

Outlook for the U.S. Economy

With Implications for the Ag Sector

Extension Outlook Conference - August 14, 2018



8/19/2018

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

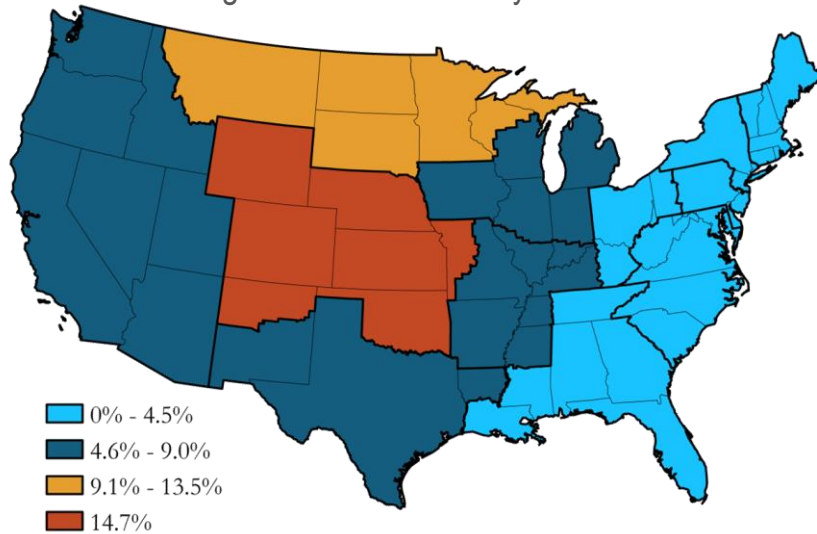
Cortney Cowley



Of the 12 Fed Districts, the 10th District is the most concentrated in agriculture by some measures.

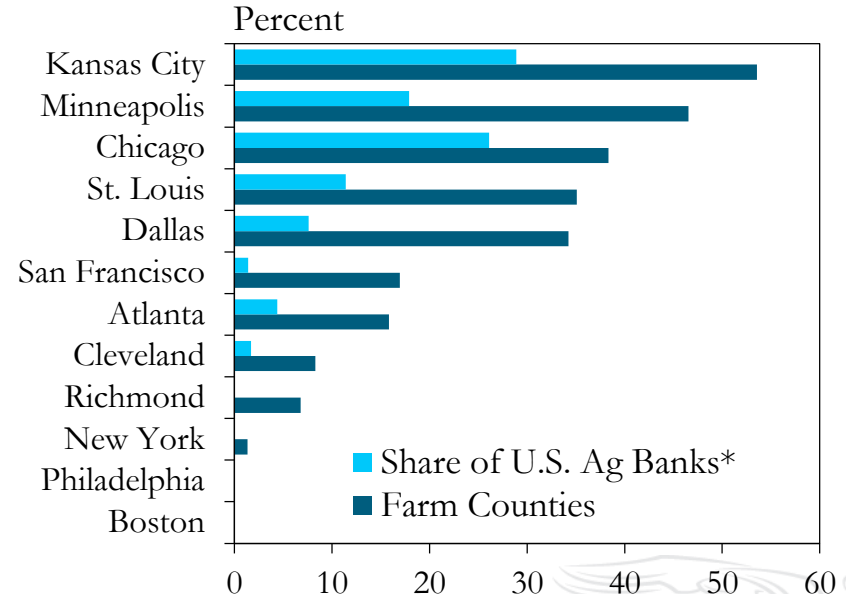
Average Farm Income as a Share of Total Personal Income

Average Across Counties by Fed District



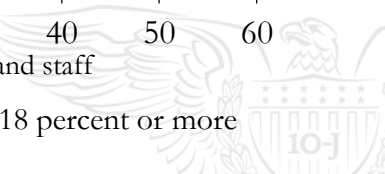
Source: BEA.

Proportion of “Farm Dependent” Counties and Agricultural Banks



Source: BEA, USDA, Ag Finance Databook and staff

*Agricultural banks are defined as banks with farm production and farm real estate loans equaling approximately 18 percent or more of total loans.



Outline

- U.S. economic outlook
 - Economic activity and labor market remain solid
 - Inflation gradually moving up
- Short- and long-term effects of agricultural trade issues
 - Price volatility and reshuffling of exports in the short term.
 - Longer-term implications of tariffs are that the US is no longer the low-cost producer and is less competitive in global markets.
- Implications for the agricultural sector
 - “The farm economy is fragile.”
 - Weak farm income and liquidity, but farmland values have remained relatively stable.

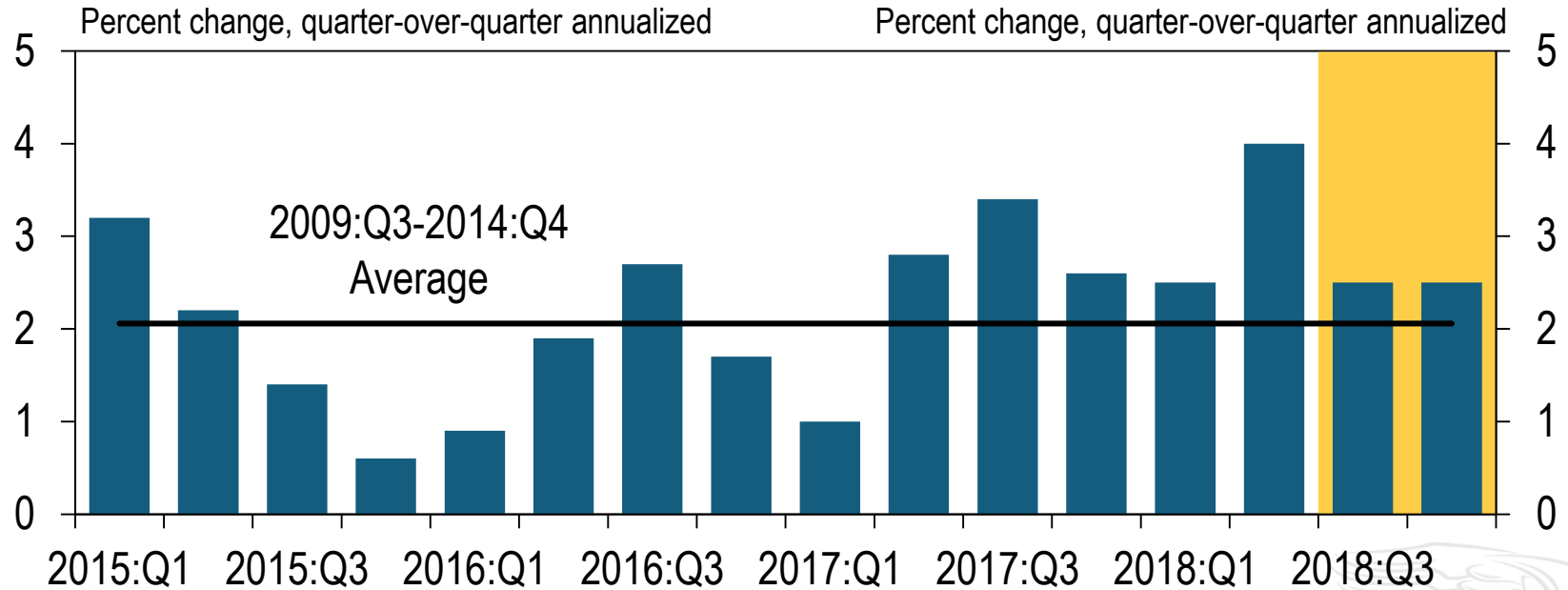


U.S. Economic Outlook



GDP growth remains solid and continues to increase above the post-recession trend.

U.S. Real Gross Domestic Product



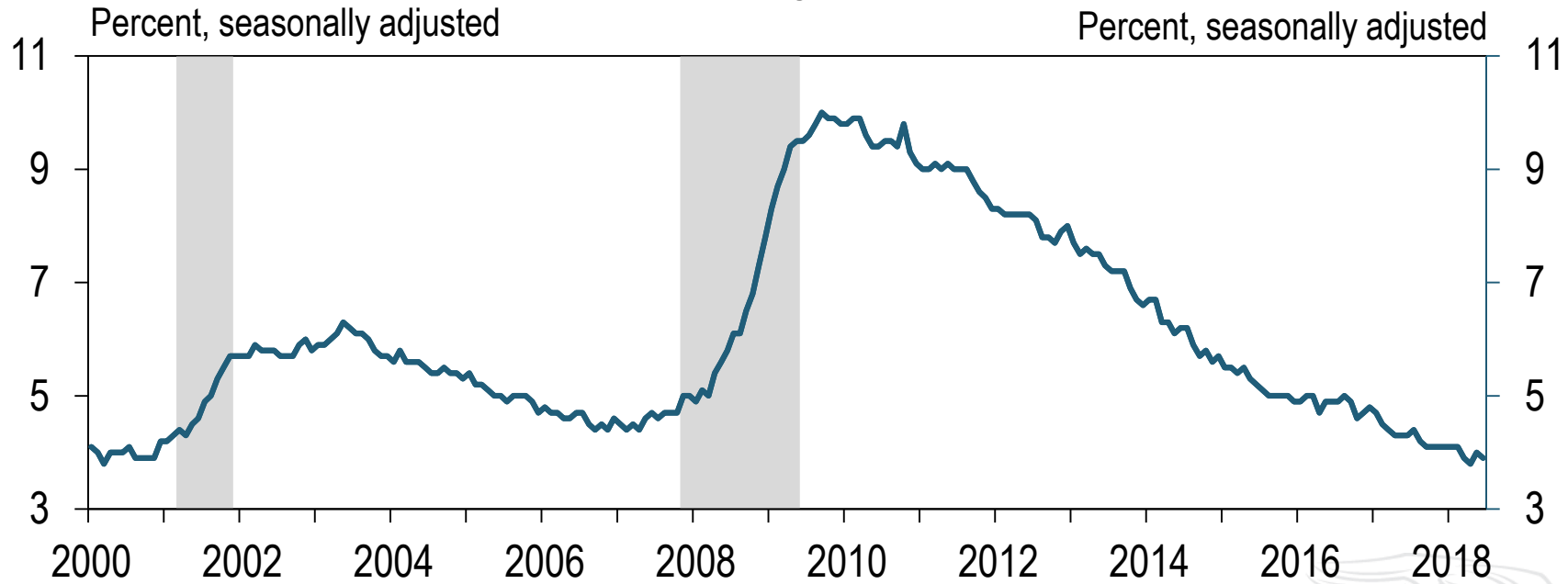
Note: Yellow shaded area denotes forecasts.

Source: Bureau of Economic Analysis and Haver.



Unemployment rates are historically low.

