Agriculture: embargo undermines strong world demand for agriculture

Last year marked the fifth consecutive year of record domestic crop production. Huge crops of grains and oilseeds—in light of the embargo on shipments to the Soviet Union—are more than enough to meet prospective utilization. As a result, carryover stocks will increase substantially, possibly weighing heavily on crop prices in the year ahead.

Livestock production was nominally larger than in 1978, and a further increase is likely this year. Beef production dropped sharply to a six-year low and may be slightly lower again this year. But large increases in pork and poulty production more than offset the decline in beef production, and further increases this year are expected to bring higher production of all meats. Small increases in milk and egg production are expected again this year.

The financial perspective

Developments in agricultural finance were highlighted last year by high earnings and continued sharp increases in farmland values and farm debt. The composite of prices received by farmers averaged about 240 (1967=100), up 14 percent from 1978. Larger marketings complemented the higher prices, boosting cash receipts from marketings 17 percent. Earnings for crop farmers rose the most, but livestock producers also saw a significant rise in receipts.

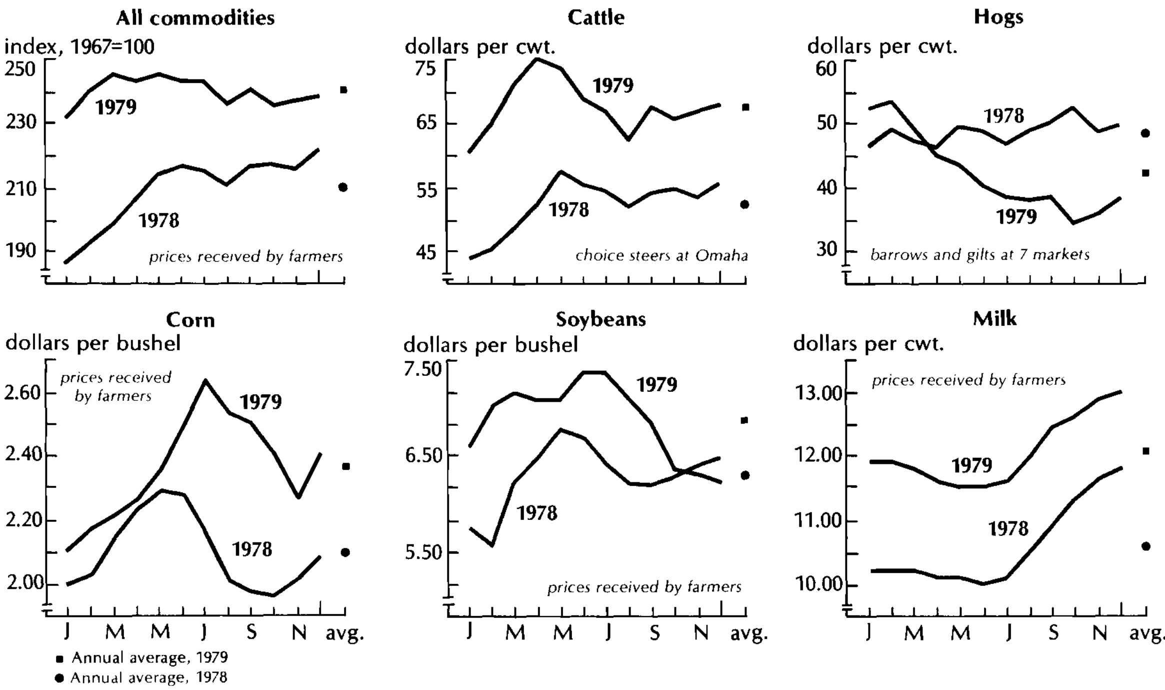
Preliminary estimates show net farm income rose from $28 billion in 1978 to $32 billion last year. Nearly all the increase, however, traced to non-money sources, such as the increased value of inventories, the higher rental value of farm dwellings, and the value of farm products consumed directly in farm households. Current estimates suggest that nearly all the increase in marketing receipts was offset by a $2 billion decline in government payments to farmers and a rise in production expenses from $98 billion in 1978 to $114 billion in 1979. Fuel and interest costs, which together account for a sixth of expenses, led the rise in production costs.

