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ECONOMIC OUTLOOK FOR 1997

General Trends—National and North Carolina

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National Economy

The national economy will finish its sixth straight year of growth in mid 1997. In 1996, economic growth was a little faster than in 1995, but still moderate. Real (inflation-adjusted) Gross Domestic Product grew 2.3% and employment grew 2% . In line with these numbers, consumers saw their "take-home pay" rise 2.1 percentage points faster than the inflation rate.

The slow growth has kept inflation from heating up. With the unemployment rate at, what many economists consider to be, "full employment" (between 5 and 5.5%), there have been concerns that the inflation rate would begin to bubble upward. However, with modest economic growth and with many industries facing increased domestic and worldwide competition, the annual inflation rate has remained a tame 2%, as measured by the Implicit Price Deflator.

Interest rates changed little in 1996. Short-term rates (Treasury bills) were 5% and long-term rates (Treasury bonds) held between 6.5 and 7%. Although many consider these to be moderate rates, by historical standards they are actually high when calculated on a "real" basis. That is, when the inflation rate (2%) is subtracted from these rates, the results show a "real" long-term rate of 4.5 to 5% and a "real" short-term rate of 3%. These relatively high real rates are the result of a moderately "tight" Federal Reserve monetary policy and have contributed to the slow pace of economic growth.

Employment increased in all major economic sectors in 1996 except for nondurable manufacturing. Declines in textile and apparel employment are the major reasons for fewer jobs in nondurable manufacturing.

Export growth was disappointing in 1996. After a strong 13% jump in exports of goods and services in 1995, exports fell 7% in 1996. Exports of agricultural products fared a little better. The 20% rise in agricultural exports in 1995 was followed by no change in 1996.

The federal budget situation improved in 1996. The federal budget deficit fell to $125 billion and only 1.6% of Gross Domestic Product. The outlook through 2002 is for the budget deficit to slowly rise in nominal dollar amount and to be about 2.1% of GDP.

National Outlook

Most economists forecast current trends to continue into 1997. Although the economy will grow, it will grow at a slower rate. The major reason is consumer debt. Relative consumer debt (outstanding credit/income) is now at an all-time high, at 18%. This is up from 13.5% in 1993. Since ours is a consumer-driven economy, the inability of many consumers to take on more debt will inhibit consumer spending in 1997.

Basic business factors, though, are in good shape and don't indicate any major change in direction for the economy. Unit labor costs are rising at a modest 3% annually, and the inventory/sales ratio is at a good, low level. If inventories are high relative to sales, this would indicate a need for factories to significantly reduce output as consumer spending slowed. The fact that inventories are not out-of-line with sales means factories will not be planning large lay-offs.

There may be a slight rise in the inflation rate in 1997 as growth, although modest, presses against limited supplies of new labor. Interest rates should remain relatively stable. The major economic question facing national policymakers is whether a balanced budget deal can be struck between the President and Congress.

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General Economic Trends – National and North Carolina

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North Carolina Economy

The North Carolina economy has followed a different pattern than the national economy in recent years. Overall growth was significantly lower in North Carolina in 1996 than in 1995 - in contrast, national growth was slightly higher in 1996 compared to 1995. Nevertheless, North Carolina economic growth was stronger in 1996 than national growth (3.1% Gross State Product vs. 2.3% Gross Domestic Product).

Job changes in the State did parallel national job changes in 1996. Jobs increased in all sectors except nondurable manufacturing, and the service sector led with the largest job increases (Figure 1). Textiles and apparel led the losses in nondurable manufacturing.

North Carolina Outlook

The economy is expected to grow in North Carolina in 1997, but at a slower rate than in 1996. Gross State Product is anticipated to increase 2.5% in 1997, compared to 1996's rate of 3.1%. The state unemployment rate will continue to hover around 4%.