Unemployment Rate



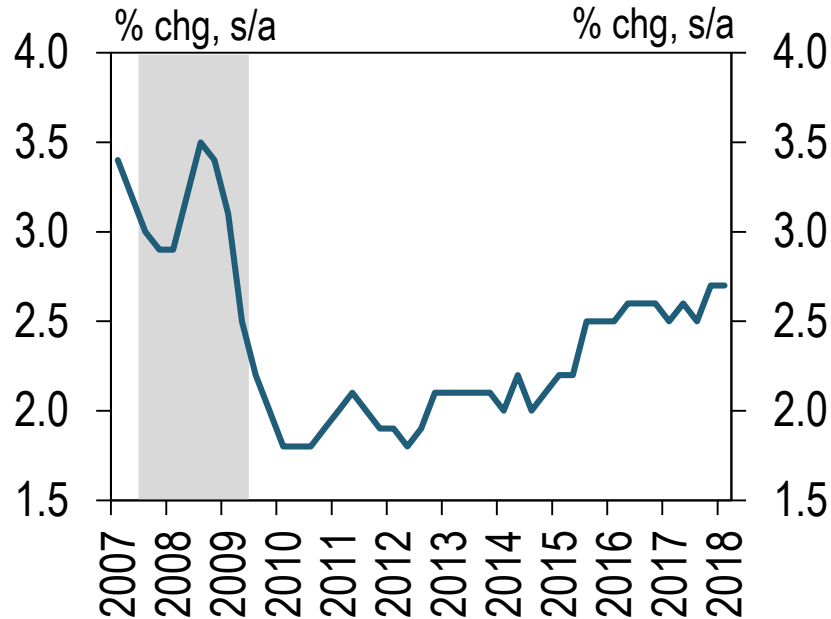
Note: Gray shading represents recession.

Sources: BLS via Federal Reserve Bank of St. Louis and NBER.

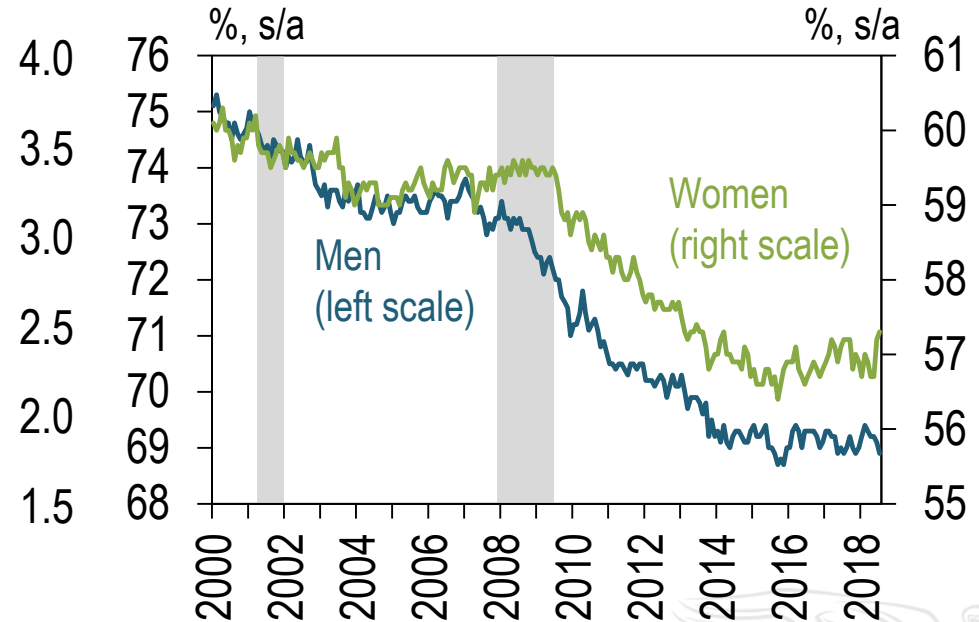


Wage growth and labor force participation have flattened.

Wage Growth



Labor Force Participation



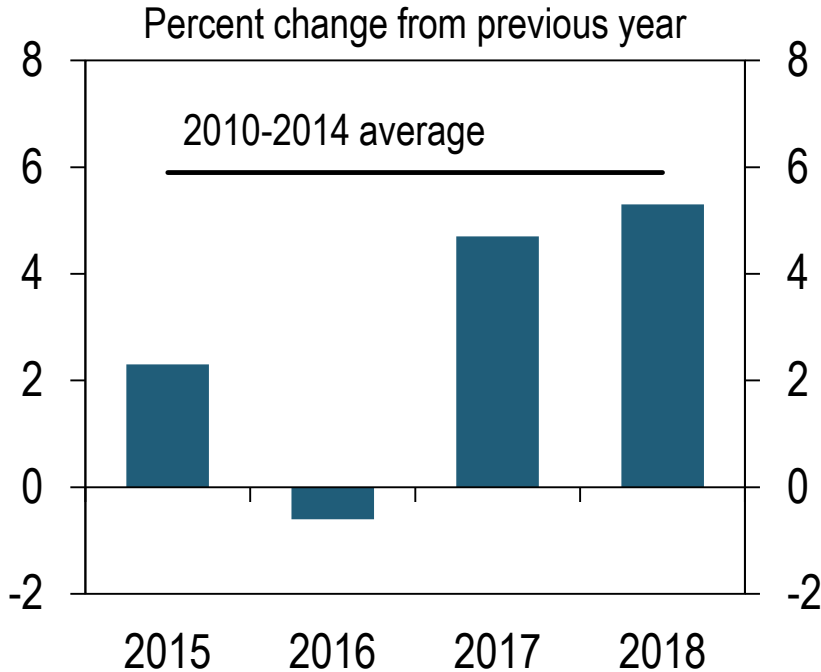
Note: Gray shading represents recession.

Sources: BLS via Federal Reserve Bank of St. Louis and NBER.

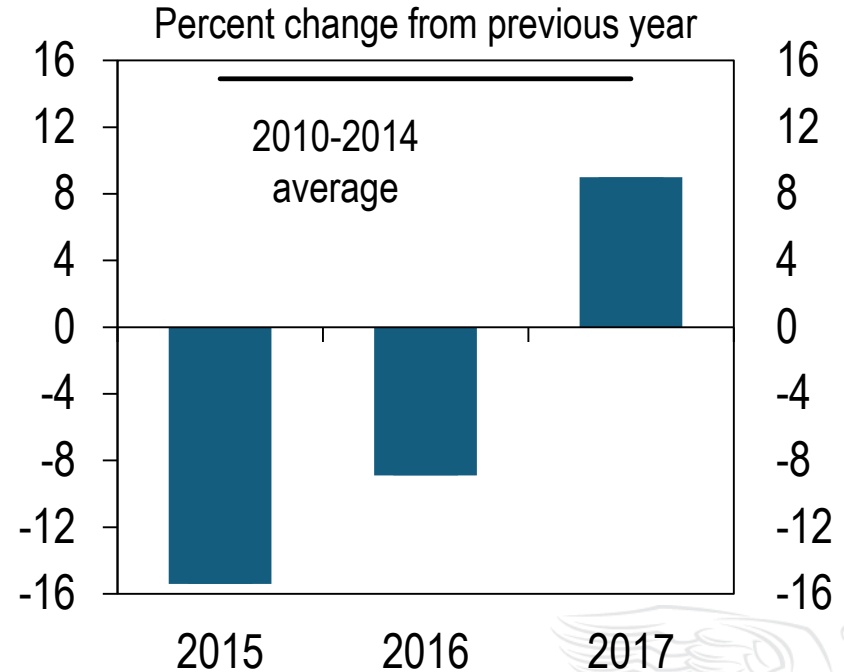


Business fixed investment continues to rebound.

Real Business Fixed Investment

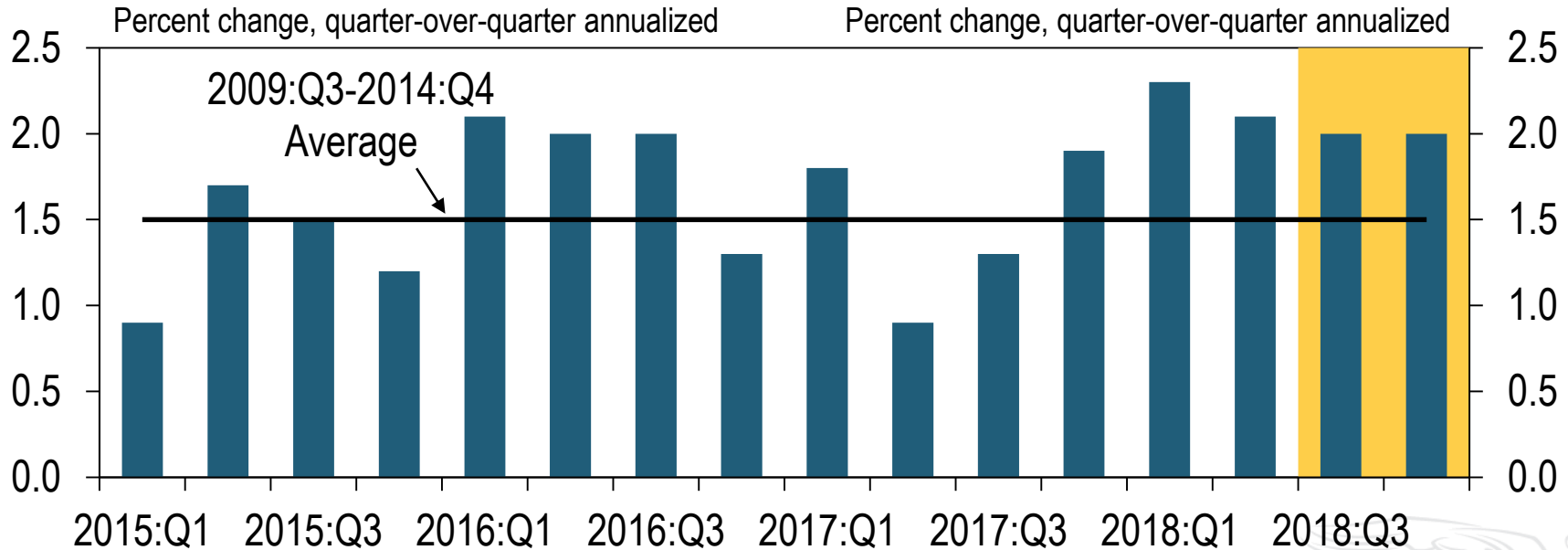


Agricultural Machinery Investment



Core inflation is expected to be above average in 2018.

Personal Consumption Expenditures (PCE) Excluding Food and Energy



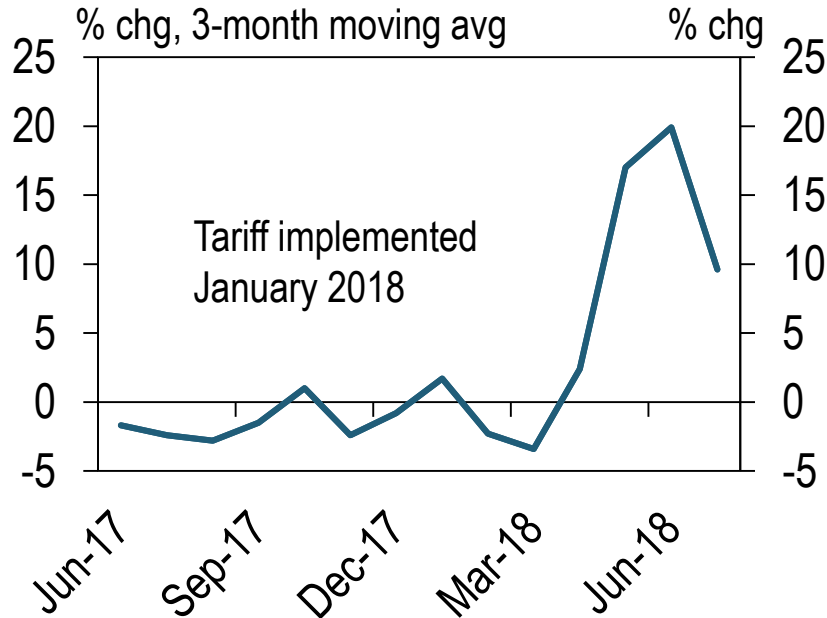
Note: Yellow shaded area denotes forecast.

