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Sizing Up the Agricultural Downturn

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SIZING UP THE AGRICULTURAL DOWNTURN

by

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The agricultural sector currently has more sick spots than good ones. Some analysts see a crisis coming like that of the 1980's, but there are some major differences in conditions now as compared to then.

In August, I attended the Midwestern and Western Price Outlook Conference and, in September, I attended the National Public Policy Education Conference. This article is my summary of and editorial comments on talks given and the general discussion that followed at these conferences.

The General Economy

The general economy looks good. Jobs and employment are growing, unemployment is the lowest in a generation, and the US dollar is strong. But the Asian crisis is starting to cause problems. Agriculture has been feeling it for several months now, and it is starting to impact other sectors.

The US has an extraordinarily tight labor market, but the Consumer Price Index (CPI) keeps falling. Therefore, inflation is not a problem. Pressure from foreign producers has limited most US firms' pricing power, restricting their ability to pass higher costs on to consumers. Productivity continues to increase, helping control domestic costs of production. The question is "how long can productivity continue to increase at the current rate?"

The gross domestic product has slowed a little, due mostly to the General Motors strike. We had robust growth the first two quarters of 1998. Domestic investment is very strong, to the point that there is little unused plant capacity, or unemployed labor. But, exports are down. This will ease pressure on resources, although its hurts our balance of payments.

Foreign Markets

Asia is a critical market, because it has been taking about 38% of our agricultural exports. Nearly half of that was to Japan. The European Union (EU) has been taking about 16%, Mexico 9% and the rest of the world (ROW) about 37%. Looking at bulk agricultural commodities, Asia takes 43%; Mexico, 10%; EU, 14%; and ROW 33%.

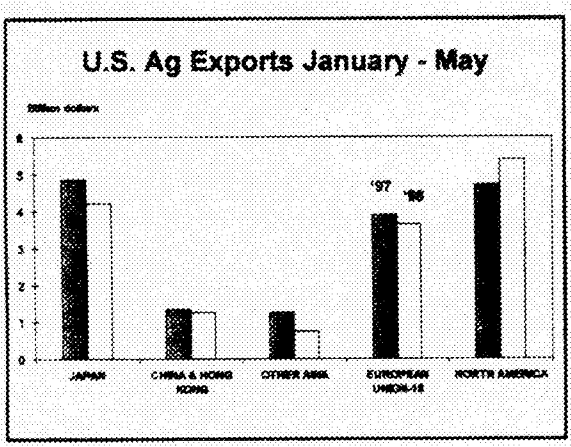
Because the Asian crisis is neither a small nor short run problem, and because it takes such a large share of our ag exports, it has serious consequences for US agriculture. Asia will be years in recovery. Except for China, Asian economies borrowed US dollars to support their currencies. This worked for a while, but then failed. Also, the Asian societies do not have the legal regulations that exist in the US to prevent, or curb, the type of activities that precipitated the crisis. Getting that problem corrected is, like one speaker put it, "not going to be a quick and simple task, like getting a new law through Congress and signed by the President." There needs to be changes in both their philosophical approaches and laws.

As a result of their economic decisions and actions, the value of Indonesia's currency has

declined 83% relative to the US dollar and Japan's has declined 20%. Other Asian currencies fall in between these two. China does not have a convertible currency and remains an unknown.

Asia's purchasing power has declined and unemployment is up. Looking at Gross Domestic Product (GDP) for 1998, China appears to be the best off with a 6% growth rate (as best we can determine). Japan is not good with a 1% decline, Korea is in a steep recession with a 5% decline, and Thailand and Indonesia are even worse off.

As a result of the Asian crisis, US ag exports to Japan for the Jan-May 1998 period were off about 650 million dollars (15%) compared to a year earlier. Exports to China have changed little, but the rest of Asia is off about 550 million dollars (45%). **This trouble in Asia is being felt in South Dakota as well**. According to a recent press release by the US Treasury Department, South Dakota's total exports to Asia declined by 47% during the first quarter of 1998 compared to the same time period in 1997. SD exports to South Korea decreased by 88% and those to Hong Kong declined by 87%.



US exports to the European Union are down also, by about 250 millión dollars (5%). [See graph above] The only bright spot in exports is the NAFTA countries (Canada and Mexico), which increased purchases from the US by about 650 million dollars (14%). The NAFTA countries are the only countries that increased their imports from the US this year, and they now buy more than does Japan.

The Farm Slump

The current farm slump has both some similarities and some differences with that of the 1980's. In the 1980's, many farmers were overextended in debt with interest rates below the inflation rate. They borrowed against increasing asset values and financial institutions were eager to lend. When the brakes were put on inflation and interest rates rose, asset values decreased, and many debt-laden farmers went under.

In 1998, farmers, as a group, are in better shape than at the beginning of the downturn of the 1980's. The farm debt to asset ratio is in the best shape it's been since the 1960's. Loan delinquencies are low and ag banks are in good shape. Also, lending institutions are more conservative now than in the 1970's. But this is not to say farmers are without problems.

