The University of Georgia
Cooperative Extension Service
College of Agricultural and Environmental Sciences / Athens, GA 30602-4356

Volume 22, Issue 2
March 2006

The Georgia Economic Issues Newsletter

Addendum to the 2006 Outlook for Georgia's Farm Economy

Editor's Note: Last month, this newsletter featured articles prepared by the department's commodity specialists on the economic outlook for various agricultural industries in Georgia this year. In this issue, we follow-up their discussions with three supplementary accounts on the outlook for the markets for production and financing inputs as well as an overview of the expected general economic conditions this year.

1. Outlook for the General Economy and Farm Economy

Archie Flanders and Fred C. White

Continued economic expansion is expected for the U.S. in 2006 as Gross Domestic Product (GDP) is forecast to increase by 3.4 percent, according to a composite of reports by Oxford Economic Forecasting, International Financial Statistics, and the International Monetary Fund that is released by the United States Department of Agriculture (USDA). This compares to an increase of 3.6 percent in 2005 and would be the third consecutive year of GDP growth exceeding the normal rate of 3 percent. The Selig Center for Economic Growth at the University of Georgia (UGA) predicts core inflation (which excludes food and energy) will rise to 2.7 percent in 2006 from the 2.5 percent rate in 2005. Energy prices should stabilize with crude oil prices in the range of $50 to $60 per barrel. The value of the dollar is forecast to decline in 2006 and cause pressure for increased price levels. Increases in corporate profits are expected to cause increased investment spending and hiring. World GDP for 2006 is forecast in the composite report released by USDA to increase at a rate equal to the 2005 rate of 3.2 percent, with the greatest increases occurring in Asia at 6.5 percent, led by 8.6 percent growth in China. Latin American GDP growth in 2006 is estimated at 3.8 percent, which is less than the 2005 growth rate, but exceeding world growth.

USDA forecasts U.S. production of red meat and poultry to increase in 2006 by 3.1 percent. Consumption is expected to increase by only 2.7 percent, leading to a general decline in prices. U.S. beef prices for 2006 should be 5 percent lower than last year, but above $0.81/lb. for the fourth consecutive year. Broiler prices are forecast to increase by 1.4 percent in 2006 and should be above $0.70/lb. for the third consecutive year. Increased U.S. ending stocks for most crops will not create conditions for increased farm prices. From the perspective of consumers, USDA predictions for food prices indicate an increase of between 2 and 3 percent.

USDA forecasts an increase in agricultural export value of 3.4 percent to a level of $64.5 billion in 2006. In terms of bulk volume of major products, exports in 2006 are expected to be 6.1 percent above 2005 levels. U.S. poultry exports in 2006 are expected to equal the 2005 value, which was a 31 percent increase over the average 2002-2004 value. Forecasted export value of horticultural products (including fruits, vegetables and tree nuts) at $15.9 billion is only slightly below the $16.3 billion for grains and feeds. Horticultural exports should increase 9.5 percent over the 2005 value. Import value increases of over 9 percent for horticultural products are part of a 6.6 percent increase in total agricultural import value over 2005 imports. The net result is a decline in the agricultural trade balance of 36 percent to $3 billion in 2006.

USDA data indicate that 2003-2005 is the historically high three-year period for U.S. net farm income, averaging $71 billion annually. Baseline projections for 2006 forecast net farm income to decrease from the 2005 level and to stabilize at approximately $60 billion for the remainder of the decade. Although at levels lower than recent years' figures, income should continue its long-term increase. Energy prices will cause increases in farm production expenses for 2006-2009, but oil prices are expected to decline from recent highs. Increased imports of fertilizer will moderate fertilizer expenses caused by tight U.S. natural gas markets.

Georgia's economy should expand at a rate of 3.2 percent in 2006 according to Selig Center for Economic Growth at UGA. This compares to a 2005 growth rate of 3 percent, thus potentially keeping the growth rate in Gross State Product (GSP) consistently above 3 percent in three consecutive years. Growth averaged 1.3 percent during the 2001-2003 period.