Source: Bureau of Economic Analysis.

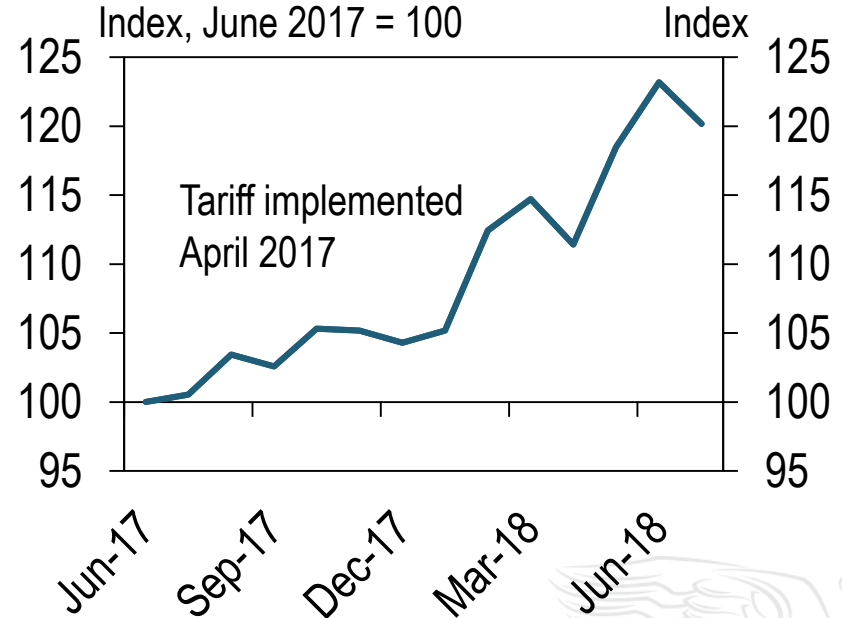


U.S. tariffs have significantly increased prices in targeted sectors.

CPI: Laundry Equipment



PPI: Softwood Lumber

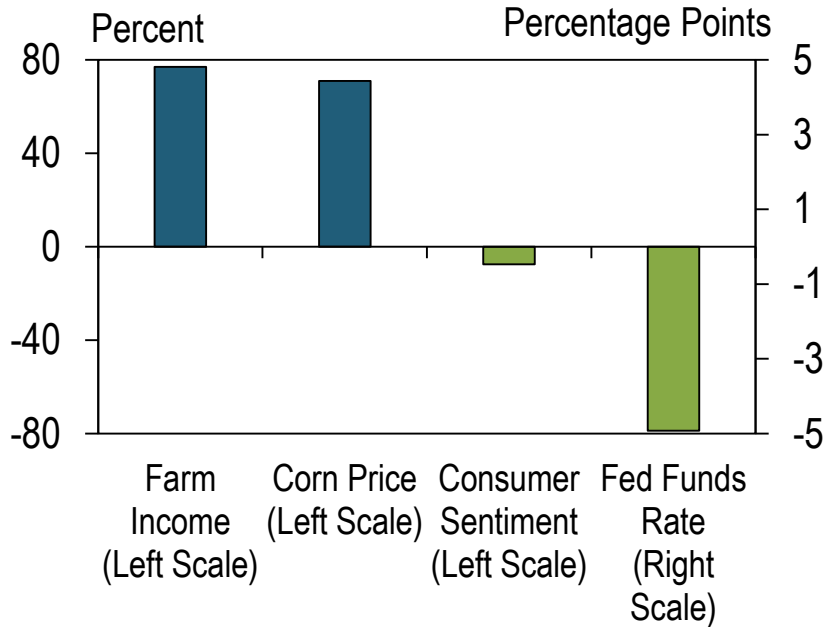


Ag Tariff Implications in the Short and Long Term

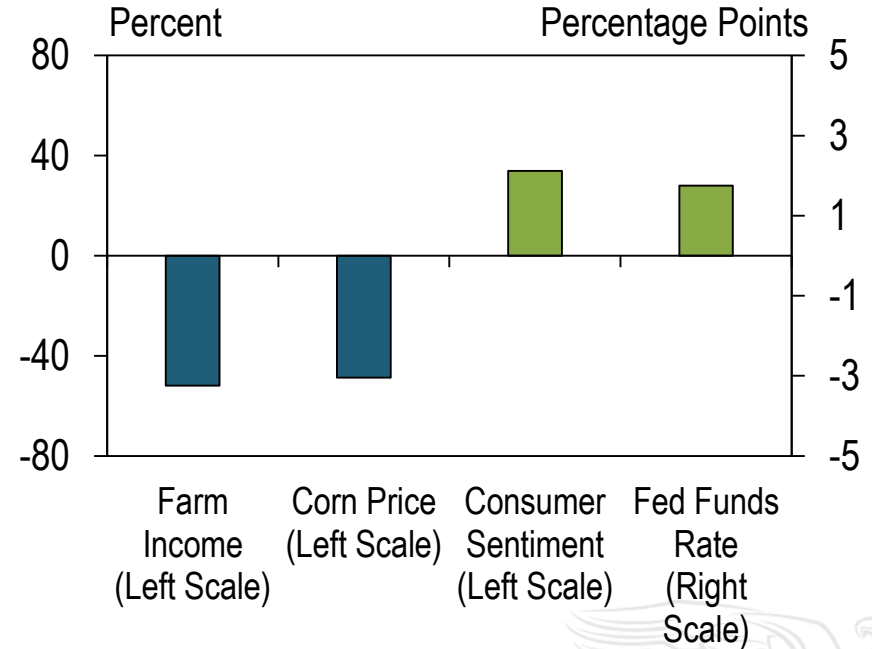


The outlooks for agriculture and the U.S. economy have reversed since 2013.

Change from 2007-2013



Change from 2013-2018

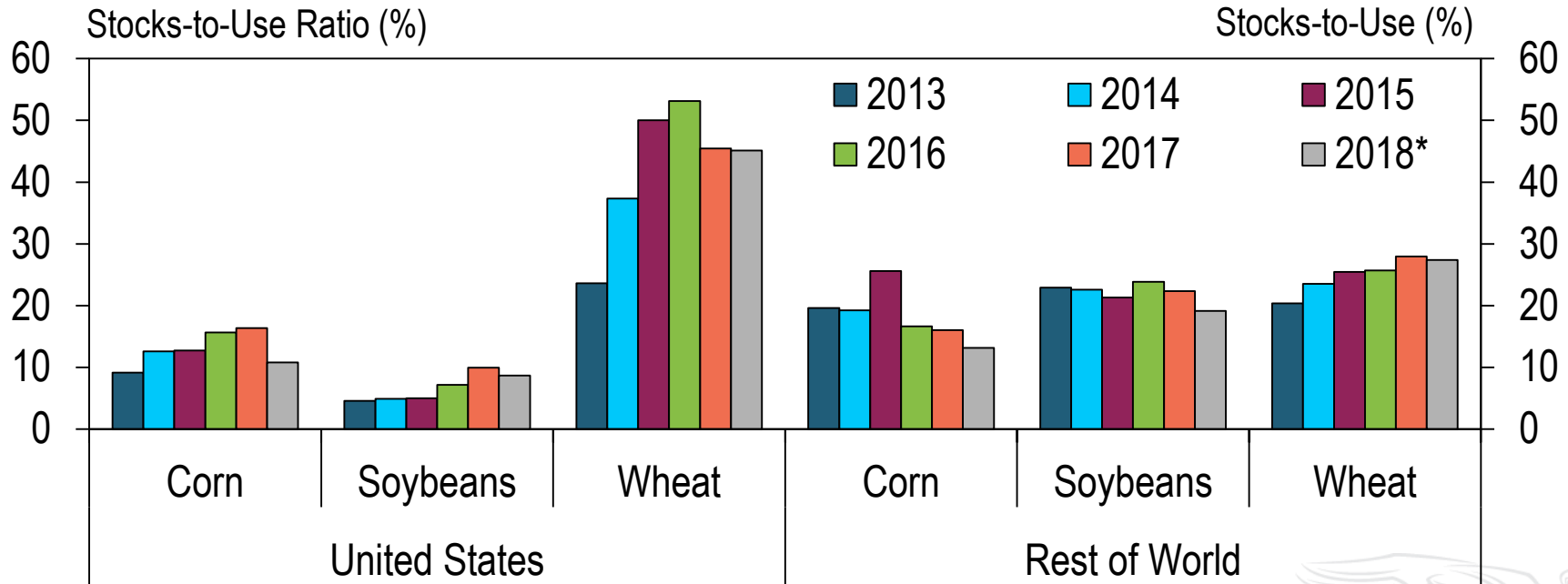


Source: U.S. Department of Agriculture (USDA), University of Michigan, Board of Governors of the Federal Reserve System, and Haver Analytics



Inventories have been record large, but are expected to decline in 2018.

Inventories

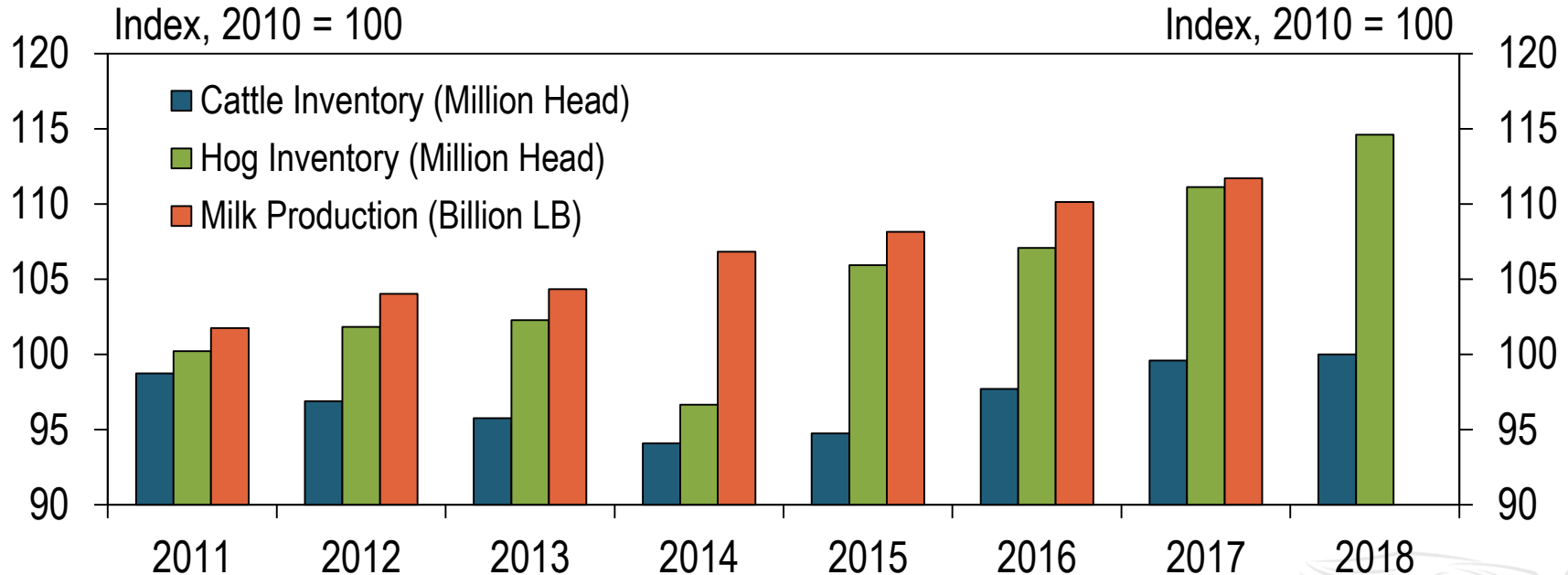


*Forecast for 2018.
Source: USDA.



