selected ratios:						
Debt-to-asset	18.8	20.8	21.2	23.2	23-25	23-26
Debt-to-equity	23.1	26.3	26.9	30.3	31-33	31-35

F = Forecast as of 11/14/85.

[1] Peak year for nominal asset values. Equity peaked in 1980.

source: U. S. Deportment of Agriculture, Economic Research Service.

Export Outlook

The prosperity enjoyed by the agricultural sector in the seventies was primarily the result of increased export demand stemming from low worldwide crop yields that forced many nations to seek external sources of food and feed grains. A relatively low dollar exchange rate also made American commodities attractive to foreign purchasers. On the supply side, the United States had relatively large stocks on hand and a highly productive agricultural sector. Both the physical volume and prices of exported commodities rose dramatically. The rise in exports boosted farm income and farmland prices. Farmers responded by directing more resources into agricultural production, especially in those commodities benefitting from the high export demand,

The current decade has witnessed a dramatic reversal of the 1970s export experience. The reasons include increased foreign production, a sluggish worldwide economy, and a strong dollar. In 1985, lower exports frustrated the efforts of the farm sector to reduce the large stocks accumulated in the last several years. Farm exports totaling $38 billion in 1983/84 fell to $31.2 billion in 1984/85. The 1985/86 forecast is for further declines to about $29.0 billion.

Export volume as well as value is down. It fell from 162.3 million tons at the beginning of the decade to an estimated 125.7 million tons in 1985 and is projected to fall to 120.5 million tons in 1986. Meanwhile, imports have been climbing, although not as fast as exports have been falling. Import values, which totaled $15.5 billion in 1981/82, are estimated to rise to $20.0 billion in 1985/86.

These data do not bode well for the U. S. agricultural trade balance, which has experienced severe reductions in the last few years. The figure stood at $26.6 billion in 1980/81 but is forecast to fall to $11.4 billion in 1984/85 and $9.0 billion in 1985/86.

Over the longer term, the outlook for improvement in the terms of agricultural trade is mixed. Commodity export incentives included in the 1985 Farm Bill are likely to help exports in the near term. A further stimulus is the recent weakening of the dollar on the foreign exchanges. The current world surplus of grain, however, suggests that worldwide structural changes have resulted in an increased global capacity to produce farm commodities. Unless economic or weather conditions dictate otherwise, substantial long-term improvements in the trade position of the U. S. agricultural sector may be slow to materialize.

Agricultural Policy

The package of agricultural legislation known collectively as the Farm Bill was renewed in late 1985. The current legislation carries with it a number of changes from the previous farm legislation enacted in 1981. These are designed in part to support the sagging income levels of farmers in the short term while allowing agricultural production and prices to gravitate to market-dictated levels in the longer term.

The shift in the emphasis of the current farm legislation was dictated in part by perceived shortcomings in the 1981 legislation. Analysts in attendance at the 1985 Outlook Conference generally conceded that the price supports for major crops were set too high in the 1981 Bill. Policymakers in 1981 had predicted that farm commodity prices would trend upward and had established price supports on the basis of those predictions. They failed to foresee the increased worldwide production and the appreciation of the dollar, both of which caused market prices to fall far short of support levels. The resulting excessive level of support prices generated surplus production, a. sharp increase in government held grain and dairy stocks, and decreased export levels,

The 1985 Bill provides for a sharp lowering of the price support through decreased loan rates.[2] Lower loan rates will reduce the compensation that farmers receive from the CCC and provide a smaller incentive to place commodities under government loan. Also, lower loan rates will encourage the export of greater quantities of eligible commodities.

Farmers will not bear the full impact of lower commodity prices resulting from the lower loan rates, however. Direct payments to farmers in the form of deficiency payments will be increased under the new legislation.[3] These payments are structured to fully compensate farmers at current price support levels through 1987 and then to fall gradually after that.

