Agricultural Economy

Chicago Board of Trade

Sluggish U.S. & World Growth Mutually Reinforcing

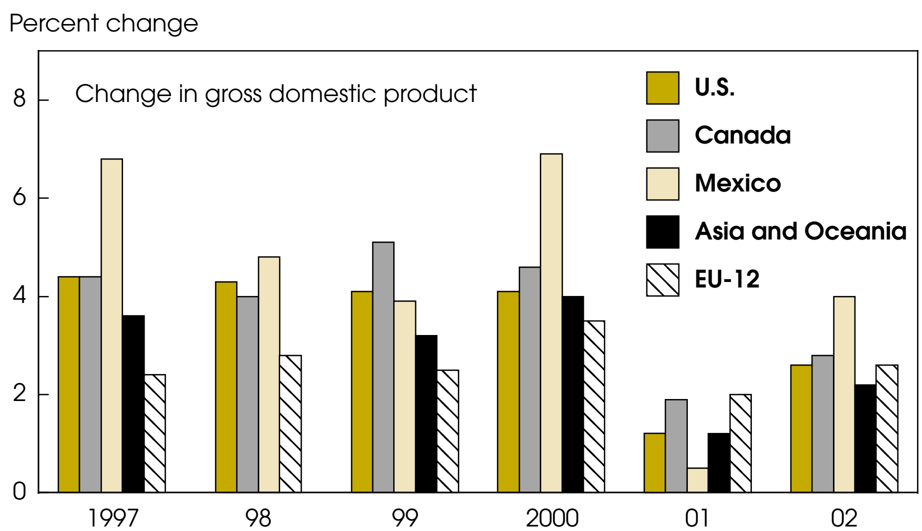
Global economic growth this year will be the slowest since the world recession of 1993, and any rebound during 2002 is expected to be modest. Agricultural exports may continue to grow but not as much as they might have if world macroeconomic conditions had been more favorable to global agricultural demand. Manufacturing exports may continue falling through at least mid-2002, due to the strong dollar and weak global growth.

The U.S. economy, the locomotive that pulled the world economy out of the 1997-98 financial crisis, is now stalled. The dollar, while weakening somewhat since the start of 2001, will continue to be strong relative to other major currencies. The combination of a strong dollar and sluggish global growth will exert negative impact on U.S. farm and manufacturing exports in 2001 and into the first half of 2002. Commodity prices and the value of farm exports are up, but not by as much as they would have been with faster world growth and a lower value of the dollar. The dollar is expected to fall modestly through the rest of 2001 and 2002. Nevertheless, the real value of the dollar will average very close to the post-World War II peak. While the U.S. economy will likely avoid a recession (defined as a decline in output lasting 6 months) in 2001, the world as a whole is less likely to avoid one. (A world recession is global output growth below an annualized 1.5 percent for 6 months or longer.)

During 1996-2000, the North American economy achieved strong growth, with Canada and the U.S. growing 4.7 and 4.1 percent in 2000, leading the G-7 economies. Growth in Mexican gross domestic product (GDP) of 6.9 percent in 2000 was higher than most developing countries.

But North American performance since late 2000 has been less than stellar. The U.S. economy is expected to grow at a relatively modest rate in 2001, while the manufacturing sector has declined in size. The slump in manufacturing is expected to continue until the last half of 2002. High energy prices, a decline in business equipment spending (especially technology-related equipment), and slow growth in demand for consumer durables have hurt earnings in the manufacturing sector across the board and have cost jobs. In June, as overall employment stabilized, loss of manufacturing jobs continued. In August compared with June, employment fell by over 100,000 jobs with over 200,000 jobs lost from manufacturing. The unemployment rise to 4.9 percent in August will likely turn around by mid-2002. The levels of decline in manufacturing output and employment since late 2000 are normally not seen except during a recession.

U.S. Economy Remains in the Slow Lane



Inflation-adjusted annual change. The last 3 years are either estimates or forecasts.
Sources: DRI-WEFA, September Outlook 2001; International Financial Statistics, IMF/Haver; U.S. forecast from ERS.

Economic Research Service, USDA

Weakness in the U.S. manufacturing sector has spread across the borders. Canada's economy is expected to achieve only 2-percent growth in 2001, with unemployment exceeding 7 percent in December. Prospects for slower growth in Canada have been mitigated by higher natural gas and oil prices on Alberta's economy, partly neutralizing higher crude oil prices in the rest of Canada.

Mexico, although benefiting from higher natural gas and oil prices, has experienced declining demand for exports of manufactured goods for the last 9 months. The worldwide recession in the manufacturing sector has hit Mexico much harder than the rest of North America. Mexico depends more on trade than the U.S., and manufacturing is a far larger share of total economic output. Moreover, Argentina's financial problems have kept long-term interest rates and the value of both the dollar and the Mexican *peso* relatively high, slowing the pace of foreign direct investment in Mexico. With three consecutive quarters of slow growth, Mexico is near a recession, even as revenues from oil and gas exports rise and farm exports to the U.S. surge.