Production of other ag commodities has also increased notably.

U.S. Commodity Production and Inventories



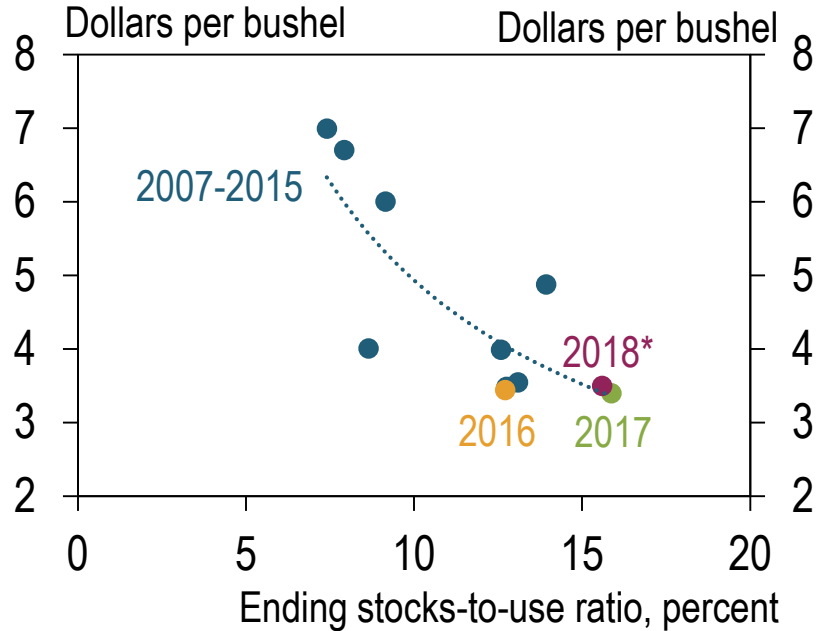
Note: Annual milk production data available through 2017.

Source: USDA.

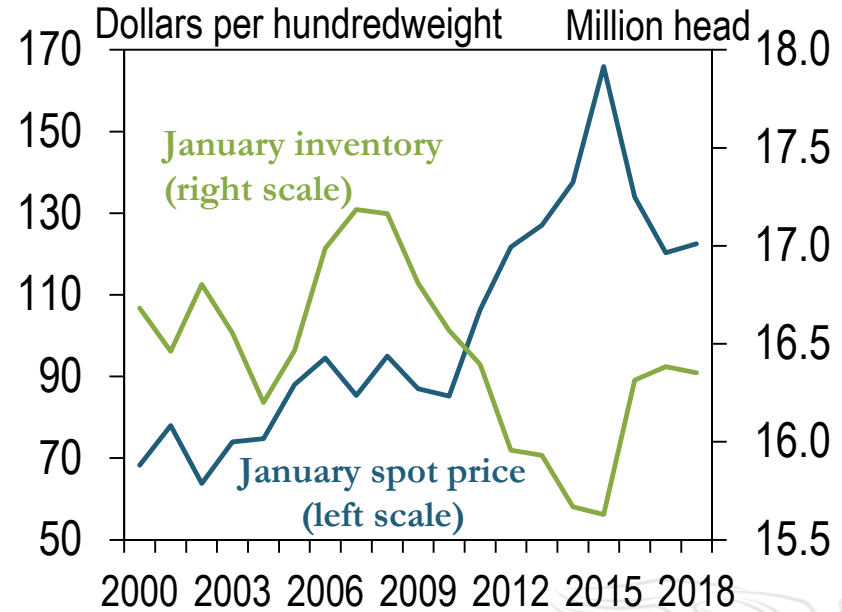


Moving forward, the size of U.S. inventories will play a critical role in the direction and magnitude of price movements.

Corn Prices and Inventories



Cattle in the U.S.

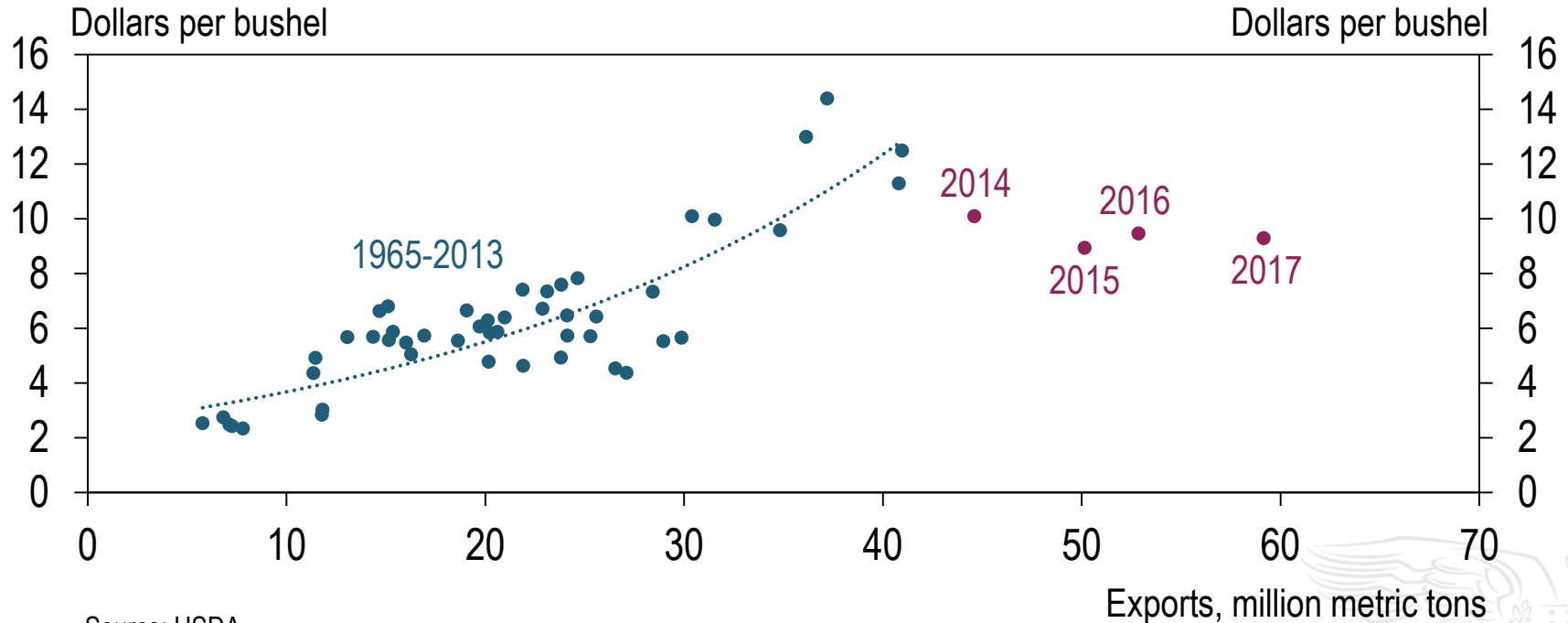


*Forecast for 2018.



Inventories have weighed on prices, even as trade has expanded.

U.S. Soybean Exports and Prices

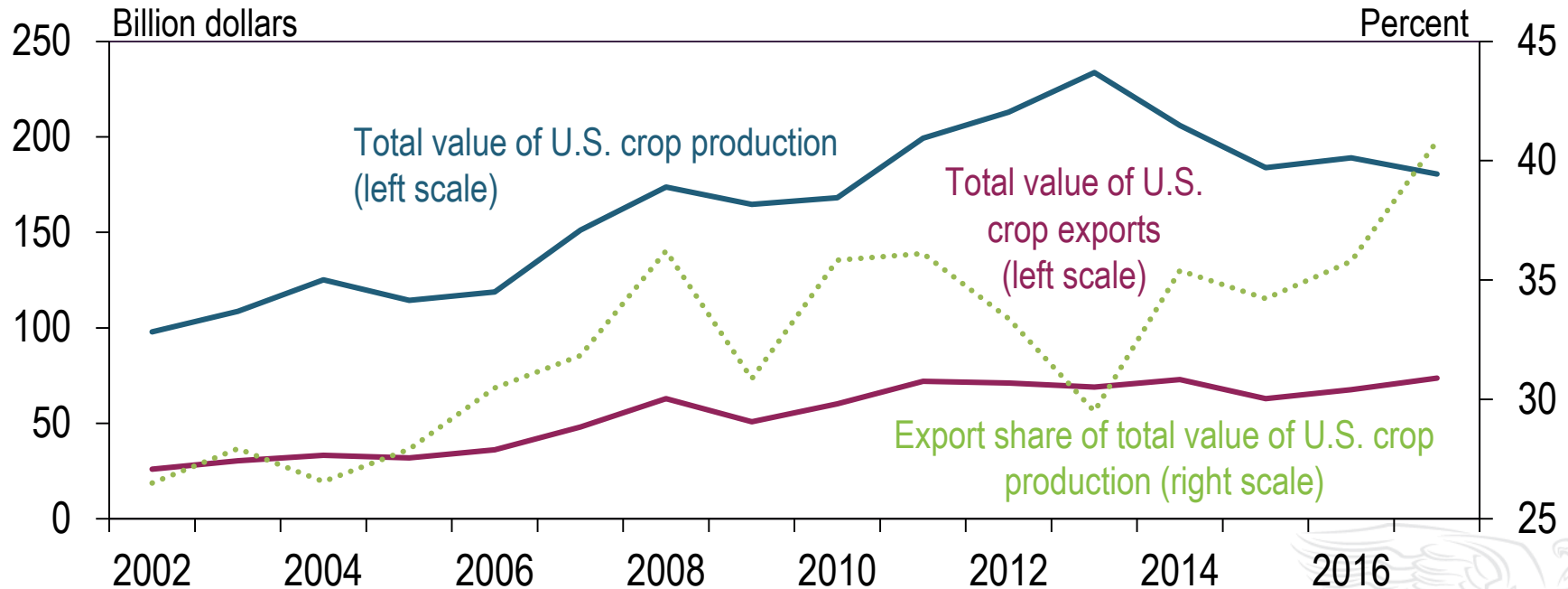


Source: USDA.



