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MONETARY POLICY, THE ECONOMIC OUTLOOK,
AND COLORADO AGRICULTURE

Remarks by
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Forecasting Conference
Center for Business and Economic Forecasting
University of Denver
Denver, Colorado
April 15, 1983

I was delighted with Doris Drury's invitation to participate in this excellent forecasting conference. Not only do I appreciate the opportunity to hear the views of the distinguished participants on the program today, but I also welcome this opportunity to discuss with you issues of interest to both Coloradans and those of us at the Federal Reserve.

Many of you know that Dr. Drury is currently serving as deputy chairman of the board of directors of the Federal Reserve Bank of Kansas City. It will not surprise you that I am pleased to report that she serves the Federal Reserve very ably and has been a delightful addition to our board. Doris has helped us to understand the regional impacts of national economic policies and she has kept us informed as to the performance of the Colorado, New Mexico, and Wyoming economies.

Doris and all our directors, including Charlie Gates, another illustrious Denverite, have shared the Federal Reserve's concern about a weak and inflation-plagued national and regional economic performance in recent years. Moreover, they have tendered good advice concerning the direction of monetary policy as the Federal Reserve has persistently pursued its anti-inflationary course in recent years. We at the central bank derive ^{some} ~~considerable~~ satisfaction from recent economic developments. We believe, and most observers agree, that Federal Reserve policy in recent years has helped cool inflation and inflationary expectations and has contributed to building a solid foundation for sustained economic expansion through much of the 1980's.

Although the ultimate dimensions of the current economic recovery are not entirely clear, I am of the view that the prospects for a sustainable business expansion are much brighter now than they have been for some time. As we have heard from other speakers, many important indicators are signaling modest growth. At the same time, recent trends in prices confirm that considerable progress has been made against inflation--though it still remains too high. If such trends continue, we may well see further favorable developments in cost structures and productivity throughout the economy.

Observers and analysts that we have heard here today have sketched a comprehensive picture of expected economic developments over the coming period. They have noted that public economic policies will have a great deal to do with the shape of the recovery and I judge that there would be agreement that monetary policy will play a key role. With this thought in mind, I want to comment briefly on my perspective of Federal Reserve policy in the period ahead. Just what are the Federal Reserve's intentions in 1983? Should the public be concerned that--as one former Fed chairman put it--the Federal Reserve will take away the punch bowl just as the party really gets going?

As you may know, the Federal Open Market Committee looks for about 4 per cent real economic growth this year. Moreover, we believe, as a group, that the 1983 inflation rate will be below the 5.6 per cent rate in the GNP deflator anticipated by the Administration.

The Federal Reserve's intentions for 1983 were detailed in the FOMC's agreed-upon targets for money and credit growth. In discussing these targets with Congress, Paul Volcker reaffirmed the Federal Reserve's objectives to maintain progress toward price stability while providing the money and liquidity necessary to support continued economic growth.

To achieve the objective of moderate noninflationary expansion in 1983, it is clear that the Federal Reserve cannot be bound by rigid rules of monetary growth, but rather must pursue these goals with a flexible policy. Such a policy will permit us to look beyond the varied impact of financial deregulation on money growth, for example, and to deal more realistically with unusual or unanticipated financial developments. In my view, the Federal Reserve's intended approach to monetary policy in 1983 will help to insure that an appropriate level of money and credit will be available to support moderate noninflationary expansion in business activity.

My own relatively optimistic view of the 1983 economic outlook is tempered somewhat as I look ahead into 1984 and beyond. What concerns me and many of you, as well, is the prospect of the massive deficit position for years to come in the Federal government's budget. These deficits are staggering, and they are growing larger relative to GNP. To illustrate, back in the Eisenhower years, the deficits--when they occurred--averaged about 1/3 of one per cent of GNP. Twenty years later, during the Carter administration, the deficit averaged about 2 per cent of

GNP. Current administration projections show deficits at 6-7 per cent of GNP, or slightly less with a strong economic recovery.

But it is not simply the scale of the prospective deficits which is the issue, but rather the potentially negative impacts on business growth, the financial markets, and the public psychology.

Because budget deficits must be financed by borrowing in credit markets, massive ongoing deficits pose a serious threat to prospects for sustained economic expansion. As business expands, private sector credit demands may well collide with the government's financing needs, raising again the specter of "crowding out." Moreover, as total credit demand grows, the possibility of rising interest rates increases, as well. Another important negative factor related to financing the deficit is that potential "crowding out" problems and rising interest rates--if they occur--would raise public fears about renewed inflation. Such rising inflationary expectations would surely weaken the foundation for recovery which has been laid. And, as we all know, if the longer term national economic recovery is in jeopardy, our regional prospects are threatened, ~~too~~ *as well.*

Given the background provided by earlier speakers, and with our full realization of the link between national policies and national, regional, and state economic developments, I want to turn now to my specific assignment today. I have been asked to consider for a few minutes the outlook for the agricultural sector. *1/1/80*
As you know, agriculture is extremely important throughout the region and no less so in Colorado, which is a leading state in

beef and grain production. But the impact of agriculture in Colorado goes well beyond production. According to estimates by our research staff, as much as 20 per cent of Colorado's output may be linked to agriculture, including suppliers to agriculture, as well as the producers, processors, and marketers.

Given the importance of agriculture to Colorado's economy, I want to discuss briefly several elements in the current situation in Colorado and the region. ~~✓~~ These elements are, first, the scope of the farm sector recession; secondly, the prospects for recovery; and, finally, some important developments in agricultural finance.

