Macroeconomic Outlook for U.S. Agriculture

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May 18, 2016

The views expressed are those of the author and do not necessarily reflect the opinions of the Federal Reserve Bank of Kansas City or the Federal Reserve System.
Overview of the Federal Reserve System

The “Fed” is the Central Bank of the U.S.

- **Board of Governors**: 7 members, each appointed by U.S. President
- **Federal Reserve Banks**: 12 Banks, 24 Branches
- The **Federal Open Market Committee** (FOMC) has 19 members, 12 voting.

**Primary functions:**

- **Monetary Policy** – pursue maximum employment and stable prices
- **Bank Regulation** – ensure safety and soundness of banks.
- **Financial Services** – bank for banks, and bank for federal govt.
- **Lender of Last Resort** – provide liquidity in times of crisis
Of the 12 Fed Districts, the 10th District is the most concentrated in agriculture by some measures.

Average Farm Income as a Share of Total Personal Income
Average Across Counties by Fed District

Proportion of “Farm Dependent” Counties and Agricultural Banks
Percent

Source: BEA, USDA, Ag Finance Databook and staff calculations

Source: BEA.
Outline

• A 3rd consecutive year of a “downturn” in the ag economy.

• Supply factors at play year-to-year, but demand strength likely the long term driver.

• Recent global and macroeconomic developments have shaped the set of concerns in the ag economy.

• Financial stress among ag borrowers and ag lenders could be more pronounced in the near future.
Farm income has dropped sharply from recent highs, along with crop prices.

U.S. Real Net Farm Income

Source: USDA.
Outside of agriculture, the last three years have also been notable for the global economy.

- Fiscal challenges
- Monetary policy divergence
- Oil price collapse
- Exchange rate volatility
- Renewed China concerns
- Global financial market turmoil
- _rexit?
Global economic growth has been sluggish the last few years.

Global Real GDP Growth

- Canada
- Euro Area
- Mexico
- Japan
- China

* 2013
* 2014
* 2015
* 2016 *
* 1996 - 2006 Average Annual Rate

* Forecast
Source: IMF April 2016 Update
U.S. growth has been slightly better, driven by the strength of the consumer.

**U.S. Real GDP Growth**

![Graph showing U.S. Real GDP Growth from 2006 to 2014 with percent change, saar on the y-axis and years on the x-axis. The growth is represented with a blue line, and the years 2008 and 2010 are highlighted in gray.]

**Contributions to GDP Growth**

![Bar chart showing contributions to GDP growth for 2013, 2014, and 2015. The chart includes PCE, investment, government, and net exports.]

Source: BEA and Haver Analytics.
U.S. labor markets have steadily improved.

U.S. Labor Market

- Number of U.S. Jobs added since Jan. 2013 (Left Scale)
- U.S. Unemployment Rate (Right Scale)

Sources: Bureau of Labor Statistics and Haver Analytics.
Monetary policy has responded to U.S. economic improvement.

Federal Funds Target Rate

Sources: Federal Reserve Board and Haver Analytics
But policy remains very accommodative.
Globally, central bank policies have shifted since 2013.

Central Bank Balance Sheet
Assets as a Percent of GDP

Sources: Federal Reserve Board, BEA, ECB, and Haver Analytics.
Inflation has been persistently low, both in the U.S. and abroad.

Source: Haver Analytics.
Sharp declines in energy prices have kept inflationary pressures subdued.

U.S. Energy Prices

Jan-13 Jan-14 Jan-15 Jan-16

Crude Oil - WTI (Left Scale)
Natural Gas (Right Scale)

Sources: Wall Street Journal, EIA, CME Group, and Haver Analytics.
Inflation in the U.S. has also been dampened by a stronger dollar.

Currency Exchange Rates

Index (Jan. 2013 = 100)

- Euro Zone
- Japan
- Canada
- Mexico

Stronger Dollar

Sources: Federal Reserve Board and Haver Analytics.
The dollar has surged even more dramatically against regions competing for ag exports.

*Nominal broad trade-weighted exchange value of the U.S. dollar

Sources: FRB, IMF and Haver Analytics.

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Sources: FRB, IMF and Haver Analytics.
Financial markets have also been marked by episodes of significant volatility.

**Stock Market Indices**

Index (Jan. 2013 = 100)

- S&P 500
- S&P Europe 350
- SSE Composite

**Market Volatility Index (VIX)**

Index

Sources: Standard & Poor's, Yahoo Finance, WSJ, and Haver Analytics.
Last year's developments in China renewed concerns about its growth prospects.
More recent developments underscore concerns about slowing in China.