Georgia is a major regional center for transportation, distribution, and logistics, and increased oil prices adversely impact these activities. Two of Georgia's four business clusters, transportation and manufacturing, will continue sluggishly in 2006. Hospitality services should expand significantly, while information technology is expected to show improvement. Job creation is expected to increase by 1.3 percent in 2006, compared to the increase of 0.7 percent in 2005. Unemployment should fall from 5.3 percent to 5.1 percent in 2006, the second consecutive year above 5 percent. Unemployment ranged from 4 percent to 4.8 percent between 2001 and 2004.

Increased business spending, demographic push, im-

proved budgetary conditions for state and local governments, and higher international trade will lead to expansion of the service economy in Georgia. Migration and relocation of businesses from hurricane-stricken areas will provide a demographic push, while Atlanta should pick up convention activity from New Orleans. Georgia ports may have increased activity until the Port of New Orleans reopens.

Strong prices for broilers will benefit Georgia's largest agricultural commodity in terms of value. Agribusiness activities related to poultry production and processing will lead to increased economic impacts throughout the state. Data from USDA show that Georgia's decreasing cotton acreage in 2005 was below its enrolled base acreage by an amount approximately equal to the level that increasing peanut acreage was above its enrolled base acreage. This indicates that government programs are succeeding in maintaining flexibility in production decisions as market conditions change. Record high cotton yields and lower than average yields for peanuts in 2005 may reevaluation of acreage allocation as farmers seek the proper rotation balance for these crops. Rising incomes will benefit Georgia horticultural products, but higher mortgage interest rates would slow residential construction and be detrimental to landscaping products and services. Cattle prices should continue high by historical standards.

2. Outlook for Agribusiness Production Inputs

Forrest E. Stegelin

Industry or Sector Forecast – Short and Long Term

As the prognostications for agribusiness inputs, in particular the manufactured inputs that are purchased for production agriculture, several issues arise in making the forecasts. The inputs sector will be facing an agriculture squeeze, a market explosion, and warp speed reactions to any supply or pricing actions.

The *agriculture squeeze* will be on several fronts: the divisive political situation arising from the development of the next "farm bill," budgetary brinkmanship from both sides of the aisle as agriculture wears a bulls-eye as a result of the agricultural trade imbalance and the rising consumer food costs, and the vulnerability of the agricultural environment, especially as rising crude oil prices push up the cost of nearly all production inputs, even if it is only seen as an increasing transportation or distribution charge. With the addition of the Caribbean Agricultural Free Trade Agreement (CAFTA) to the other exports and trade legislation of the North American Free Trade Agreement (NAFTA), a *market explosion* is possible for agricultural commodities, although a bulk commodity mentality versus the opportunities resulting from value-added promotions and subsidies still exists. The market reaction to pricing signals will be at *warp speed,* with the market demand for value-added products (and services) being driven by legislative/farm policy/consumer reactions to price changes. With the basic human needs (the physiological needs) for food, shelter, and comfort all being affected by the rising energy expenditures, discretionary consumer spending may see some shifting away from those items consumers have some control over in rationing their limited monetary resources (such as food and fiber) to those comfort and shelter needs, such as energy/fuel and mortgage/rent.

Manufactured Inputs

Fuel and petroleum prices experienced major increases during 2005, with the price hikes being demand driven this time, as compared to OPEC (1970s and 80s) and the 1990 Gulf War. Granted, the hurricanes impacting the Gulf of Mexico drilling platforms and refineries did not help control prices, but the weakening of the dollar, the growth of China and India in energy intensive manufacturing as well as their awakening to the automobile industry earmarked the demand driven price increases. Farm or off-road diesel prices have shown a steady run up over time, from less than $1/gallon in the fall of 2002 to $1.50 in the fall of 2004 to an average fall 2005 price of over $2.50 a gallon. The winter months typically reflect the highest costs for diesel as this fuel is a residual to home heating oil, still heavily relied upon in the Great Lakes and Northeastern US regions. With crude oil prices in the upper $60-$70 a barrel range, farm diesel prices will average over $2 a gallon in 2006.