Earnings of farmers in states of the Seventh District were mixed. Except for fuel and interest, the rise in the costs of producing crops was fairly modest. Earnings from crops were supported by higher corn and soybean prices and by the larger marketings made possible by bountiful harvests in 1978 and 1979. Livestock producers were affected by higher feed costs throughout the district. With milk prices up 14 percent, dairymen had another year of favorable earnings. Budgets prepared by Iowa State University indicate, however, that earnings of hog producers and cattle feeders turned sharply lower in the latter part of the year. Net returns for hog producers were negative during most of the second half because of sharply lower hog prices. For cattle feeders, the earnings squeeze was due mostly to the high prices paid for feeder cattle during the first half of the year.

Farmland values made big increases again last year, continuing a trend that highlighted agricultural developments of the 1970s. Estimates by the USDA show a 16 percent increase nationwide last year. If that is right, the year capped a decade in which per-acre values rose at a phenomenal compound annual rate of nearly 13.5 percent. Quarterly surveys by the Federal Reserve Bank of Chicago suggest values in the district parallelled the rise in farmland values nationwide. Year-to-year gains ranged from 7 percent in the district portion of Illinois to 18 percent in Iowa.

Farm debt rose substantially again last year, topping out a threefold increase for the decade. Government estimates show farm

1979 farm commodity prices in perspective



debt reached $158 billion, up 15 percent from the year before. Higher input prices, expanded production, strong capital expenditures, and higher land values all contributed to the rise.

There was wide variation in the contribution of major lenders to the rise in farm debt. Rural banks struggled to meet the strong farm loan demand. The liquidity pressures that had been building at rural banks in recent years intensified last year as deposit growth slowed and soaring interest rates compounded bankers' problems of liquidating securities to fund new loans. Evidence suggests that with loan-to-deposit ratios well above the levels of a few years ago, farm debt held by banks at the end of the third quarter was up less than a tenth from a year before. By contrast, the debt held by the cooperative farm credit system was up nearly a fifth. That held by life insurance companies was up a sixth. Government lending continued strong last year, fueled by the availability of funds through various disaster and emergency lending programs and more liberal ceilings on traditional farm lending programs. Overall, farm debt held by government agencies rose a third. This was despite a marked decline in farm loans held by the Commodity Credit Corporation.

The inflationary perspective

Food was one of the main factors boosting consumer prices. Although pressures eased substantially in the second half, the index of retail food prices averaged about 11 percent higher than in 1978. That made 1979 the fourth year of double-digit increases in food prices in the 1970s. Retail beef and veal prices led the rise last year with average increases of a fourth.

Raw food commodity prices trended lower during the second half. But retail food prices continued to edge higher because of the escalating costs of processing and distributing food. The third-quarter index of utility costs (fuel, power, and lights) to food marketing companies was up a fourth from the year before. Food container and packaging costs were up 11 percent and rising. Rail freight charges for food products were up 22 percent in October from a year earlier. Labor costs for processing and distributing food were up 12 percent last year. Together, labor, transportation, utilities, and packaging account for more than 70 percent of the costs of marketing domestically produced food. Nearly half of the retail spending on domestic food goes for these four items.

Overall, consumer demand for food was fairly strong last year, due to continued growth in employment, large nominal gains in disposable income, and huge increases in food-stamp benefits. One area of consumer food demand showed considerable softness, however. That was for food eaten away from home. Sales at eating and drinking places averaged 12 percent higher than a year earlier in the first quarter. But that gain was cut in half during the late spring and summer as concern over gasoline supplies and prices forced changes in vacation plans. The gain widened some in the fall. Nevertheless, the increase in sales was still less than the rise in prices of food eaten away from home, indicating a significant decline in the amount of food eaten out.

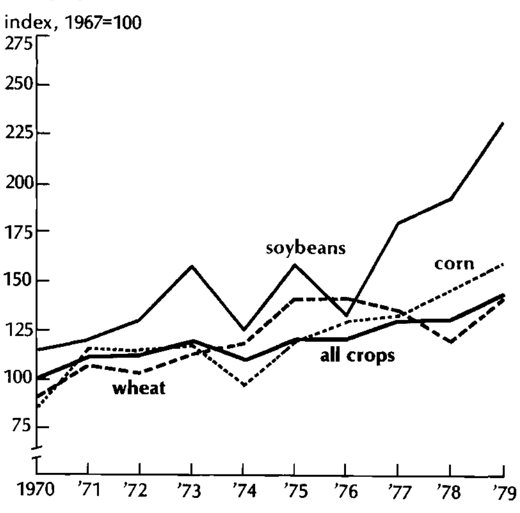
Commodity highlights

The cropping season was characterized by rain-delayed plantings, late developing crops, and a late harvest. The outcome was, nevertheless, phenomenal. Current estimates show crop production up a tenth nationwide—and that from the previous year's peak. Feed grain production (corn, sorghum, oats, and barley) was up 8 percent to a new all-time high. Food grain production (wheat, rye, and rice) was up 16 percent and above the previous high in 1975. Oilseed production (soybeans, cottonseed, peanuts, flaxseed, and sunflowers) was up 20 percent from the peak in 1978.