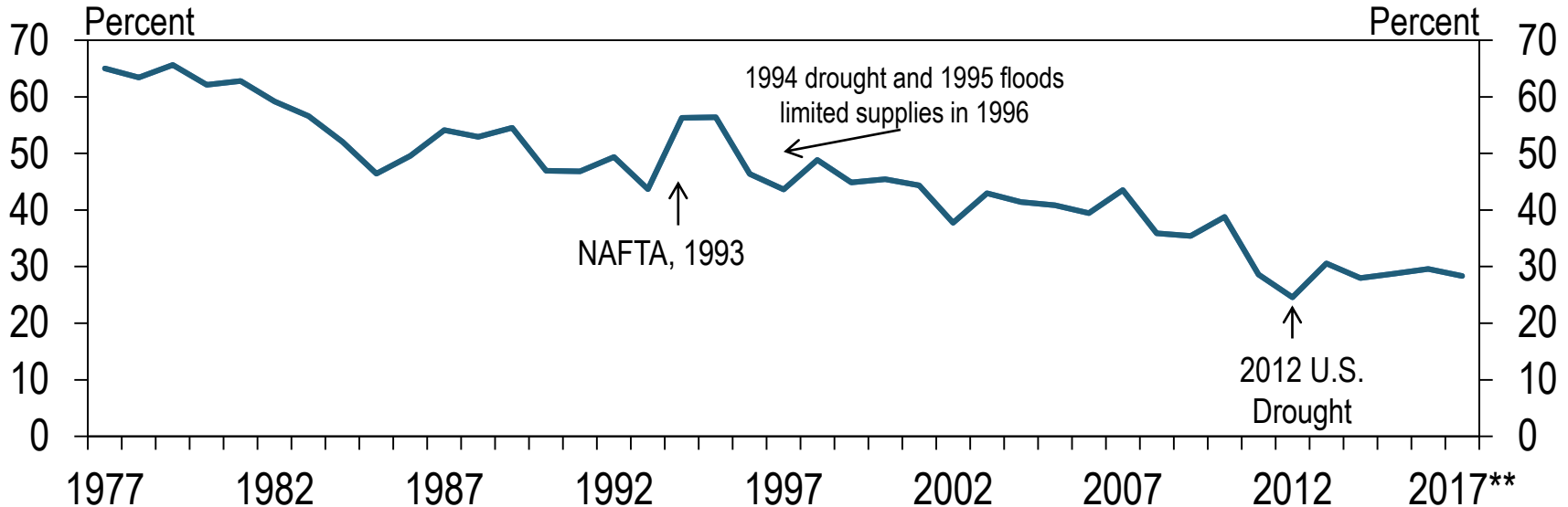
The export share of the total value of U.S. crop production has increased recently.

Export Share of Total Value of U.S. Crop Production



However, the U.S. share of world crop exports has fallen steadily over time.

U.S. Share of World Corn, Soybean and Wheat Exports



*2016 estimate

**2017 forecast

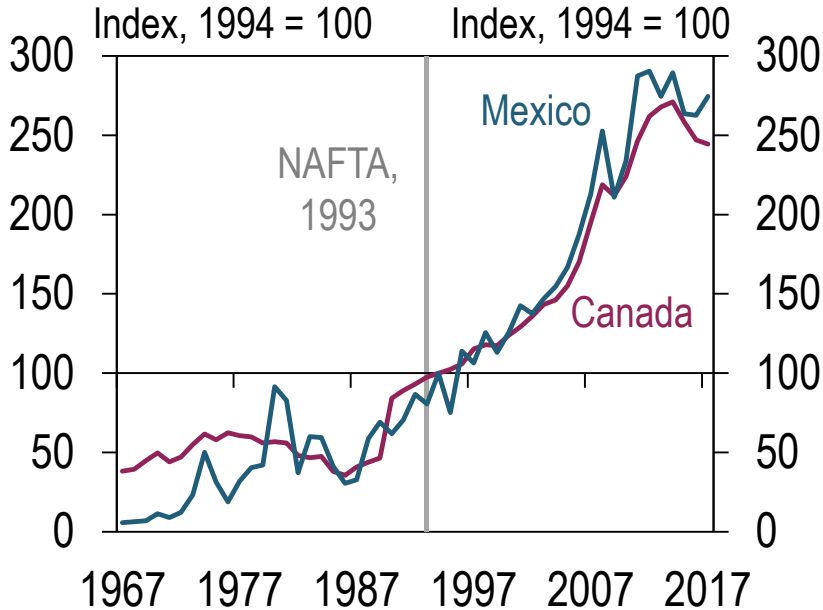
Note: Corn, soybeans, and wheat are responsible for 50 percent of crop cash receipts in the U.S.

Source: USDA Production, Supply, and Distribution estimates.

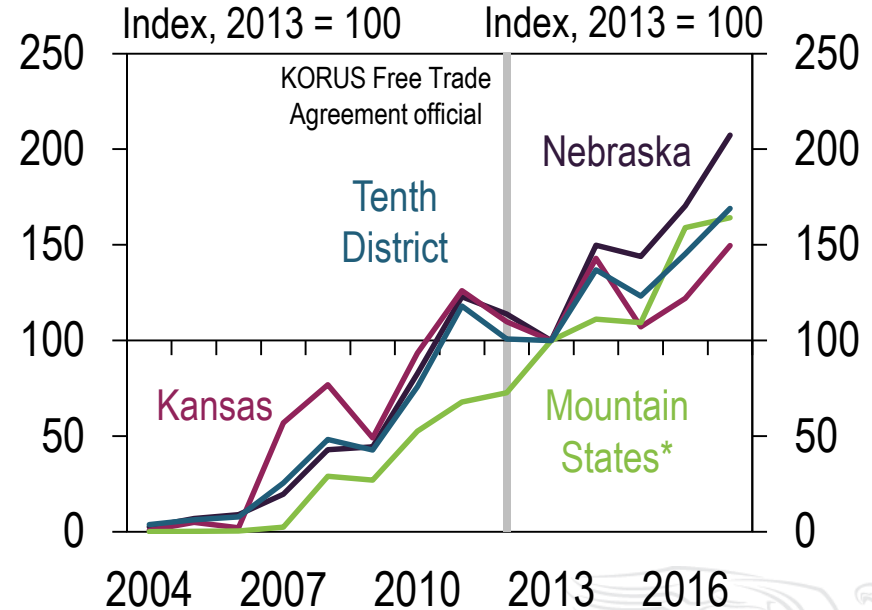


One mitigating factor or increasing global competition has been U.S. participation in trade deals.

U.S. Ag Exports to NAFTA Partners



10J Ag Exports to South Korea



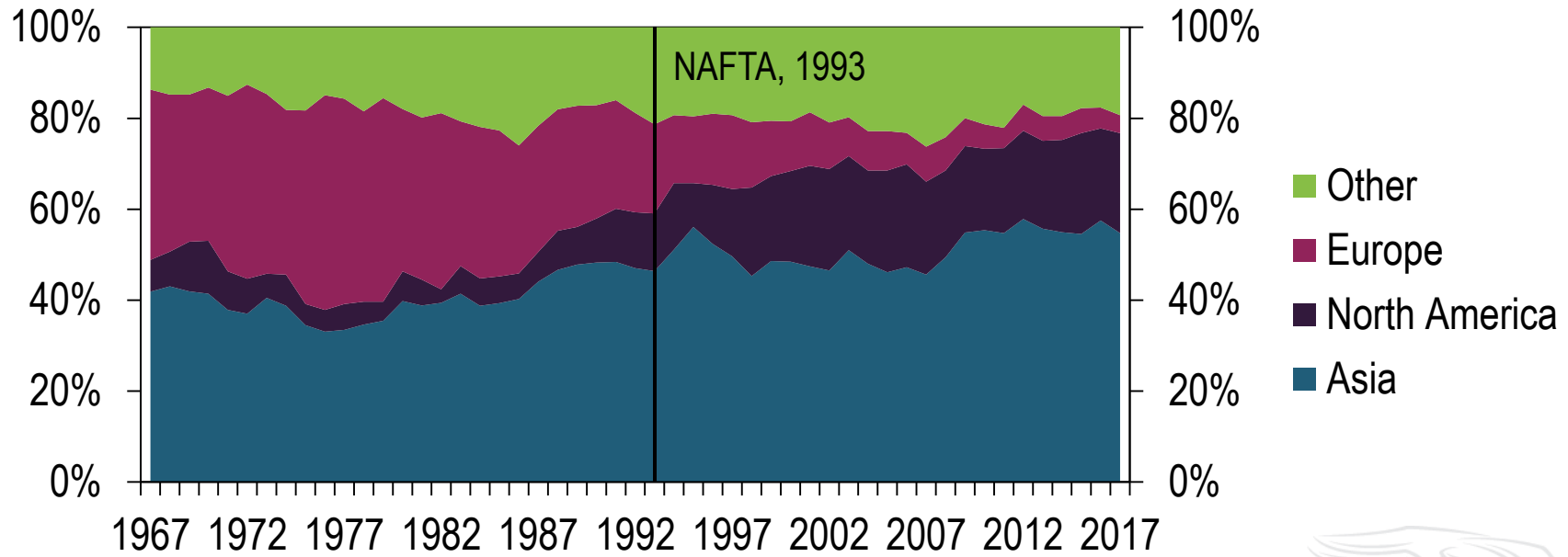
* The Mountain States include Colorado, Wyoming, and Northern New Mexico.

Source: WisersTrade.



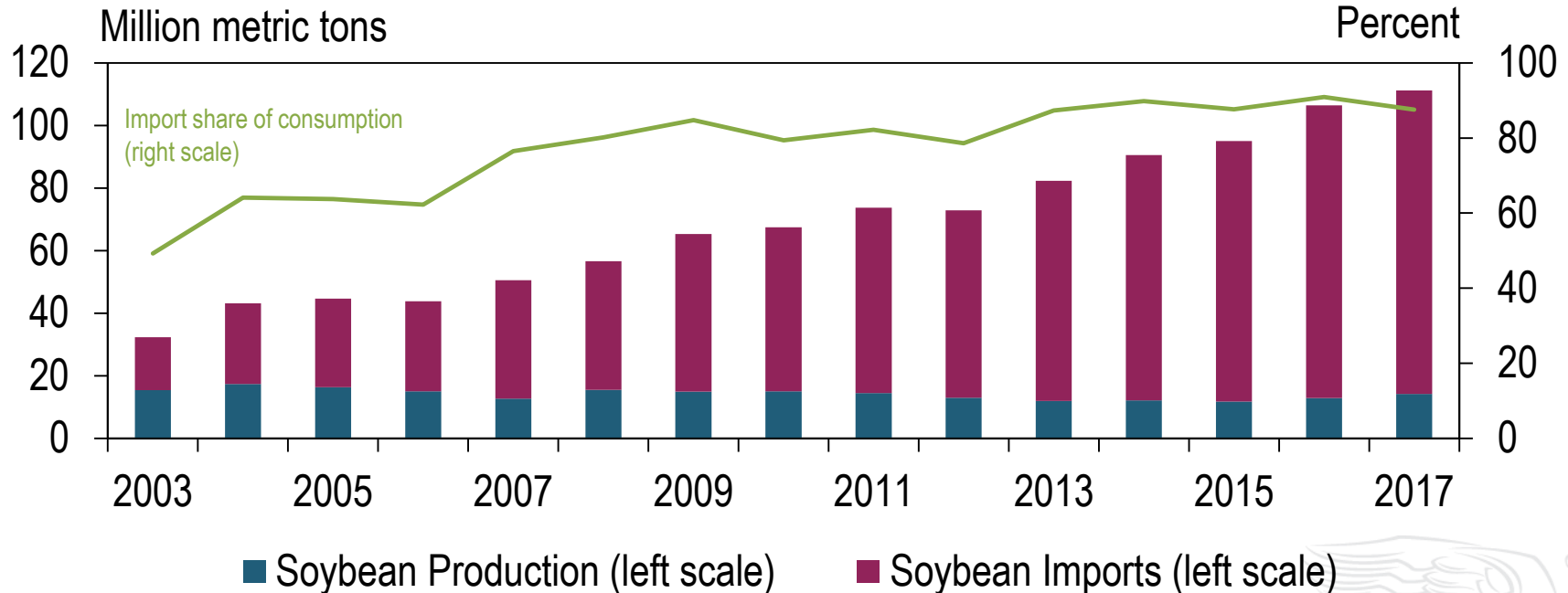
In fact, trade with North American and Asian partners now accounts for almost 80% of U.S. ag exports.