**Apple Inc. Sales and U.S. Ag Exports to China**

Index (2013:Q1 = 100)

- **Apple Inc. Sales in Greater China***
- **U.S. Ag Exports to China**

* Greater China includes mainland China, Taiwan, and Hong Kong.
Sources: Apple and USDA.
Debt in China has increased notably, but is still lower than in the U.S.
And other indicators point to momentum in the Chinese economy.

**Gross Savings**

- **Percent of GDP**

- **Source**: World Bank.

**China Consumer Spending**

- **Index (2010 = 100)**

  - Expenditure on Outbound Travel
  - China Box Office Revenue
  - Passenger Vehicle Sales in China

- **Sources**: World Travel & Tourism Council, China Association of Automobile Manufacturers, Motion Picture Association of America, and Haver Analytics.
Some trends may also be hard to reverse.
Understanding demographic trends will be key to understanding future global demand.

**Working Age Population**

Sources: United Nations and Haver Analytics.
In agriculture, weather plays a crucial role in determining crop prices in the short-term.

**U.S. Crop Prices and Drought**

Index (Jan. 2007 = 100)

- **U.S. Crop Price Index (Left Scale)**
- **U.S. Drought (Right Scale)**

Sources: USDA, University of Nebraska-Lincoln and NOAA.
* Includes lower 48 states only.
Expectations of expanded crop acreage in the Corn Belt could play a significant role this year.

Projected Change in Corn and Soybean Acres Planted

Source: USDA
But demand strength will be the key long-term driver.

**U.S. Ag Exports**

- World Total
- China

Source: USDA.

**U.S. Ethanol Production**

* Year-to-date average through April.
Source: EIA.
As it stands, crop price expectations are even slightly more bearish than last year.

U.S. Corn Price Expectations

Source: Calculations based on data from barchart.com
An unexpected demand shock may be needed to envision a higher path of growth for crop prices.

**Long-term Crop Price Projections**

Sources: University of Missouri: FAPRI, *Wall Street Journal* and Haver Analytics
Livestock prices are also generally projected to remain below current levels.

Long-term Livestock Price Projections

Sources: University of Missouri: FAPRI, *Wall Street Journal* and Haver Analytics
The downturn in the U.S. ag economy has persisted for 3 years. Implications for credit markets?
Financing needs began rising notably in 2013, and have remained high.

Source: Federal Reserve Bank of Kansas City, Ag Finance Database
Credit conditions have gradually deteriorated.

Tenth District Credit Conditions
2015, Fourth Quarter

Source: Federal Reserve Bank of Kansas City, Survey of Ag Credit Conditions
Farmland values have also declined, but only at a modest pace.

Changes in High Quality Farmland Values

*Percent changes are calculated using responses only from those banks reporting in both the past and the current quarters.
Source: Federal Reserve Bank of Kansas City
Cash rents have declined somewhat, but not as quickly as most producers have hoped for.

Changes in Tenth District Cash Rents

Source: Federal Reserve Bank of Kansas City
In the short-term, liquidity may be a more significant concern than solvency.

**U.S. Farm Sector Operating Loan Volume**
(Commercial Banks)

- Operating Loan Volume as a Share of Total Volume (Left Scale)
- Ratio of operating debt to net farm income (Right Scale)

**U.S. Farm Sector Debt-to-Asset Ratio**

Source: Federal Reserve Bank of Kansas City

Source: USDA.
How might a changing interest rate environment affect the ag economy?
Farm interest rates have increased, but only slightly.

Interest Rates on Non-Real Estate Farm Loans
First Quarter

Source: Agricultural Finance Databook, Table A.5
Interest expenses, however, are small when compared to fluctuations in commodity prices.

U.S. Corn Producers - Interest Expenses and Price Fluctuations

Sources: USDA, barchart.com and author’s calculations.
Concluding Points

- Farm income has continued to weaken with low commodity prices.
  - Supply-side headwinds: strong U.S. and global production.
  - Demand-side headwinds: ethanol blend wall, export markets and China.
    - Biofuel exports may be a longer-term boost.

- Effects of the downturn in the farm economy:
  - Tightening credit conditions.
  - Pressure on cash rents and farmland values.
  - Consolidation (opportunities for some).
  - Accelerating decline in rural, agricultural areas.
Questions?

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