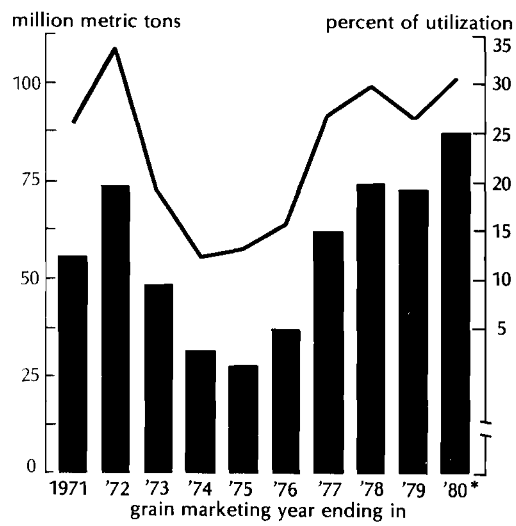
The bumper harvest was equally apparent in district states, which account for more than half the nation's corn and two-fifths of its soybeans. Per-acre corn yields reached new highs in all district states, except Wisconsin. For the five states, corn yields averaged 120 bushels, nearly 22 bushels per acre more than the average for all other corn-growing states. Soybean yields for the five district states averaged 37 bushels per acre, over a fourth more than the average for other soybean producing states.

Last year's record domestic grain and

Another banner year for crop production . . .



. . . promises to boost carryover stocks of grain substantially



*USDA projection.

oilseed harvest was particularly fortunate, considering the situation worldwide. Wheat production in the Southern Hemisphere set new records last winter, but bottlenecks in transportation kept producing countries from sharing proportionately in the burgeoning world market. Production of coarse grain was no better in the Southern Hemisphere last spring than the year before. It was even lower in the top exporting countries. Contrary to expectations, Brazil's soybean harvest was only marginally better than the weather-devasted crop of the year before.

Except in the United States, grain production in the Northern Hemisphere was off appreciably last summer. The most evident downturn was in the Soviet Union, where production fell from the record 237 million metric tons in 1978 to an estimated four-year low of 179 million tons. Although wheat production reached a new high in India, production of coarse grains and rice (by far the dominant crop) fell nearly a fifth. In Canada, the grain harvest fell 14 percent to a five-year low. Western Europe had a bumper grain crop, but the harvest was still 4 percent less than in 1978. In Eastern Europe, a sharp decline in wheat reduced the total grain harvest 5 percent.

World demand and prices for U.S. grains and soybeans proved stronger than expected because of the adverse crop developments throughout much of the world. The value of U.S. agricultural exports rose 17 percent to $32 billion in fiscal 1979 boosting the agricultural trade surplus to nearly $16 billion. That closed a decade that had seen agricultural exports increase nearly sixfold and the agricultural trade surplus nearly 18-fold. Grains and oilseeds accounted for over two-thirds of the exports last year.

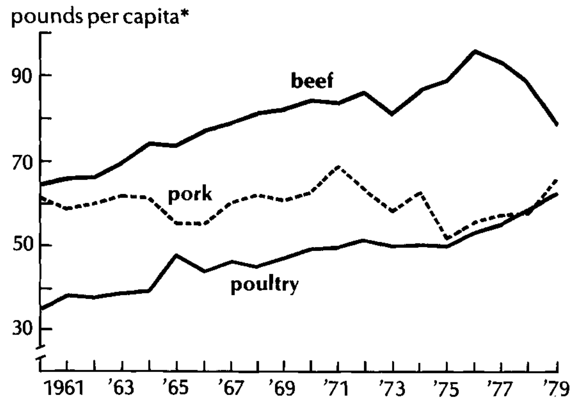
Strong world demand—and significantly greater domestic utilization—led to higher crop prices, despite record domestic supplies. Monthly corn prices received by farmers averaged $2.37 a bushel, compared with $2.10 in 1978. Soybean prices averaged $6.86 a bushel, against $6.28 in 1978. Prices varied between regions more than in 1978, however. A 12-week strike at the Duluth/Superior port facilities and bankruptcies and strikes on major rail lines contributed to smaller price gains in western and northern areas of the Midwest.