Share of U.S. Ag Export Value by Region



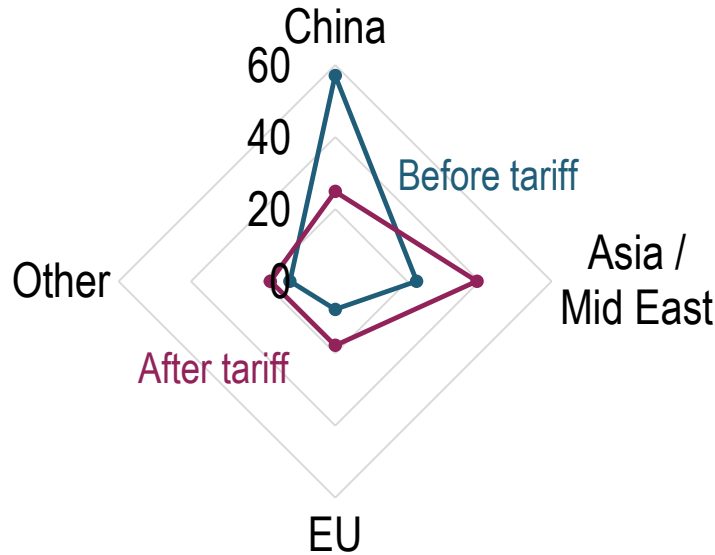
China has become increasingly dependent on imports of soybeans.

China Soybean Import Dependence

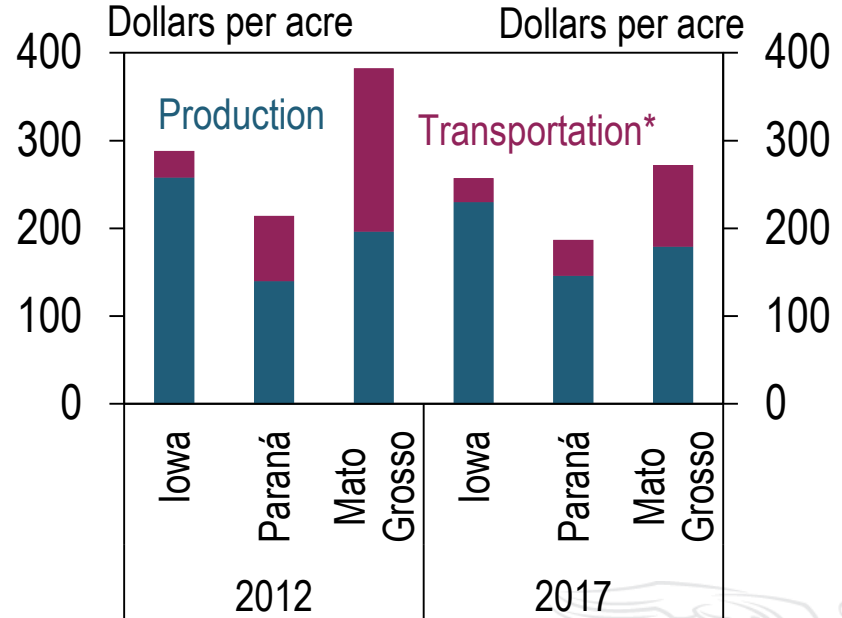


Tariffs from China could cause some reshuffling in trade flows and prices.

U.S. Exports of Soybeans



Soybean Costs in the U.S. and Brazil

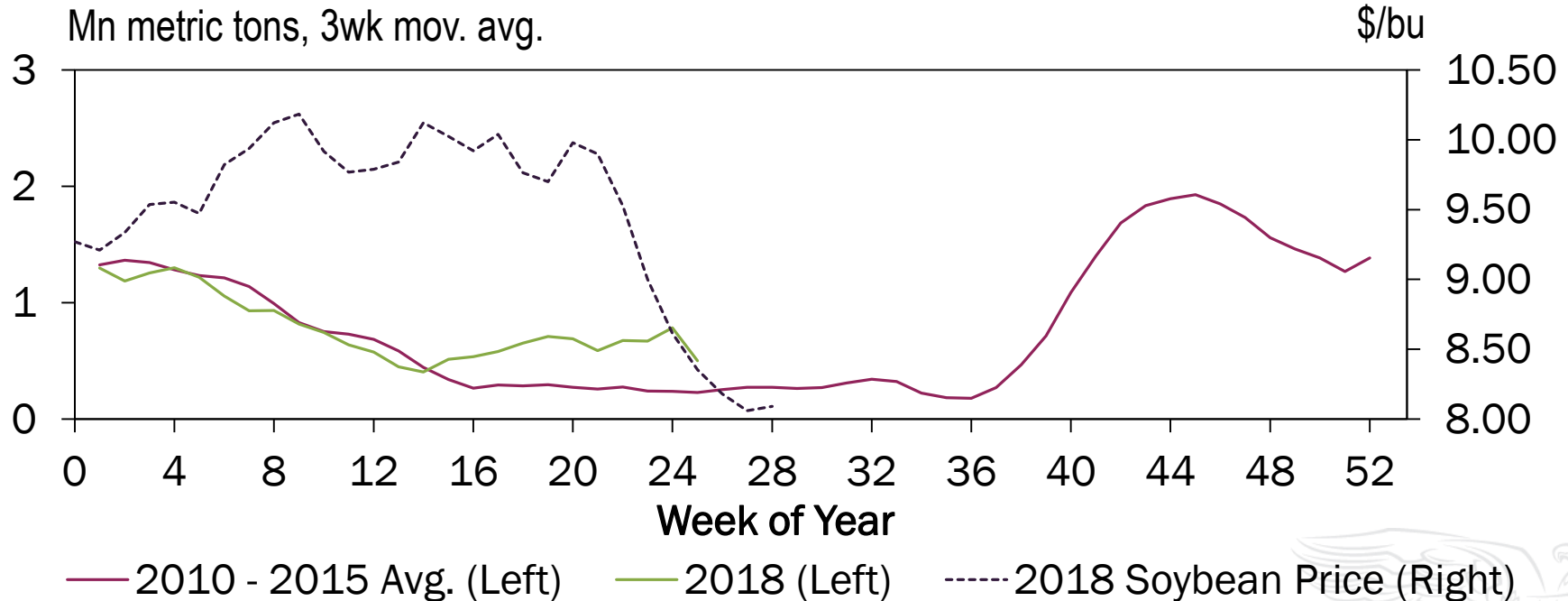


* Costs to ship from farm to port.
Sources: Gavilon and USDA.



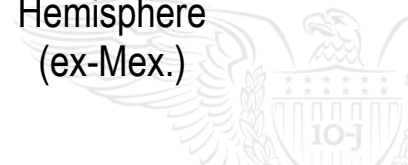
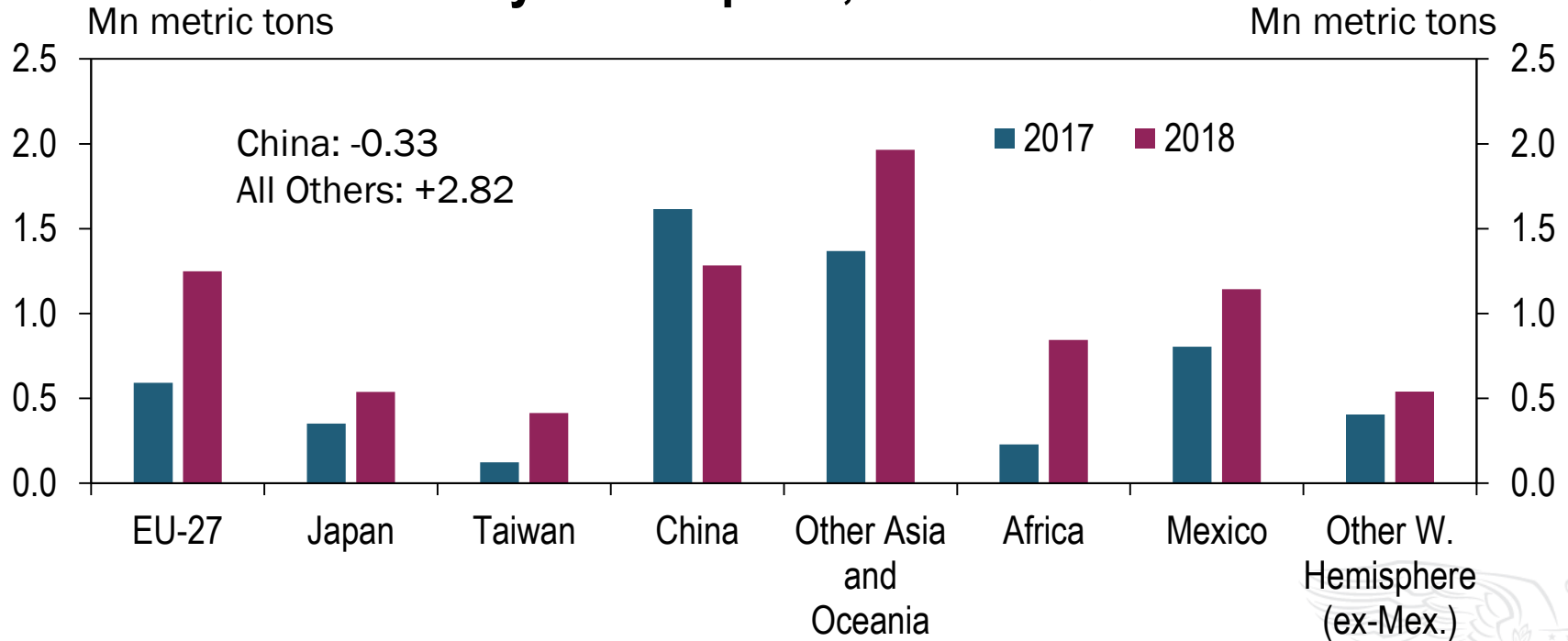
In fact, second quarter soybean exports were very strong.