The recent lackluster economic performance in North America has been cited as the reason for the recent modest decline in the dollar. Lower short-term interest rates engineered by the Federal Reserve Board (Fed) did not immediately cause the dollar to fall, as long-term U.S. bond yields remained relatively high. Foreigners, fearing weakness in their own economies and expecting higher U.S. stock market returns, continued investing in U.S. financial instruments, keeping the demand for dollars strong through early 2001. The large number of corporate earnings disappointments slowed the flow of funds into the U.S. and weakened the dollar against the *euro*, in late-summer 2001. Despite this recent modest decline, the dollar remains strong by historical standards.

New Locomotive Low on Steam

Despite the sluggishness of North American growth, most analysts had expected Europe to become the new growth engine for the world through rising imports from Asia and Latin America. But most analysts have now lowered 2001 growth forecasts for Europe, after weak German growth in the first quarter of 2001. The 4-percent inflation in the Netherlands and Spain has prevented the European central bank from significantly lowering short-term interest rates to stimulate their economy. The slowdown in North America was reflected in lower European corporate export earnings which, in turn, depressed capital spending and compounded weakness in European consumer spending. As a result, growth in the European Union will be below 2 percent in 2001.

European growth in 2001 is expected to be a drag on global economic growth, given the effects of the American slowdown. Lacking a developed-country growth engine, world growth is expected to be 1.5 percent below world growth rates since 1993—and slower than global growth during the 1998 Asian financial crisis.

Prospects for Growth in Asia & Latin America

The Argentine financial crisis (*AO* September 2001) has the potential to spill over into countries of Asia that have not undertaken serious financial reforms. Most analysts do not expect such a spillover in 2001 or 2002, but other factors will probably slow Asian GDP growth.

Asian growth will drop to 2 percent in 2001 as the recession in Japan continues, despite strong growth in India and China. Growth rates in Taiwan, Singapore, and Malaysia are likely to fall from 2000 rates due to weak semiconductor and specialty chip export gains. China and India will roar ahead with over 5-percent growth, preventing the Asian outlook for 2001 and 2002 from being as weak as the performance in 1998.

Sluggish Asian growth was a key factor in the recent decline in crude oil, gasoline, and diesel fuel prices. A rise in Asian GDP growth requires two to three times as much energy as a 1-percentage point U.S. GDP growth. So, slowing Asian growth has had a larger impact in curbing oil price rises than a slowing of U.S. growth. As a result of slowing Asian growth, and despite tightening oil supplies, oil prices came down sharply from the peak in late spring 2001. The recent increase in U.S. gasoline prices reflects a modest expected rise in third-quarter growth in the U.S. and Asia.

Latin American growth rates will slow to less than 2 percent—about half of its 2000 growth rate. As almost half of the emerging bond market index consists of Argentine and Brazilian bonds, the impact of Argentina's financial situation is potentially large. The 2-percent growth projection assumes the Argentina situation does not spill over into the rest of the world.

Slowdown Is Contagious In Integrated World Economy

More than ever before, finance and trade integrate the world economy. Intervention of the Fed will show up in stronger U.S. growth in early- to mid-2002, with some decline in long-term bond interest rates. The tight international bond market and active U.S. corporate bond issuance have kept long-term bond rates high.

Actions by the Fed in lowering short-term interest rates resulted in the largest corporate bond financing in U.S. history. This provides a solid base for strong future capital spending as inventories are cleared and capacity utilization tightens in late 2001. The housing sector has shown remarkable strength due to lower mortgage interest rates, induced by both the Fed's easing of interest rates, and low unemployment.

Until recently, the dollar had been extraordinarily strong, rising by some indexes to the highest real (inflation-adjusted) level since the U.S. dollar started floating in the early 1970s. The resulting growth in imports makes it likely that 2001 will have a near-record trade deficit—second only to 2000.

When U.S. companies experienced declining sales, earnings, and cash flow, they laid off workers in Europe and Asia, not only in the U.S. headquarters. Similarly, European corporations with weak earnings and sluggish sales in the U.S. laid off workers in U.S. affiliates. These connections amplified the impact of the slowing U.S. economy and spread the slowdown to Europe, despite modest direct trade links. Inability of the European central bank to lower short-term interest rates

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contributed to depressed investment growth and exacerbated the European slowdown.

For the world economy to recover quickly, the U.S. economy must return at least to a GDP growth trend of 3.2 percent in mid-2002. As this occurs, the world economy would likely recover fully.

