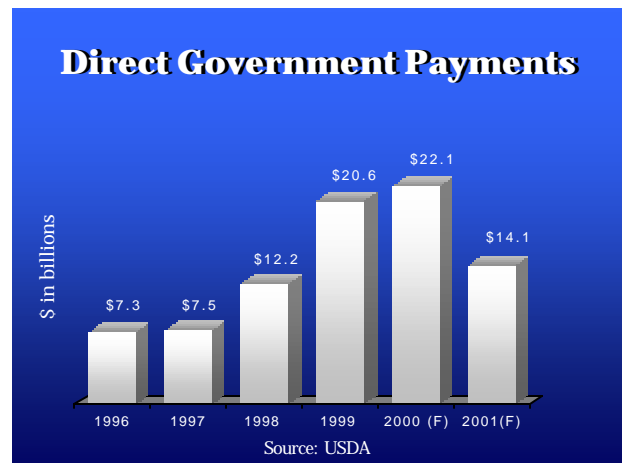
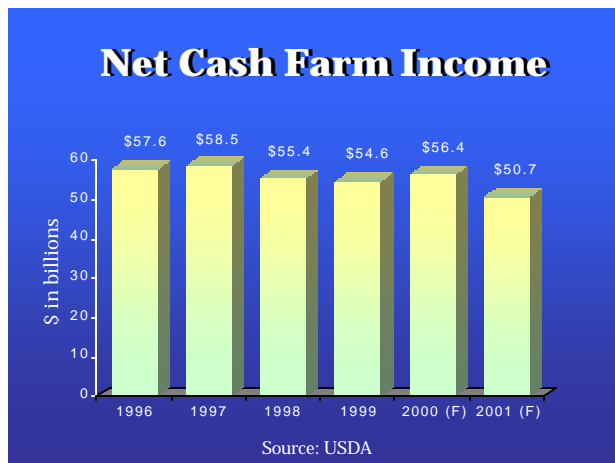
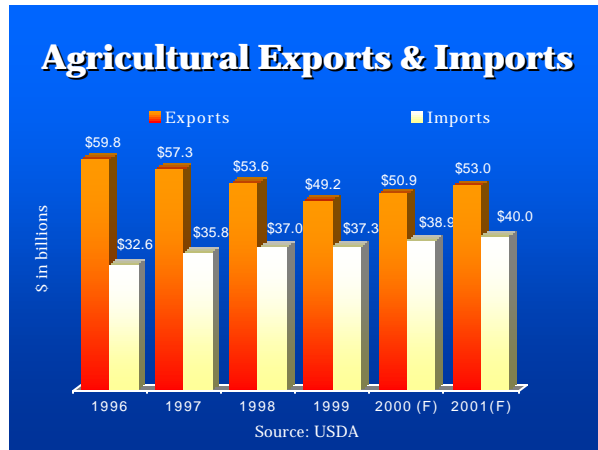


# BACKGROUND ON THE AGRICULTURAL ECONOMY

The world economy grew by 4 percent in 2000, with Asia registering the highest GDP increase of 7 percent. Most regions of the world including North America, South America, and Middle East reported favorable economic growth figures. Looking forward, high crude oil prices are expected to stunt growth in developing nations and Asia, as well as in some developing nations in 2001. Even though higher energy prices may not adversely affect the overall U.S. economy, they might lead to an increase in farm expenses.