Manufactured inputs (fuel, fertilizer, pesticides, and electricity) are directly affected by rising prices for crude oil and natural gas. While the effects of rising energy costs are significant, the expenses they affect most still account for only about one-sixth of the farm sector's total costs of production. Electricity generation, although a power source itself, relies on the use of natural gas by many of the power plants to turn the turbines, so electricity costs will rise in tandem with the natural gas expenditures, as will the other fuel and petroleum-based inputs.

Fertilizer costs were the second largest price hike culprit in 2005, behind the fuel and oil costs. Fertilizer expenditures rose nearly 20% in 2004, followed by a 15% increase in 2005, and a 15% to 25% increase in 2006, depending upon the fertilizer composition (supply driven), the importance of nitrogen in the blend, and the crop to which the fertilizer is applied (demand-driven). There is an 80% correlation between natural gas and nitrogen prices. Urea will likely see the greatest increase of 25% to over an average $400-425/ton projected price, while ammonium nitrate prices will increase about 10% for a season-average price of nearly $325/ton.

Since chemicals are mostly petroleum-based, a*gricultural chemical* prices are mostly petroleum-based, are also forecast to rise by nearly double-digit percentages in 2006. Although most patents have expired to increase the competition from generic or copy-cat brands, thereby theoretically lowering prices, the advent and increased use of Bt- and pesticide-ready seed varieties have lowered the demand for several of the agricultural chemicals. Furthermore, as farmers continue to "farm" the 2002 farm-bill in its waning years and as they anticipate the next agricultural policy, acreage, yield, and market price become more focused in the decision of which crops to produce.

Seed prices will also rise between 6% and 10%, as more mergers and consolidations occur in this biotech-influenced industry which will spend more dollars on marketing and development, and less on research. The industry will still be seen as taking a proactive stance, due to the influence of bio-engineering and biological transformations.

Feed prices should stabilize, increasing at the projected rate of inflation. Concerns over animal health, especially with regards to feeds and food safety, will still be paramount in both the producers' and the consumers' minds. Recent pet food contamination has broadened the issue beyond just the farm-gate and livestock production.

Machinery and repairs go hand-in-hand, although repair expenditures are more driven by labor costs. Moreover, as the farm machinery becomes more technical, the need for more skilled operators and computer-savvy repair specialists increases. With steel prices continuing to escalate, price increases for farm machinery and equipment are also likely. Small line manufacturers are more likely to pass the increased manufacturing costs of tillage and harvesting equipment on to the farmers in higher purchase prices. Overall, self-propelled farm equipment (tractors, combines, corn and cotton pickers, haying equipment and balers, etc.) will rise in sticker price by about 10% while mounted or pulled farm equipment will rise by 5% to 6% as there is ample inventory already at the dealerships.

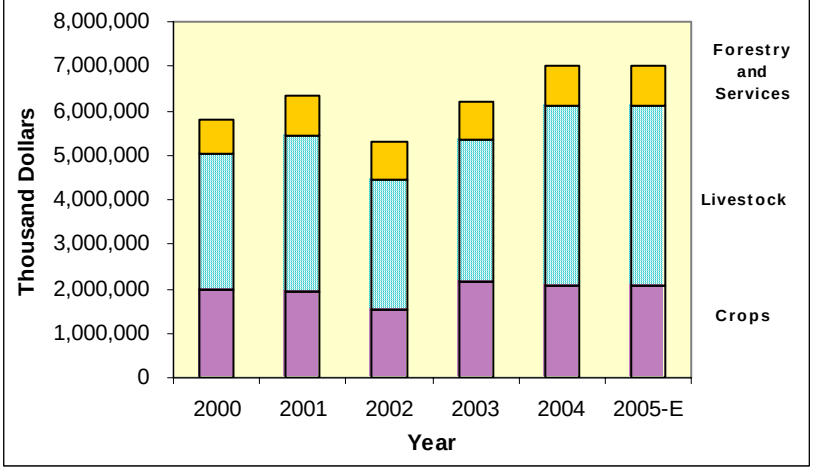
Wages for farm laborers will be consistent with the trends of the private sector, although lower at levels hovering just above the mandated minimum wage (in many cases, farm wages are about