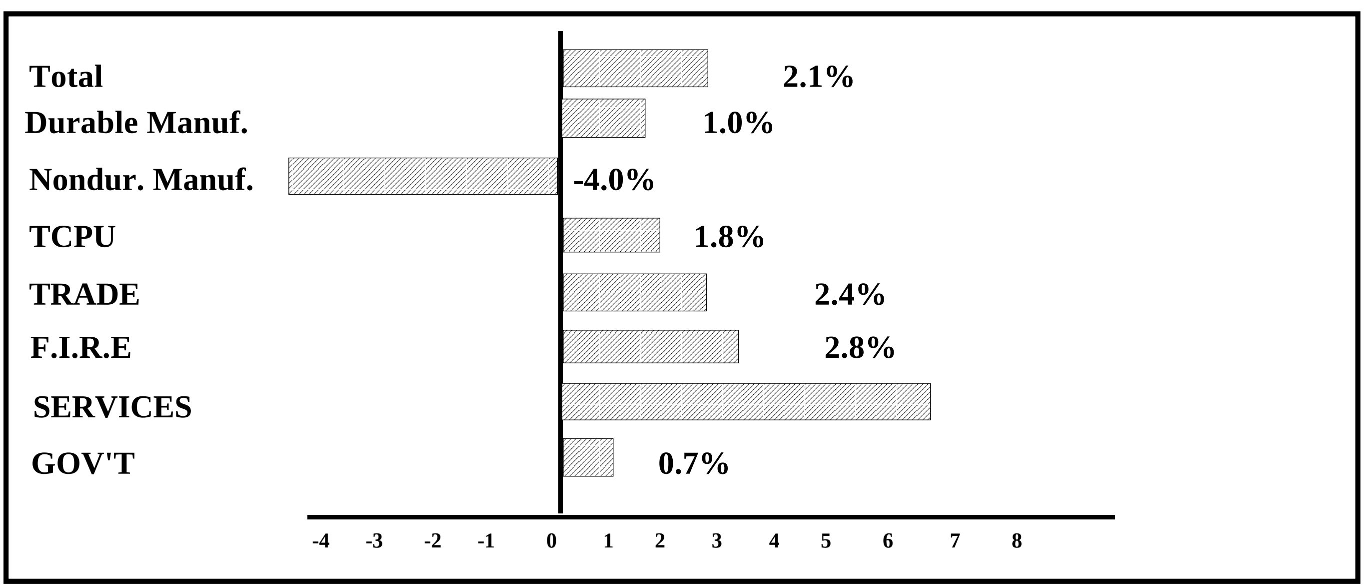
State policymakers will face a tighter state budget in 1997. The slower economy will bring slower revenue growth. Also, there are several sources of spending pressures on the state budget, including double-digit Medicaid spending growth, pressures to increase public school teacher pay, and new debt service payments from the recently approved state school construction bond issue.

Contribution and Composition of N.C. Agribusiness

Agribusiness in North Carolina, defined to be the farming, manufacturing, and distribution of food, tobacco, natural fiber, and forestry products, continues to be an important part of the state economy. It is estimated that agribusiness accounted for 27% of North Carolina Gross State Product in 1994. This was as high as the contribution in 1963 and higher than the contributions in 1977 and 1982 .

However, the composition of North Carolina agribusiness has significantly changed over the years. In 1963, manufacturing accounted for 46% of agribusiness, followed by farming at 36%, wholesaling at 11%, and retailing at 7%. In 1994, manufacturing accounted for 62% of agribusiness, followed by farming at 21%, and wholesaling and retailing each at 8.5%. The shift in relative value from farming to manufacturing is a result of increased consumer demand for processed and time-saving products.

Figure 1. N.C. Job changes by Sector, 1996 (% Change)



Farm Sector Trends and Selected Commodities Outlook

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Aggregate 1997 U.S. **Net Cash Income** and **Net Farm Income** are forecast to drop from their near record high in 1996 to below the 1990-95 average. Even so, the overall financial health of the U.S. farm sector remains strong and viable.

Net Cash Income is forecast to drop to $50.8 billion for 1997 down from $57.4 billion in 1996 and below the 1990-95 average of $53 billion. The major cause of this decline is lower crop prices, and thus, lower total crop receipts. Even though there has been some improvement in beef prices and some increase in cattle cash receipts, a decline in dairy receipts will keep total livestock receipts close to the 1996 level. The nearly $7 billion decline in **net cash income** is the result of lower crop receipts.

Net Farm Income (net cash income adjusted for changes in inventories of crops and livestock) is forecast to fall from the forecast 1996 record high of $51.7 billion to $40.4 billion. The 1990-95 average **Net Farm Income** is $43 billion. A large factor in the decline in NFI in 1997 is the anticipated small change in inventory. In 1996 there was a $4.9 billion increase in inventory from the beginning to the end of the year. The increase in inventory expected in 1997 is less than $1 billion.

Examination of the Balance Sheet for the U.S. Farm Sector shows farm assets exceeding the $1 trillion level in both 1996 and 1997. Farm Assets are expected to reach $1.1 trillion in 1997 up from $1.03 trillion in 1996. Total farm business debt is anticipated to reach $160 billion in 1997, the highest level since 1986.

Asset growth is expected to be at a rate of near 6 percent in 1996-97 while growth in total debt is expected to be only 2-3 percent. Thus, farm equity continues to rise. More than 90 percent of the growth in farm assets is due to increased land values. Farm real estate values are expected to increase 5.5 percent in 1997, following a 6 percent rise in 1996 and an average increase of 5 percent annually 1990-95. Expectations for fairly robust farm income, stable interest rates, and strong long term outlook for exports lead to continued strong demand for farm real estate.

Even though overall the farm sector is in good financial health, the increase in debt and the decline in net cash income will cause problems for some farmers. Close attention to financial management decisions is essential for success.