U.S. Soybean Exports and Prices



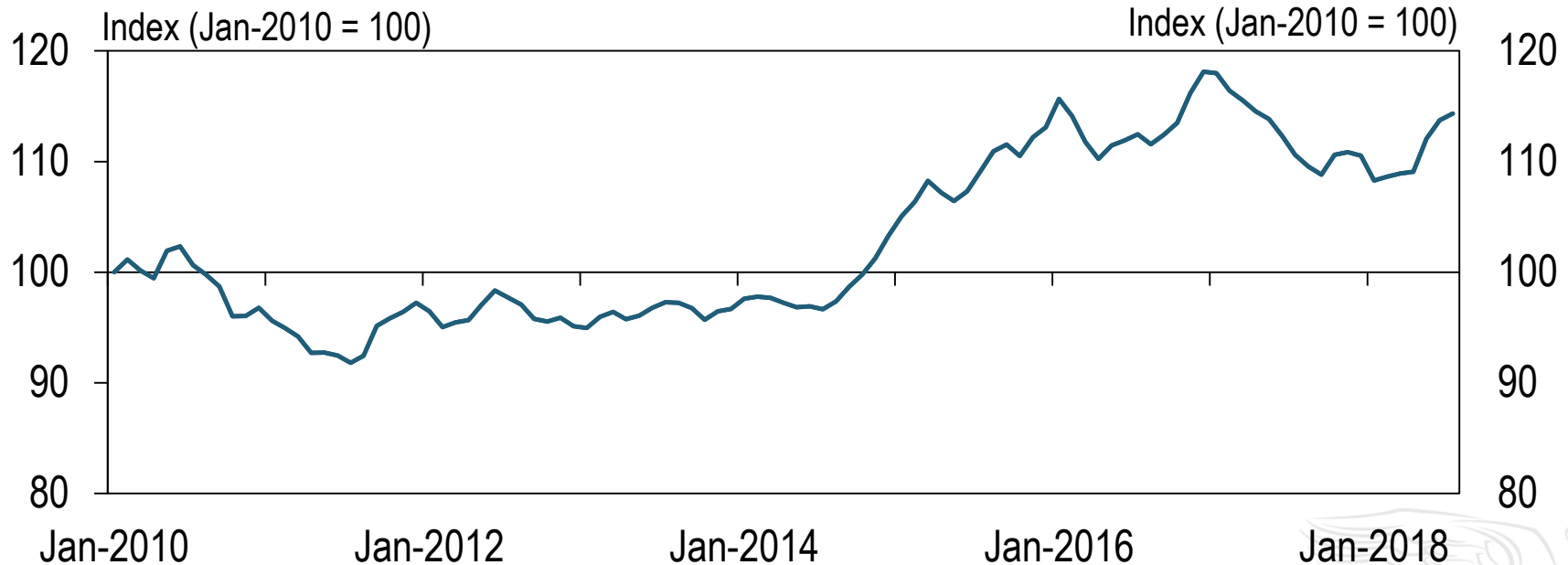
And trade flows have already begun to reshuffle.

U.S. Soybean Exports, Second Quarter



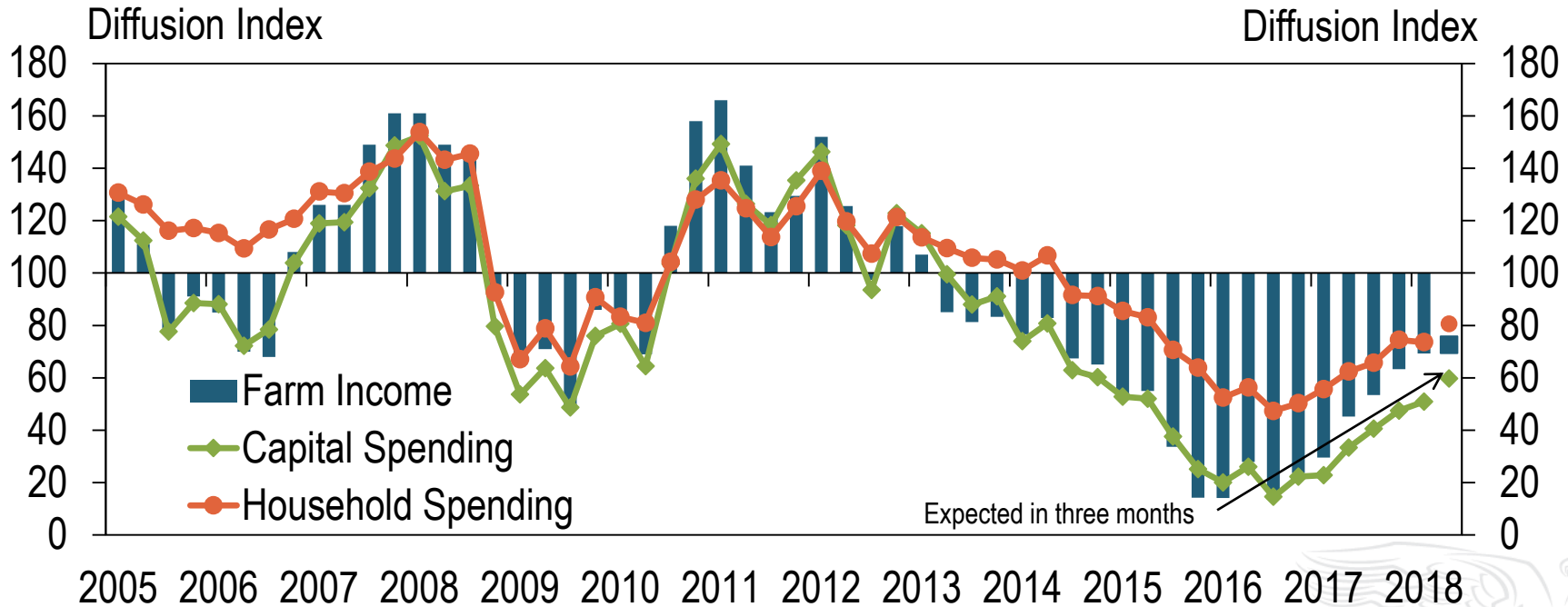
The value of the US\$ ticked up recently, which could create additional headwinds for exports.

Real Broad Trade-Weighted Exchange Value of the US\$



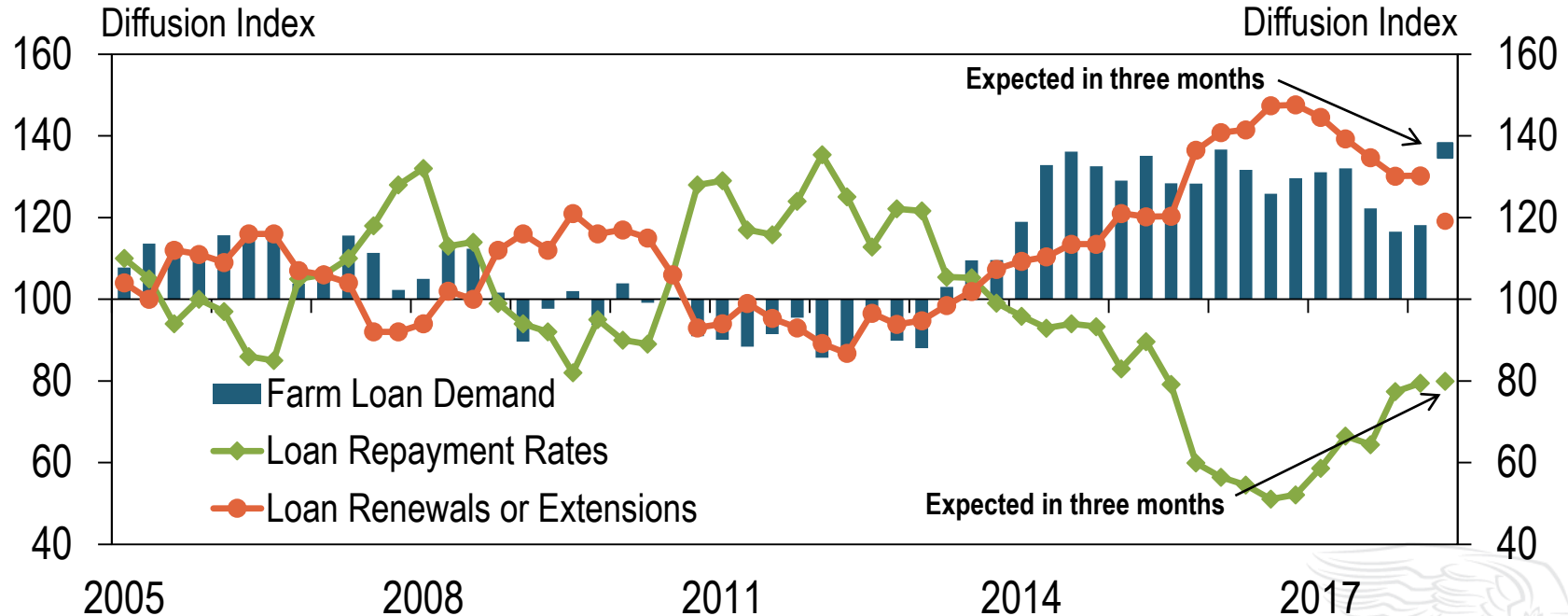
During the downturn in the ag economy, farm income and spending have been persistently low.

Tenth District Farm Income and Spending



Credit conditions also continue to weaken but at a slower pace.

Tenth District Credit Conditions

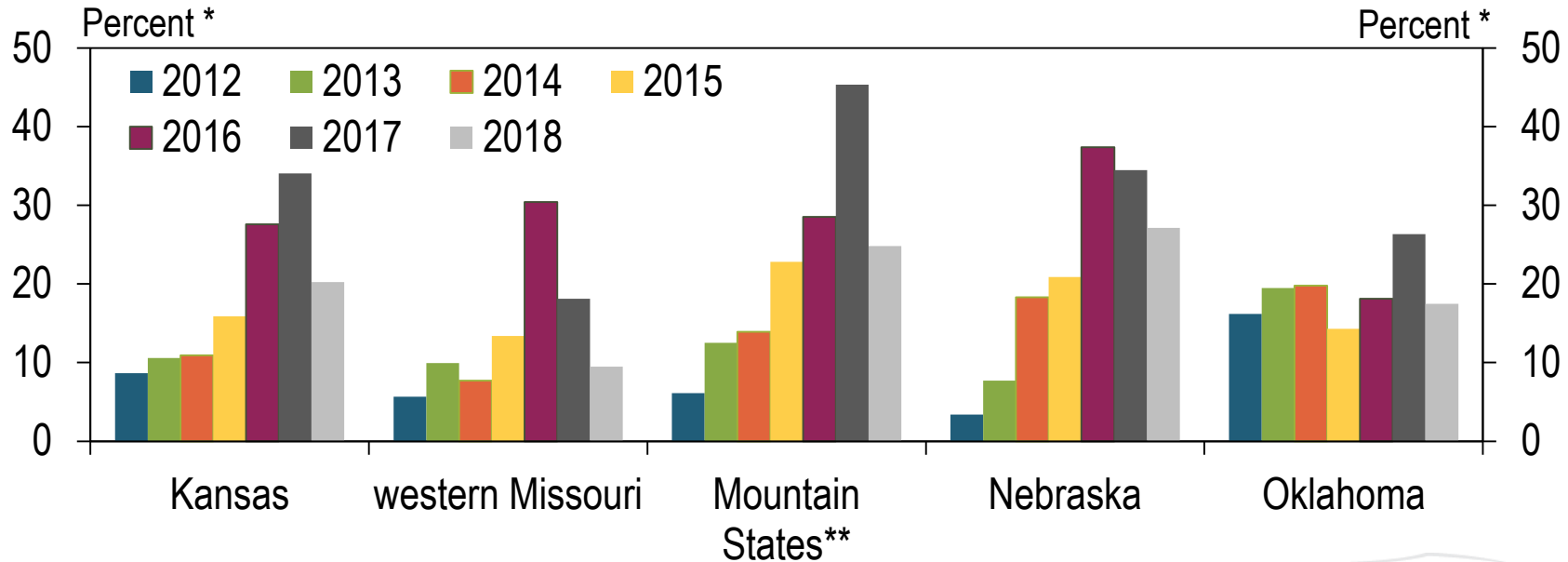


Source: Federal Reserve Bank of Kansas City.