To be eligible for price supports, farmers must enroll in the USDA conservation programs. These programs generally require the farmer to reduce

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[2] The loan rate is the amount that a farmer can borrow from the Commodity Credit Corporation (CCC) when pledging a commodity as collateral. The loan is subject to a designated rate of interest and must be repaid at the expiration of its term, or the collateral will be forfeited. Eligible commodities under this program include wheat, corn, sorghum, barley, oats, rye, soybeans, rice, peanuts, cotton, sugar, honey, and tobacco.

[3] Deficiency payments are those made to farmers enrolled in the price support programs. The amount that eligible farmers receive equals the smaller of the average cost of producing a commodity less either the market price or the loan rate.

plantings of the commodities having price supports. Under the new farm legislation, the required acreage reductions have been increased to 20 percent for feed grains, 35 percent for rice, 25 percent for wheat, and 25 percent for cotton.

Livestock producers will also be affected by the 1985 Farm Bill, Lower loan rates should translate into lower feed costs and higher profit margins for cattle, hog, and poultry producers. The dairy industry also will benefit from lower feed costs, but more important is the incentive to reduce dairy production by reducing herds. Under a new program, dairy producers may offer to sell part or all of their herds to the government on a bid basis. Producers submitting successful bids must agree not only to reduce their herds but to remain out of dairy production for at least five years. The program is to be funded through fees paid by dairy farmers.

Besides reduced loan rates, other incentives to promote agricultural exports are incorporated into the new farm bill. The USDA has the authority to spend up to $325 million for direct export credits. Also not less than $5 billion in loan guarantees must be made available for short-term export credit in 1986. Both measures, together with other provisions in the bill, are intended to encourage exports and to reduce the buildup of domestic grain stocks.

Food Prices

Abundant food supplies and a low inflation rate combined to keep food price increases modest despite strong consumer demands. The retail price of food rose only 2.2 percent in 1985, one of the smallest increases in 18 years. The price of food bought in grocery stores was up only 1 percent, while the price of food in restaurants rose 4 percent.

Contributing to the abundant supplies were large harvests and higher than normal slaughter weights for livestock. The overall farm level price for food dropped 7 percent in 1985. Food processing and distribution costs, which comprise a large portion of the total cost of food, rose 5.2 percent as strong consumer demand enabled food processors to widen their profit margins.

A price increase of 2 to 4 percent is forecast for 1986. Food bought in grocery stores should rise only 1 to 3 percent but restaurant prices may rise 3 to 5 percent. Higher meat prices will largely account for the increases. Cattle herd liquidations which contributed to abundant meat supplies in 1985 have ended, meaning smaller meat supplies and higher prices in 1986.

The outlook for individual food prices is for generally modest increases in most categories this year. Red meat prices can be expected to rise 3 to 5 percent at the retail level. Poultry consumption will likely benefit from higher red meat prices as consumers shift more of their meat expenditures toward poultry. Prices are expected to be unchanged as poultry production and consumption rise in 1986.

Egg prices fell sharply in 1985 as the disruptions to supplies caused by the 1984 avian flu ended. Output will be lower in 1986 and price increases of 3 to 5 percent are expected. Dairy prices have shown only modest increases in recent years as dairy price supports have fallen. The outlook is for unchanged dairy prices this year. Fruit prices should rise again in 1986. Substantial fruit tree damage during the last two winters has decimated fruit production, and it will be several years before new trees reach the fruit bearing stage.

Vegetable prices are expected to fall 3 to 5 percent in 1986. Supplies should be plentiful due to good weather conditions in winter vegetable growing areas and to extensive imports from Mexico. Cereal products prices should increase 2 to 4 percent this year. These products are highly processed and their retail prices are influenced by marketing costs.

1986 COMMODITY OUTLOOK

The Outlook Conference's analysts offered price and production prognostications for key farm commodities in 1986. Their forecasts for several commodities produced in the Fifth District appear below.

Tobacco

The outlook for tobacco in 1986 is dominated by large carryover stocks resulting from decreased exports of domestically produced leaf and declining domestic demand. Industry analysts point to high support prices in the United States as a primary factor for lost export sales. Production in other countries has increased to fill the gap created by reduced U. S. exports, effectively supplanting American leaf on international markets with foreign leaf.