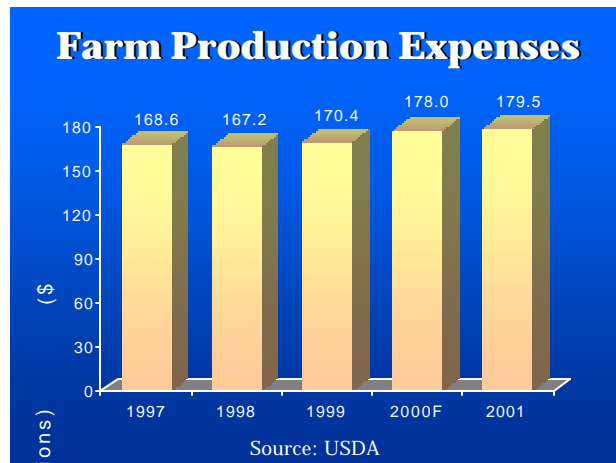
While the countries in Asia and elsewhere were going through the 1997-1999 international financial crisis, the U.S. economy continued to grow rapidly, attracting large capital inflows. This generated an increased demand for the dollar and led to its appreciation. The appreciation of the dollar in the last five years has been the major factor hindering the growth of U.S. agricultural exports, allowing competitors to gain market share and expand production. U.S. agricultural exports saw a modest gain in 2000, despite the strengthening of the dollar, due to increased demand from recovering Asian economies and foreign investor's confidence in U.S. stock markets. Although the demand for dollars is expected to fall in 2001, the lingering effects of the strong dollar could cause trouble for U.S. farmers in the coming year. Agricultural exports are forecast at \$53 billion dollars in 2001, up from \$51 billion in 2000. Exports of bulk commodities are expected to increase, however, large global supplies will limit price gains.



Agricultural imports totaled \$39 billion in 2000. The U.S. Department of Agriculture forecasts a \$1 billion increase in this figure for fiscal year 2001.

Net cash income is expected to increase 3.3 percent, from \$54.6 billion in 1999 to \$56.4 billion in 2000. The growth in net cash income is due to the additional government support. Net cash income is forecasted at \$50.7 billion in 2001. This represents a \$5.7 billion decline from \$56.4 billion in 2000 and is \$4.1 billion below the 1990-2000 average of \$54.8 billion. Direct government payments reached an all-time record of \$22.1 billion in 2000. Of this amount, \$8.9 billion came in the form of emergency assistance and \$6.4 billion in loan deficiency payments. Loan deficiency payments are expected to fall by about 30 percent in 2001 due to moderately higher prices for several commodities. Emergency assistance in 2001 will be available only to those farmers who are eligible for payments under the 2000 legislation, and thus will be \$5.2 billion lower. Production flexibility payments are also projected to be \$800 million less than the 2000 amount.

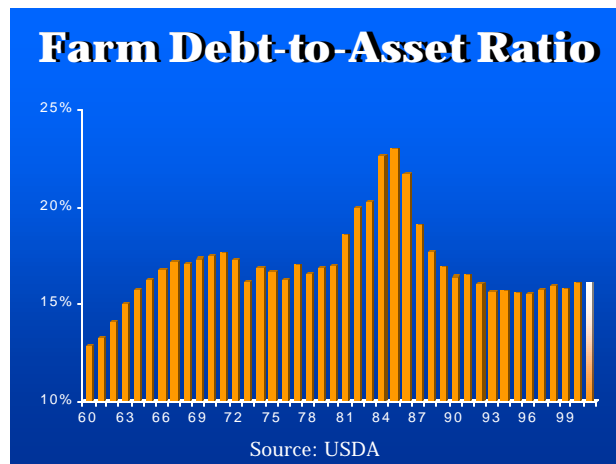
Agricultural production costs increased in 2000, mainly due to higher fuel prices. Fuel expenses in 2000 were over \$8 billion, 40 percent above the 1999 level. Total production expenses increased by 5 percent to \$178 billion. In 2001, fuel and other energy-related input costs will continue to concern producers. Production expenses are projected to rise to \$179.5 billion in 2001.



Weather conditions were mostly favorable in 2000, a factor that contributed to record corn and soybean harvests. On the other hand, southern and central Great Plains experienced hot and dry weather in the summer and fall of 2000, causing severe drought conditions. Cotton producers in particular lost a substantial portion of their crop whereas cattle producers encountered animal losses due to heat and lack of water.