The current agricultural recession--three straight years of low farm income--is the most severe in the postwar period. Farm income has dropped sharply since 1979 because of large grain supplies, / a U.S. recession that limited growth in consumer demand, / and weak farm export markets. Colorado's agricultural producers have shared in the national farm recession. The recession has been even longer for Colorado's cattle ranchers, who have experienced disappointing prices and profits since 1974.

In financial terms, depressed farm income has created significant stress for both producers and agribusiness. Agricultural lenders have felt the effects in increased loan delinquencies and even some loan foreclosures. According to our Bank's survey of the region's agricultural bankers, the proportion of farmers in the region who left business was 40 per cent higher than normal during the second and third quarters of 1982. For

the same period, the proportion of farmers who partially liquidated to relieve financial stress--but remained in business--was three times as high as normal. And it is not only producers who have been affected. At yearend 1982, our survey showed that nearly 20 per cent of nonfarm rural businesses were experiencing serious financial difficulty.

Over the past year, livestock producers have fared relatively better than crop producers, largely because cutbacks in livestock production have resulted in higher livestock prices. Since Colorado derives more than two-thirds of total farm cash receipts from livestock, the state may not have experienced quite as much farm distress--except among its calf producers--as other states in the region more heavily dependent on crop production.

In view of that rather grim background for Colorado's agricultural sector, it is a pleasure to shift to a more optimistic tone as we turn to consideration of the outlook. In our view, the 1983 farm outlook has improved as a result of the Payment-In-Kind (PIK) program and the emerging U.S. economic recovery. The PIK program, in combination with a voluntary acreage reduction program, may reduce total U.S. planted acreages by 82 million acres. More than 90 per cent of Colorado's farmers have participated in the PIK program and 1.8 million acres, roughly 40 per cent, of Colorado crop-base acres will be idled in 1983 as a result. Most observers expect that the resulting drop in 1983 U.S. grain production will create upward pressure on grain prices, although the weather factor and the uncertain effects of ^{the} PIK grain

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on the markets raise some ^{significant} questions about the outlook for grain prices. The U.S. economic recovery now under way is critically important to farmers. Farm prices should improve as growing income and employment levels add to the demand for farm products--especially livestock products. Export markets, however, are expected to remain weak ~~and somewhat inactive~~ in 1983, as U.S. farm exports are currently forecast to decline again in fiscal 1983. *for the second straight year.*

The outlook for Colorado's livestock producers remains fairly bright. Cattle prices have remained strong so far in 1983 and will continue to benefit from the general economic recovery.

Farm income also should be aided this year because of declining farm expenses. Reduced plantings will reduce farmers' purchases of equipment, fertilizer, and other inputs. Moreover, most farm input prices are expected to increase only slightly due to moderating inflation and relative stability in energy prices. In addition, farmers will benefit from the lower levels of interest rates in recent months.

Nationally, we believe 1983 net farm income may improve by as much as \$3 billion. While much of the income improvement will result from large government payments to farmers--which may total \$18 to \$19 billion--reduced farm expenses and strong livestock receipts will be additional elements in the likely upturn in farm income. Colorado's farm producers should share in these welcome developments.

The final element in the agricultural outlook is the agricultural finance situation, which we monitor very closely at the Federal Reserve Bank. We have seen that farm loan demand has remained relatively weak throughout the past three years as a result of low farm income and historically high interest rates. On the supply side, funds have been readily available to agricultural banks, and new financial instruments available to them have provided additional tools for attracting deposits. However, the rapidly growing proportion of interest-sensitive deposits at country banks has resulted in a significant increase in the cost of funds which is passed on to borrowers in higher loan rates.

Farm loan problems have been a major concern for agricultural banks over the past year. Our data suggest that 12 to 15 per cent of farmers in the region may be experiencing significant financial problems, though that proportion could be somewhat higher in Colorado. However, the data also suggest that the number of farmers leaving agriculture because of financial difficulties has remained relatively small, although many of those farmers with financial problems may need to sell some assets to bring debt service costs to manageable levels.

Farmland values have declined across the nation and in the region for the past year and a half because of the farm recession and the sharp increase in the real cost of servicing debt. Values of all categories of farmland in the region have fallen 14 to 18 per cent from the highs reached in 1981. Prices for irrigated land have generally declined more than for nonirrigated land,

while ranchland prices have shown the smallest decline.

Declining land and farm equipment values have reduced the total value of farm sector assets. In addition, while the growth in farm debt appears to have slowed in the last two years, there has been--on balance--a significant decline in the farm sector equity. ~~Moreover, a large share of the sector's debt is held by commercial-sized farms, creating particular financial management problems for many of them.~~ Nonetheless, we believe that the sector retains a great deal of financial resilience.

In summary, the prospects of improved farm income in Colorado and the region suggest that the farm credit situation will likely stabilize and probably improve in 1983. Reduced plantings because of the PIK program probably will reduce farm loan demand in 1983 and the large government PIK payments to farmers will help make more farmers creditworthy this year. Although many farm loan problems remain to be worked out, improving farm income prospects suggest that the worst financial difficulties may be ~~over~~ ^{limited U.S.}

In my view, the growing sense of optimism we are seeing among the region's farmers and agribusinessmen is encouraging. This optimism will be fully justified if the ^{NATIONAL} economy continues to recover at a moderate, sustainable pace and if there is continued progress against inflation.