half of the private sector wages). The concerns for farm labor are two-fold: availability (supply) and wages paid. There are plenty of jobs available, but many go un-filled because of the seasonality of most farming activities.

Managerial Implications

Because there is a lot of volatility in the agricultural inputs sector, and that there are a lot of unknowns, focusing on price projections or outlook may be emphasizing the wrong issues. From a farm management perspective, a wise task among farm operators should be to keep in contact with their suppliers for volume discounts, inventory sell-offs, pre-pay discounts, etc. With increased costs a certainty, it will be difficult for crop producers to breakeven at average yields, so the goal of farmers should be for the highest economic yield relying on basic-yet-best agronomic management practices. With low feed grain and other crops' prices being tossed about by some forecasters, government payments will have a strong impact on farm profitability. Farmers need to start planning now by pushing a pencil to evaluate alternative scenarios (production and marketing) as difficult decisions will have to be made throughout 2006.

Figure 1. Value of Georgia's Farm Production, 2000-2005



3. Farm Financial Inputs Outlook

Cesar L. Escalante

Despite various weather disturbances which affected certain areas in the county and oil price hikes, the U.S. farm sector fared considerably well in 2005, although operations were not as profitable as the record-breaking performance in 2004. The farm sector's net value added contribution to the U.S. economy is estimated at $118 billion, down from $126 billion in 2004. The average U.S. farm business operator earned about $69,900 in net cash income in 2005, which is translated to an aggregate net farm income level of $71.5 billion. According to USDA estimates, cash receipts for crops, except for cotton, hay, peanuts, greenhouse/nursery, vegetables, fruits and nuts, have decreased slightly from the 2004 level due to a decline in production and downward pressure on market prices in the latter part of 2005. Cash receipts from livestock operations in 2005, on the other hand, exceeded the 10-year average figure for the period 1995-2004 under conditions of low cattle inventory, high demand, and rising prices. Total production costs increased by 6% as the impact of rising energy costs was not fully felt by farm businesses in 2005 owing to the timing of the oil price hikes and the nature of farming operations (harvesting and drying activities) affected.

The financial performance of Georgia's farm sector in 2005 was reconstructed using historical financial conditions and revenue and cost growth rate estimates provided by the USDA. In 2005, Georgia's value of farm production increased by 0.18% to $7.01 billion. The resulting net farm income for 2005 is $2.59 billion, which represents an 8.78% drop from the 2004 income, but an improvement of 5.13% from the 2003 level. Figure 1 presents a graphical summary of the breakdown of Georgia's value of farm production from 2000 to 2005. The summary indicates the livestock sector's increasing share of the state's value of farm production in the last two years.

The average price of farmland in the U.S. continued to increase in 2005 as a result of low interest rates, high commodity production and prices, and strong demand for the conversion of farmland for non-agricultural uses. The Southeast region led the nation in average price increases in cropland values and rents. As of January 2005, the average value of farm real estate in Georgia was $2,590 per acre, with cropland and pasture attracting average prices of $2,730 and $3,150 per acre, respectively. Average rents for cropland and pastures in Georgia were $58.00 and $22.00, respectively. Pasture rents have been on a declining trend among Southeastern states. In 2006, the growth trends in farm real estate values and most rental rates could possibly not be sustained as demand for residential construction is expected to drop and housing market activity could diminish.