Selected Commodity Outlook

Tobacco: Due to a combination of factors including reduced production in other countries, poor weather conditions in 1995 and 1996, a strengthening of the Brazilian currency, increasing export demand, and stabilizing U.S. cigarette demand, 1996 was a good year for most tobacco producers. Season average price for 1996 was $1.84. Even though 1997 price will likely return to more normal levels of 1.70-1.75 if weather conditions are favorable, given that the effective quota is 1018.8 million pounds of 1997, farmers will likely have a “bright” year in 1997.

Cotton: U.S. cotton production increased in 1996 even though acreage declined. Higher yields boosted total 1996 production by 5 percent over the 1995 crop. North Carolina acreage dropped from the 1995 level of 800 thousand acres to 720 thousand in 1996. With grain prices declining during the last half of the year and expected to be lower in 1997, acreage in 1997 may again increase somewhat. The slight increase in domestic use may be more than offset by a decline in export demand, and with an “average” production year in 1997, ending stocks are expected to remain at end of 1996 levels. Fall prices could drop from the current December 1997 futures price of 76-78 cents to 70-72 cents. Weather will play a key role here and abroad.

Peanuts: Under the new farm bill, quota peanut support price was reduced from $678 per ton to $610, and quota was reduced by 10 percent. Also, under the new legislation quota is set at the domestic edible demand level each year and the old 1.35 million ton threshold is gone. U.S. peanut acreage fell in 1996 by over 8 percent, however, good yields boosted production by 5.3 percent over 1995 levels. Virginia-North Carolina harvested acres was down 14.1 percent at 200,000 acres the lowest in 50 years. As a result of smaller quota and tight supply, permanent quota for 1997 is up 3 percent at 1.133 million tons. Quota price remains at $610 per ton.

Corn: Due to extremely low ending stocks a year ago and high export demand causing very favorable 1996 price levels, production is expected to be up 26 percent over year earlier levels at 9.3 billion bushels. This is the third largest crop on record behind 1994 and 1992. U.S. corn exports are expected to be down because of foreign competition, importing countries substituting wheat for corn, and these countries also experiencing higher corn production as well. U.S. ending stocks are expected to be at 1.16 million bushels, 1.7 times larger than a year earlier. Prices should range 2.50-2.75 range, 50 to 75 cents lower than last year but above the $2.30 1990-94 average price.

Soybeans: U.S. soybean production for 1996-97 is expected to be the second highest on record, 10 percent above year earlier levels. Despite the large crop, prices are expected to remain stable because of higher exports. Also, meal demand, both domestic and foreign, lend support to current price levels. U.S. meal use is expected to increase due to expansion in both hog and poultry industries. Total use for should range in the mid $6 range for 1997.

Wheat: 1996-97 U.S. wheat exports are expected to be 23 percent lower than the previous year due to increased output by several major exporters. Global wheat production for 1996-97 is projected to be the second largest on record.

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1997 Outlook for Some Selected Commodities

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Wheat prices have fallen as a result. Partially off setting the export decline is a doubling of U.S. domestic feed and residual use. Even though ending stocks are expected to be up 16 percent at 435 million bushels, this is still well below the nearly 492 million bushel previous 5 year average. Prices are expected to remain strong in the $4.20-4.40 range.

Swine: Profit margins were very thin in 1996 as high hog prices were offset by high feed costs for most of the year. North Carolina production increased by 14 percent in 1996 while the U.S. as a whole increased by only 2-3 percent. Based on December 1, 1996 inventory, North Carolina will produce 12-14 percent more pigs in 1997 while the U.S. as a whole is expected to decline by 4 percent. Thus, 1997 expected prices in the $51 range coupled with lower feed costs will stimulate predicted expansion.

Broilers: 1996 U.S. broiler production is expected to reach 26.5 billion pounds, up 5.7 percent over 1995, yet average wholesale price for 1996 will average 61.3 cents, 8.7 percent higher than a year earlier. Increased export demand (up 18 percent over 1995 levels), strong domestic demand, and lower feed prices bode well for the broiler industry in 1997. 1997 production is expected to expand by 5.4 percent.

Turkeys: Production in 1996 was up 6.5 percent over the 95 level, and with prices unchanged and higher feed costs, many producers faced negative net returns all year. Turkey exports however are projected to show a 32 percent increase for 1996 over 1995. Turkey production is expected to increase by 2 percent in 1997 with exports up another 11 percent. Prices should remain in the 64-69 cent range.

Cattle: The November *Cattle on Feed* report covering major feedlots indicated inventories in the seven major states were up 1 percent from year earlier levels. Increased placements, and heavier placement weights are likely to push up slaughter levels at the same time as domestic per capita consumption is predicted to decline slightly. Exports are predicted to be very sluggish. Fed cattle prices are likely to be in the mid-$60's through much of 1997.

Regretfully, production problems prevented publication of the N.C. STATE ECONOMIST during the last half of 1996.
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