Domestic production and price depend on the quota set by USDA. The flue-cured poundage has been set at 757 million pounds, 2 percent below the 1985 level and the maximum reduction allowed by law. Although the burley quota has yet to be announced, it is likely that it too will be set below the 1985 amount.

Lower production quotas are the result of both high carryovers and overmarketings in 1985, the latter being the excess of what tobacco producers sell in a season over what the quota allows. The overmarketing must be matched by a corresponding undermarketing in the following season. That is, overmarketings must be subtracted from the total quota of the following season to yield the effective quota. For the current year, the effective quota for flue-cured leaf will be 722 million pounds, a figure reflecting the 1986 quota of 757 million pounds less 35 million pounds of 1985 overmarketings.

Even with lower quotas, lower exports combined with weak domestic demand mean no significant reduction of tobacco stocks in the near term. Domestic cigarette output fell to 662 billion pieces in 1985, 75 billion below the 1981 figure. Domestic tobacco demand has fallen in response to health concerns and sharply increased taxes on tobacco products.

Dairy

Dairy producers are expected to raise production in 1986 unless the federal dairy herd buy-out program can substantially reduce total herd size. In the absence of the buy-out program, USDA has projected a 3.3 percent rise in milk production at the current support price of $11.60 per hundredweight of milk. Consumption is expected to rise more slowly than production in 1986 leading to projected CCC milk purchases of a near record 16 billion pounds.

The provisions of the 1985 Farm Bill may dramatically alter the current 1986 production projections however. Actual production is expected to hinge on the success of the dairy herd buy-out program. If successful, the herd reductions will act to limit milk output. Critics of the buy-out program warn, however, that the dairy herds liquidated are likely to be the least productive ones, and that their removal will have little impact on total production levels.

Soybeans

High yields in 1985 translated into a bumper soybean crop of over 2 billion bushels. Although last year's demand was strong, the size of the crop exceeded usage, causing carryover stocks to be large entering 1986. In response to large stocks, prices fell, possibly averaging only $5.15 per bushel in 1985/86 according to USDA estimates.

For 1986, soybean and soybean meal exports are expected to grow by 13 percent and 12 percent, respectively. While growth in the export market is a welcome sign, soybean market analysts feel that it cannot long continue since export potential is limited by the saturation of foreign markets and by competing oilseeds such as sunflowers and rapeseed.

Poultry and Eggs

Broiler producers are expected to benefit from (1) lower feed prices resulting from lower crop price supports and (2) decreased red meat production this year. Broiler production is expected to increase 4 percent in response to expected higher profit margins, to 14.1 billion pounds, Even with expanded output, prices will likely average 50 cents per pound, about the same level as in 1985.

Turkey production is projected to be up 9 to 11 percent in 1986. Favorable returns in 1985 should give producers incentives to raise slaughter rates in 1986. Prices may weaken in the current year, however, in light of the high stocks of frozen turkeys currently on hand. Over the first six months of 1986, turkey prices are expected to average 59 to 63 cents per pound, below the 67 cents per pound average of the same period a year ago. Prices for the second half of 1986 will likely show some improvement, but the expected 62 to 67 cents per pound will fall short of the 84 to 85 cents per pound received in **the last six months of 1985.**

Egg production will be lower but prices higher this year. An abundant supply of eggs in 1985 kept producers' returns low. For 1986 a decrease of 1 percent, to 2,805 million dozen, is expected in egg production. Prices are expected to average 68 to 72 cents per dozen, up from 66 to 67 cents per dozen received in 1985.

Cattle and Hogs

Beef production should be down 4 to 6 percent in 1986 as slaughter numbers and weights are expected to be lower. Smaller beef supplies should strengthen prices. Choice fed steers will likely sell for the middle $60s per hundredweight this year, up from $58 per hundredweight in 1985.

Hog producers are also ending their herd liquidations, As a result, hog production may fall 1 percent in 1986, although lower grain prices or stronger hog prices could send production higher by year end. Prices for barrows and gilts averaged $45 per hundredweight in 1985 and may reach the upper $40- per hundredweight this year.