The rate of farm borrowing has slowed down a bit in 2005, as aggregated farm business debt increased by only 3% after registering a 4.5% increase in 2004. Before the end of 2005, the Federal Reserve has raised the target federal funds rate for the 13th time in a row to 4.25%, which increased the prime lending rate to 7.25%. Interest rates for short-term credit facilities, such as consumer credit and home equity lines of credit, are expected to rise within a billing cycle or two. Interest rates for other credit facilities with longer terms do not instantly respond to these adjustments as they depend more on market forces and speculations on other macroeconomic conditions, such as inflation. While

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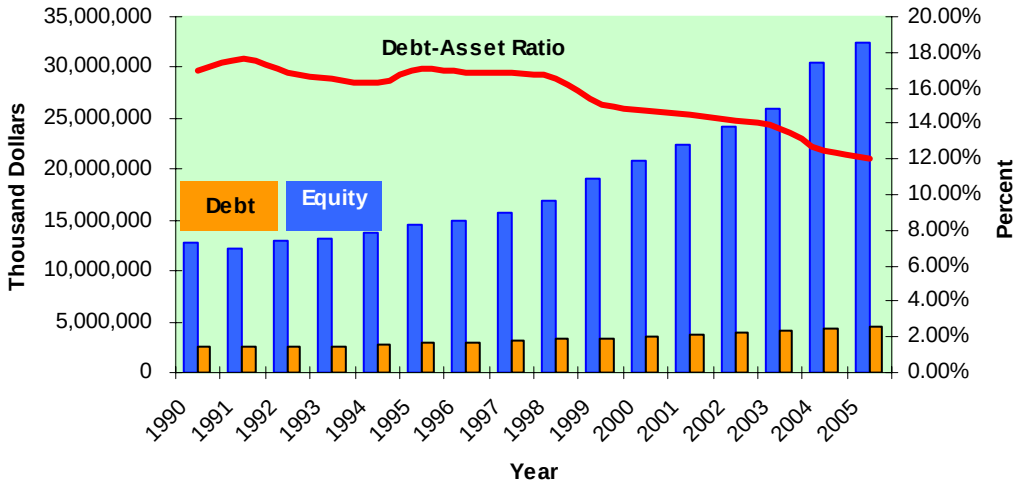
Figure 2. Debt-Equity Levels and Debt-Asset Ratios, Georgia Farms, 1990-2005



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- AGECON 06-110: "Beef Cattle Outlook for 2006" by C. Lacy and J. McKissick
- AGECON 06-111: "Vegetable Economics: 2006 Planning Guide" by E. G. Fonsah

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analysts agree that the economy is currently expanding solidly despite high energy prices and hurricane-related damages, and core inflation has stayed relatively low in the latter part of 2005, the threat of an impending inflationary period can be heightened by the continued trend in rising oil prices and a tighter labor market where workers could demand for higher wages. Given this prognosis, the overall direction of all interest rates in 2006 seems to be upward.

Given these expectations and USDA's estimates of the national distribution of assets and liabilities, a 2005 aggregate balance sheet was reconstructed for Georgia's farm businesses. Figure 2 presents a summary of the Georgia's farm debt and equity levels from 1990-2005. The summary indicates that while the borrowing activity of Georgia farms has steadily increased since 1993, their equity levels have consistently grown even more significantly than debt since 1991. As of 2005, the estimated net worth of Georgia farms in $32.4 billion while total debt is estimated at only $4.4 billion. The plot of the resulting debt-asset ratios shown in the same graph indicates a declining leverage position since 1997 when debt accounted for 16.88% of total farm assets. In 2005, only 12.05% of the assets were financed by external debt. The national debt-asset ratios during the past several years also reflected the same declining trend, with the 2005 level of 0.134 considered the most favorable since 1961. ©

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