For livestock producers, last year ended the downturn in the cattle cycle and brought forces that could end the upswing in the hog cycle this year. Improved prospects for cow-calf operators led to a one-third decline in cow and calf slaughter. As a result, cattle numbers are up slightly from the very low level a year before. A similar increase is expected in this year's calf crop, following the 16-year low set last year. These developments provide the base for an increase in beef supplies in another year or two.

Commercial feedlot activity turned lower last year, resulting in an 8 percent decline in fed cattle marketings. That, plus the decline in cow slaughter, pulled beef production to a six-year low, 11 percent less than a year before. Per capita beef consumption, as a result, fell to a 12-year low.

Even with the downturn in beef, increases in pork and poultry production raised per capita consumption of meat 1 percent back to the 1977 record. Broiler and turkey production increased a tenth. Pork production, paced by year-to-year gains of more than a fifth in the second half, rose 16 percent. These large increases sharply lowered prices,

Lower production pulled per capita beef consumption to a 12-year low in 1979



*Retail weight basis.

Economic events in 1979—a chronology

Jan 1 Minimum wage rises from $2.65 to $2.90. (On January 1, 1980, minimum wage rises to $3.10.)

Jan 1 Social Security tax rate rises from 6.05 to 6.13 percent, and taxable income rises from $17,700 to $22,900. (On January 1, 1980, tax base rises to $25,900.)

Jan 1 Mandatory private retirement age rises to 70 .

Jan 3 Secretary Schlesinger urges energy conservation because of the cutoff of oil from Iran.

Jan 15 Chicago temperature falls to a record low of minus 19 degrees; heavy snows in Midwest snarl transportation.

Jan 16 The Shah leaves Iran.

Jan 24 Department of Energy (DOE) urges states to encourage natural gas hookups to save oil.

Jan 30 Chinese Vice Premier Teng begins official visit to U. S.

Jan 31 Religious leader Khomeini returns to Iran.

Feb 5 Farmers in Washington, protest low farm prices.

Feb 5 Gold jumps to a record $246.50.

Feb 13 Iranians attack U.S. embassy in Tehran.

Feb 18 China invades Vietnam border area.

Feb 19 Heavy snows impede traffic on East Coast.

Feb 20 Federal Reserve's report to Congress projects monetary growth for 1979 at 1½ to 4½ percent for M-1, 5 to 8 percent for M-2, and 6 to 9 percent for M-3.

Feb 22 DOE predicts serious gasoline shortage.

Feb 26 Airlines reduce flights because of fuel shortages.

Feb 28 Major oil companies curtail fuel allocations.

Mar 13 Nuclear Regulatory Commission orders five large East Coast nuclear power plants closed.

Mar 13 European Monetary System goes into effect.

Mar 21 Rail transport of fresh foods deregulated.

Mar 21 Supreme Court rules, 6-3, that states can pay unemployment compensation to strikers.

Mar 22 Iran cancels $700 million in contracts with U.S.

Mar 26 Egypt and Israel sign peace treaty in Washington.

Mar 27 OPEC votes 9 percent rise in base price for crude oil.

Mar 28 Accident closes nuclear plant at Three Mile Island.

Apr 5 Carter proposes phase out of oil price controls, along with a "windfall" profits tax.

Apr 11 Teamsters end 11-day strike.

Apr 12 Moody's reduces rating on Chrysler bonds.

Apr 16 Jane Byrne takes office as mayor of Chicago.

Apr 17 UAW official denounces price-wage guidelines.

Apr 20 Federal court declares bank ATS accounts illegal and sets January 1, 1980, deadline for Congressional action.

Apr 30 Israeli ship passes through Suez Canal, first since Israel was founded in 1948.

May 4 Margaret Thatcher becomes Britain's Prime Minister.

May 4 Long lines develop at California gas stations.

May 23 Crude oil sells in spot markets abroad at over $30.

May 24 Strike ends at United Airlines after 55 days.

May 24 Diesel fuel shortages slow truck traffic.

May 25 DC-10 crashes after takeoff at O'Hare—274 die in worst air disaster in U.S. history.

Jun 1 Long lines reported at gas stations on the East Coast.