With the current situation, demand for agricultural products is down world wide, while supply is up. The very good prices of 1996 encouraged production under the Freedom to Farm Bill. Livestock producers have been producing in high gear. Weather problems have caused serious problems in some local areas, and Freedom to Farm has caused some regional adjustments as farmers respond to new market signals after 60 years of distortion by price supports and acreage controls.

As a result of increased world production and reduced demand, prices are lower. And, with fewer dollars coming from Washington, farm income is expected to be down by 10% (some later quotes are 16%). But, this reduction is from a year that produced very good income for farmers as a group, and before any emergency relief legislation was passed.

Outlook for 1998-99

The economy is expected to remain strong, but grow more slowly in 1999. A prolonged weakness in Asia can be expected. This will

hurt exports to our biggest market area. Agricultural commodity prices will remain soft in the US, but high in importing countries, due to a strong dollar relative to other currencies.

China is a wild card. By some indications it looks good, but some analysts see it as being shaky beneath the surface. Because China is such a secretive society, it is hard to get a good reading on it.

Japan, Korea, Thailand, and Indonesia are in rough shape. Financial experts see a strong need for financial help for these countries. But, there is also a strong need for reforms in these countries, without which the financial help will be of limited value.

The world's population is growing and US agriculture has some big stakes in the global economy and political systems. There is an effort under way to create a "Free Trade of the Americas." This would include all of the western hemisphere. The population of this area is about 800 million people, 300 million in the US and Canada and 500 million in Latin America. The per capita gross domestic product for Latin America is $1,750 and $17,000 for North America. The European Union has a population of 380 million and a per capita DGP of $15,000. The average gross domestic product for the western hemisphere is about $7,500. South America needs more food. For every $1.00 in trade, it buys $.30 in food. It, therefore, has great potential as a buyer as it improves its income.

If the creation of such a trade area should fail, the creation of an agreement between the EU and South America becomes a real possibility. This would be very detrimental to US agriculture. If an EU - South American free trade area were created, we will still be buying Latin American coffee, bananas and oil, while it will get its agricultural products from European farmers. We may find ourselves on the outside looking in. American agriculture needs the benefits of free trade protected by the US government. But these benefits are not without costs.

There are some forces in the US which, for the sake of short run perceived benefits, do not want free trade, regardless of the cost to agriculture or to themselves in the long run. They see the cure of the current problem to be the same "cure" which was tried in the 1920's, which helped bring on the great depression. There are some in agriculture who do not want free trade, because they will carry a large share of the costs while the benefits go to others. For example, South Dakota soybean producers tend to be benefactors from free trade, while the Texas tomato growers must compete with Mexican produce.

Conclusions

The US is expected to have a strong but slowing economy. Asia will remain weak for some time, possibly for 6 to 10 years. Farm income for 1998 will be off about 10%, and with it, some rise in farm loan problems. For ag producers astute in marketing, the impact will be minimal this year, but damages could be significantly worse next year. Regional disparities will continue to grow within the US. Global stakes have never been higher. Wheat growers will feel more pressure than feed grain producers because wheat can be grown in more areas of the world. As exchange rates (a strong dollar) make US wheat more expensive, foreign growers will increase their production at the expense of US exports. The US has a distinct cost advantage for feed grain production, easing the impact on feed grain producers, somewhat.

While deflation is a possibility, it appears highly unlikely to occur in the US because of the makeup of our economy. Most expansions end because of resource imbalances that cause bottlenecks which, in turn, put on the economic brakes. All bear markets in the US have been associated with increased long term interest rates. But US long term interest rates are not increasing, as money from Asia is coming this way. Also, the labor restructuring of the 1980's is still paying off and the information age is making us more productive.

COMMODITY MARKETING WORKSHOPS FOR PRODUCERS

Oct. 1998	Herreid, Hot Springs, Pukwana
Nov. 1998	Kennebec, Martin, Murdo, Milbank, Flandreau, Highmore, Webster, Beresford
Dec. 1998	Watertown, DeSmet, Brookings
Jan. 1999	Alcester, Veblen, Mitchell, Forestburg, Charles Mix Co., Beresford
Feb. 1999	Tulare, Huron, Yankton, Aberdeen
Mar. 1999	Sioux Falls, Hayti

GRAIN OUTLOOK MEETINGS

Kadoka, Timber Lake, Ralph, Bison, Morristown, Dupree, Lennox, Sisseton, Britton, Watertown, Onida, Milbank, Webster, Renner, Brookings, Onida, Gettysburg

Contact you local County Extension Agent in your county for the specific details of the marketing and outlook meetings nearest you.

INTEGRATED RISK MANAGEMENT TRAINING EDUCATION

Risk Management has become a major issue for most producers. The agricultural economy is radically different from that which existed just a few years ago, and current market prices are discouraging for most of the major commodities. The goal of this train-the-trainer workshop is to deliver risk management education to producers.

Training sessions will be held in Sioux Falls on Nov. 6 and in Aberdeen on Nov. 18. Registration fee is $35. For more information, contact Dr. Burton Pflueger, 605-688-4141, at Extension Economics, Box 504, SDSU, Brookings, SD 57007.

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