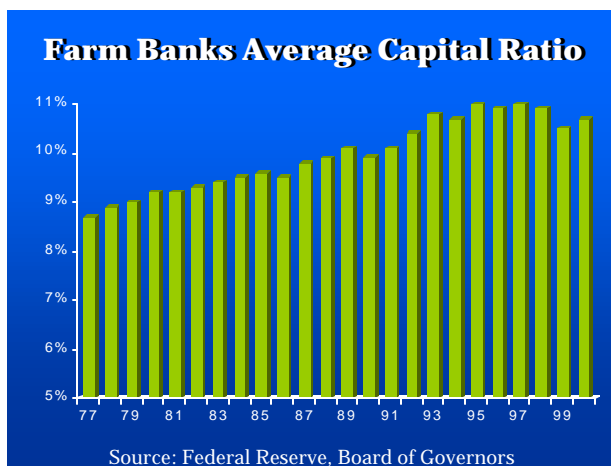
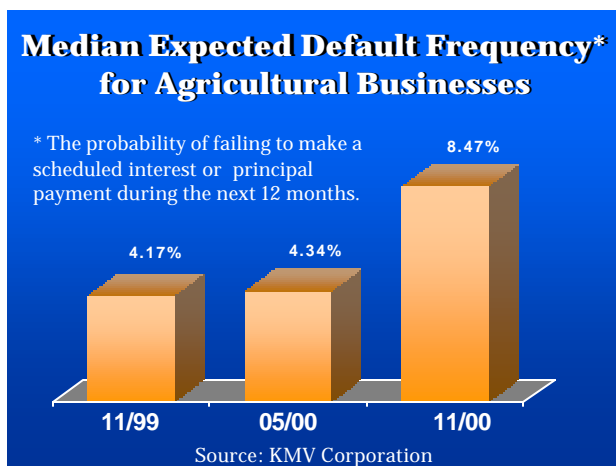
### The Condition of Agricultural Borrowers and Agricultural Banks

Farm debt is expected to rise 1.2 percent in 2001 after increasing 2.4 percent in 2000. It is observed that farmers are more restrained in taking on new debt while lenders are more conservative in supplying credit. Farm assets and debt increased by equal amounts in 2000, leaving farm business equity unchanged. Given large world stocks of commodities, prices will probably remain at low levels in 2001, raising concerns over repayment problems in the future. The debt-to-asset ratio is projected to be 16.1 percent in both 2000 and 2001.



The interest rate environment might be more favorable for borrowers in 2001, given expectations that the Federal Reserve will aggressively lower interest rates. However, farm business interest expense is expected to increase in 2001 and rates on existing loans will not change to reflect current market interest rates.

The debt repayment capacity utilization (DRCU), which compares farmers' actual debt levels with the amount of debt they could repay using their current annual income, indicates that farmers will be using credit lines more fully in 2001. This measure is projected to increase from less than 60 percent in 2000 to almost 65 percent in 2001, the highest level since 1985. The rise in DRCU implies that some farmers may have a difficult time meeting interest and principal payments on their debt in 2001. According to KMV Corporation's Credit Monitor, the median expected default frequency<sup>1</sup> for agricultural businesses (excluding farms) is 8.47 percent as of November 2000. This is more than 100 percent higher than last year's figure of 4.17 percent.



The average capital ratio for agricultural banks edged up slightly in 2000, from 10.3 percent to 10.4 percent, with banks continuing to build their capital cushions. Total farm loans increased by 4.3 percent over the last year with farm real estate loans accounting for a growing share of the total. Problem nonreal estate loans declined through the first three quarters of 2000 relative to a year earlier, registering the lowest reading in the last decade. Delinquency rates for farm real estate loans also declined while charge-offs for both types of farm loans remained high compared with most of the 1990s. There was only one agricultural bank failure in 1999 and no agricultural bank failed in 2000. It is likely that the number of failures will remain fairly low, considering the strong capital positions of these banks and declining levels of problem loans.

<sup>1</sup> The probability of failing to make a scheduled interest or principal payment during the next 12 months.