In addition, the amount of debt carried over from the previous year also continues to increase, but at a slower rate.

Farm Borrowers with an Increase in Carryover Debt



* Average response of banks in each region shown

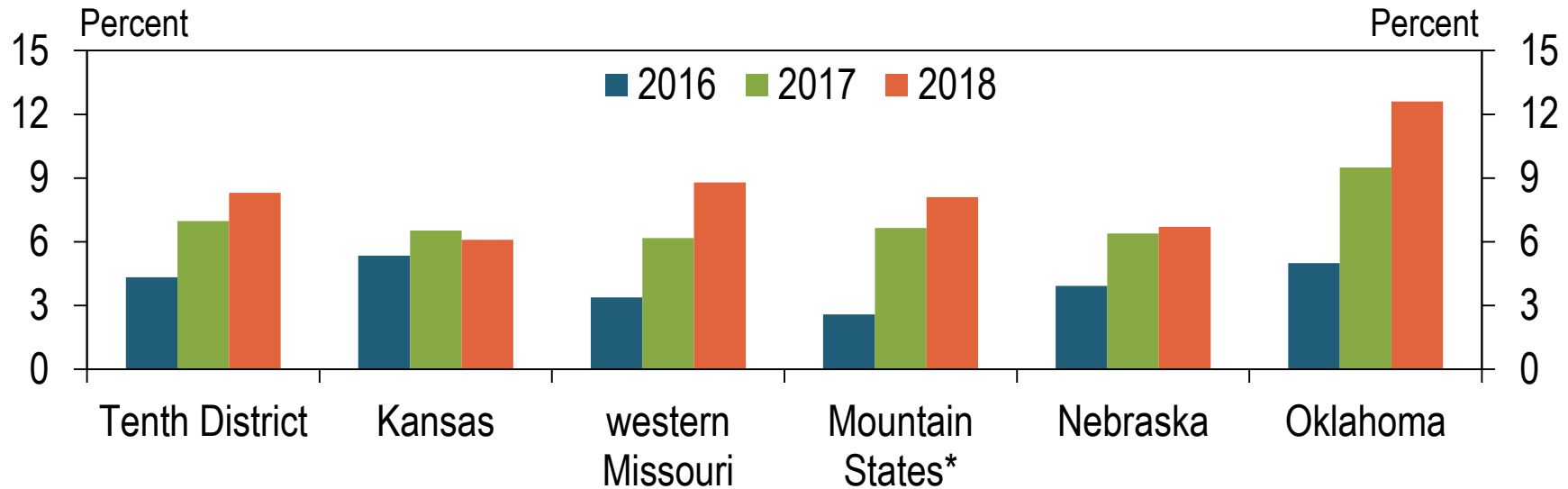
** Mountain States include Colorado, northern New Mexico and Wyoming, which are grouped because of limited survey responses from each state.

Source: Federal Reserve Bank of Kansas City.



Reduced farm income has restricted cash flow and contributed to more farm loan denials than in recent years.

Farm Loan Requests Denied Due to Customer Cash Flow Shortages



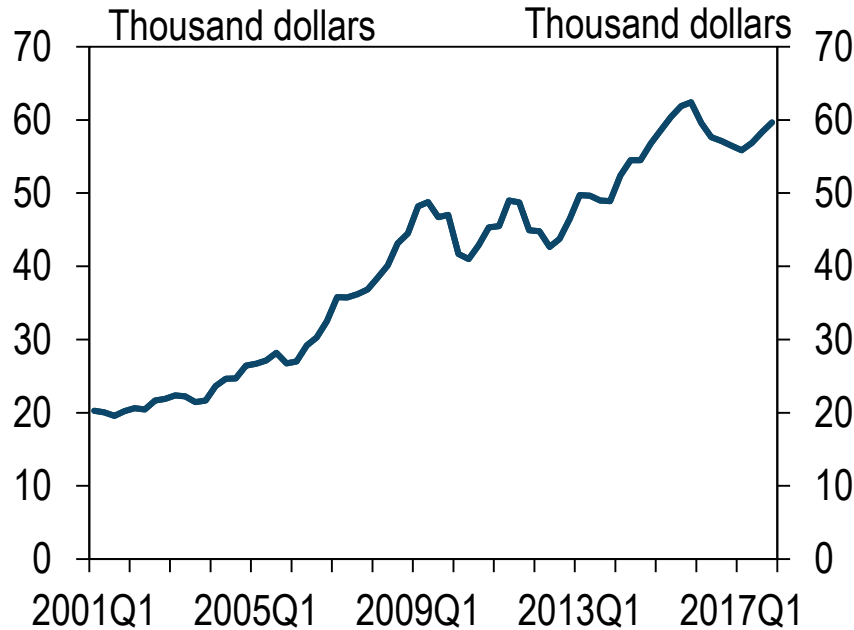
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Source: Federal Reserve Bank of Kansas City.

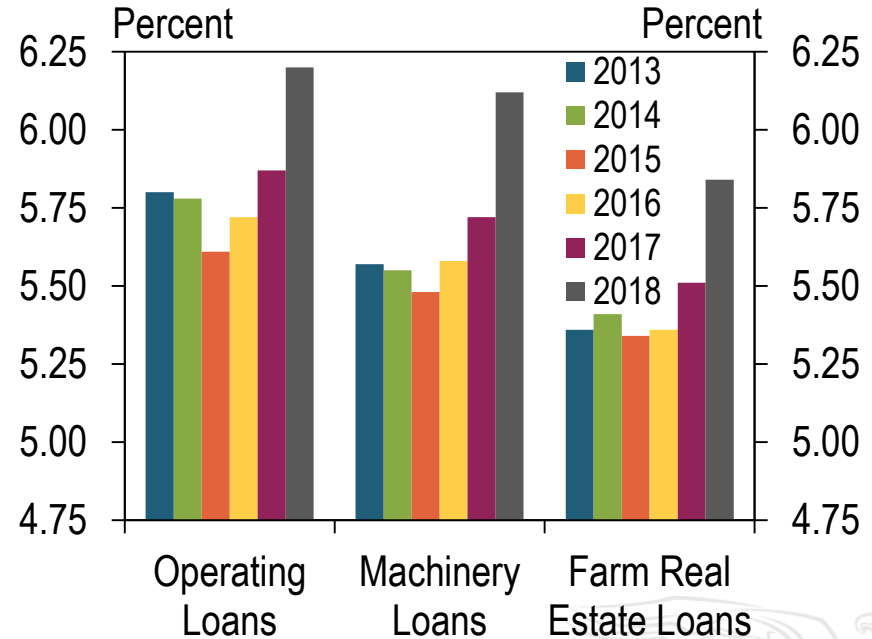


Higher interest rates have increased farmers' debt obligations on new loans, but the effect on short-term loans has been relatively small.

Average Size of Farm Operating Loans

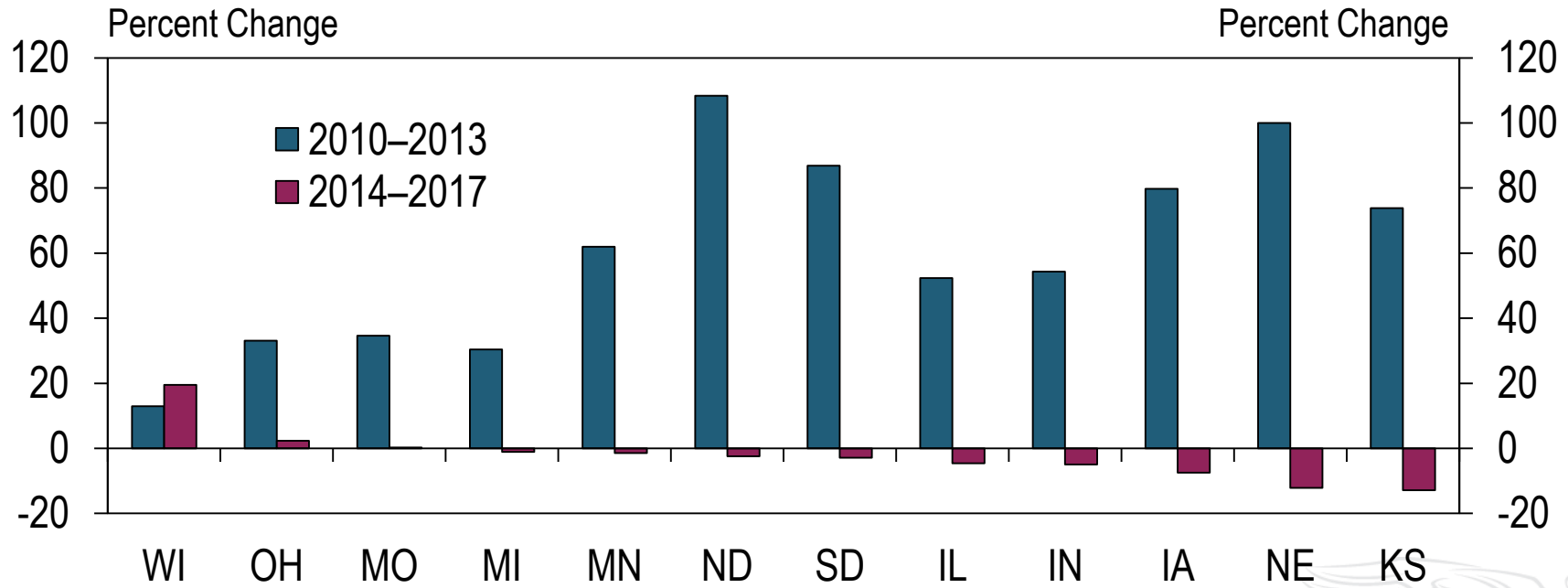


Fixed Interest Rates



Although farmland values have declined in most states, the decreases have been quite modest.

Midwest Region Farmland Values



Concluding Thoughts

- The outlooks for agriculture and the U.S. economy have reversed since 2013.
- The U.S. economy remains strong.
 - Evolving trade policy has increased downside risks to growth and upside risks to inflation.
- Supply and demand fundamentals continue to drive conditions in the farm economy, but recent trade developments have created more challenges for farm borrowers and lenders.
 - Prices are highly correlated with inventories.
 - Farm income and credit conditions remain weak, but farmland values are relatively stable.
 - Farm liquidity remains a larger concern than solvency.
 - Producers are farming on smaller margins with higher volatility.



Questions?

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