U.S. recovery is likely, as consumer confidence is still high. Growth in real wages, declining oil prices, low interest rates, lower utility prices, and recent tax rebates will further stimulate consumer spending. Robust growth in retail sales clearing inventories, tightening capacity utilization, and the funds from recent corporate bond issues would boost business equipment spending in 2002 and help get the U.S. economy back on track.

The U.S. slowdown was essentially due to production cutbacks to work off excessive inventory accumulation through the first 3 quarters of 2001. Based on current trends, the excessive inventories will be worked off so the growth seen in final demand will be reflected in GDP growth in 2002. By mid-2002, given the favorable interest rate, both consumer and producer spending will improve so GDP growth will be in the 3-percent range—with growth averaging 2.6 percent in 2002.

Impact of Slowdown on Farm & Rural Sectors

The world growth slowdown comes with a notable decline in exports in 2001 and 2002. The higher value of the dollar relative to the *yen* and *euro* compared with 2000 will amplify the effect of sluggish world growth on U.S. exports. Thus, manufacturing will be weak through 2001 and 2002. Nonmetro employment will continue to decline through 2001 and early 2002. Nonmetro manufacturing, heavily dependent on export markets, is not likely to recover until late 2002, as the economies of major U.S. trading partners recover and U.S. exports rise sharply. Off-farm income prospects, particularly for small operators, will be quite weak through 2002.

The rise in energy-related expenses in 2001 will be smaller than previously expected. First, diesel fuel prices have been falling since May 2001, and dropped below January levels in the late summer. Also, although nitrogen-based fertilizer prices surged by over 50 percent, an expected fertilizer shortage never emerged. Domestic fertilizer production dropped despite higher demand, as some producers faced with higher natural gas and electricity prices did not produce any fertilizer in the early part of 2001. In fact, some western fertilizer plants sold electricity that was available to them rather than produce fertilizer. Fertilizer imports from Saudi Arabia induced by high U.S. fertilizer prices made up for the domestic fertilizer production shortfall and mitigated the expected price increases.

As natural gas price increases subside and diesel fuel prices stabilize, energy-related farm expenses will decline in 2002. Further, lower long-term interest rates will pull down farm interest rates.Average interest rates charged on farm loans from commercial banks have fallen well below 9 percent and are likely to drift lower through the first half of 2002. Through the first half of 2002, the combined effect of continued mild domestic and foreign economic growth, slightly lower inflation, and the continued easing of monetary policy will push farm interest rates moderately lower and increase the overall availability of farm loans.

While the full impact of recent events is unknown, many factors will influence near-term growth. Consumers kept the domestic economy out of recession during the first half of 2001, but consumer confidence began dropping in mid-summer and downside effects of recent events may negatively affect consumer spending.

Should a recession emerge in the U.S. in 2002, with Europe and Asia in decent shape, the dollar will likely weaken and long-term interest rates will fall even more than expected. This will modestly aid farm income prospects, but off-farm farm household income would be adversely affected—reducing farm household income prospects. AO

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October Releases—USDA's Agricultural Statistics Board

The following reports are issued electronically at 3 p.m. (ET) unless otherwise indicated.

October

1 *Crop Progress (4 p.m.)*
2 *Weather - Crop Summary (12 noon)*
3 *Agricultural Chemical Usage - Restricted Use Summary*
Broiler Hatchery
Egg Products
4 *Dairy Product*
5 *Dairy Products Prices (8:30 a.m.)*
Poultry Slaughter
Vegetables
9 *Crop Progress (4 p.m.)*
10 *Weather - Crop Summary (12 noon)*
Broiler Hatchery
12 *Cotton Ginnings (8:30 a.m.)*
Crop Production (8:30 a.m.)
Dairy Products Prices (8:30 a.m.)
Milkfat Prices (8:30 a.m.)
Turkey Hatchery
15 *Crop Progress (4 p.m.)*
16 *Weather - Crop Summary (12 noon)*
Milk Production
17 *Broiler Hatchery*
19 *Dairy Products Prices (8:30 a.m.)*
Cattle on Feed
Cold Storage
Livestock Slaughter
22 *Chicken and Eggs*
Crop Progress (4 p.m.)
23 *Weather - Crop Summary (12 noon)*
Catfish Processing
Monthly Ag News
24 *Broiler Hatchery*
25 *Cotton Ginnings (8:30 a.m.)*
26 *Dairy Products Prices (8:30 a.m.)*
Milkfat Prices (8:30 a.m.)
Monthly Hogs and Pigs
29 *Crop Progress (4 p.m.)*
30 *Rice Stocks (8:30 a.m.)*
Weather - Crop Summary (12 noon)
Peanut Stocks and Processing
31 *Agricultural Prices*
Broiler Hatchery