Jun 4 Independent truck drivers halt traffic, protesting price and availability of diesel fuel.

Jun 6 FAA grounds all DC-10s operated by U.S. airlines. (Ban lifted July 13.)

Jun 7 Carter again rules out wage and price controls.

Jun 15 United States and Russia sign SALT pact in Vienna.

Jun 17 United Nations projects world population at 4.3 billion in 1980 and 6 billion in 2000.

Jun 20 Emmett J. Rice joins Federal Reserve Board, succeeding Stephen S. Gardner.

Jun 27 OPEC raises basic oil price to $18, plus surcharges.

Jun 27 In Weber case, Supreme Court rejects a "reverse discrimination" plea.

Jul 1 Social Security and welfare payments rise 9.9 percent.

Jul 1 Passbook savings rate ceiling raised to 5.5 percent at thrifts and 5.25 percent at banks, four-year floating rate certificate authorized, and other regulations are eased.

Jul 2 Circulation of Susan B. Anthony dollar coins begins.

Jul 11 Skylab falls into Australian desert.

Jul 16 Thermostats in nonresidential buildings ordered set at 78 in summer, 65 in winter.

Jul 17 Carter announces receipt of resignations of his entire cabinet and senior staff. (Most are retained.)

Jul 17 Treasury auctions gold at a record $296.

Jul 17 Federal Reserve's report to Congress retains 1979 monetary growth ranges announced February 20 and sets similar ranges for 1980.

Jul 18 Frederick H. Schultz confirmed as Vice Chairman of the Federal Reserve Board, succeeding Philip C. Jackson, Jr. as Governor and Stephen S. Gardner as Vice Chairman.

Jul 19 G. William Miller, Federal Reserve Board Chairman, named to replace Blumenthal as Secretary of the Treasury.

Jul 19 Federal Reserve announces increase in discount rate from 9.5 to 10 percent.

Jul 25 Paul Volcker named to succeed Miller as Chairman of Federal Reserve Board.

Jul 26 Legislation implements Multilateral Trade Negotiations.

Aug 1 Chrysler reports large operating losses and asks federal financial aid.

Aug 1 RPs of less than $100,000, maturing in 90 days or more, made subject to Regulation Q interest rate ceilings.

Aug 15 Andrew Young resigns as ambassador to the U.N.

Aug 16 Federal Reserve announces increase in discount rate to a record 10.5 percent.

Aug 17 Price controls end for "heavy" crude oil.

Sep 1 California lettuce growers sign pacts with United Farm Workers, raising wages by about two-thirds over three years.

Sep 12 Major bank raises prime rate to 13 percent.

Sep 14 General Motors agrees to boost compensation 34 percent over three years, assuming 8 percent annual inflation.

Sep 18 Gold rises to $382 and silver rises to $16.

Sep 18 Federal Reserve announces increase in discount rate to 11 percent.

Sep 25 HUD raises ceiling on government-backed residential mortgages to 10.5 percent.

Sep 26 Duluth grain elevator strike ends after 12 weeks.

Sep 27 Auto manufacturers again reduce assembly schedules to cut inventories.

Oct 1 Federal workers receive general pay boost of 7 percent, in addition to annual step increases.

Oct 1 Panama's sovereignty extended over the Canal.

Oct 1 Gold jumps to $416, double year-earlier price.

Oct 5 Dow industrial stock index closes at 898, high for the year. (Low of 797 reached on November 7.)

Oct 6 Federal Reserve takes strong actions to slow inflation: discount rate rises to 12 percent, marginal reserve requirements are established on increases in "managed liabilities," and monetary policy emphasis is shifted to control of member bank reserves.

Oct 15 Libya raises oil price to $26.27, exceeding OPEC's $23.50 ceiling.

Oct 17 1,800 Marines reinforce Guantanamo Naval Base, following reports of Russian troops in Cuba.

Oct 18 John Deere strike ends after 18 days.

Oct 22 Treasury 90-day bills hit record 12.93 percent.

Oct 23 Major banks raise prime rate to 15 percent.

Oct 23 Britain terminates long-standing exchange controls.

Nov 1 Britain's Conservative government announces sharp cuts in welfare outlays.

Nov 1 Company-wide strikes start at Caterpillar and International Harvester.

Nov 4 Iranian "students" invade U.S. embassy in Tehran and seize.hostages.

Nov 5 Iranian Premier Bazargan resigns.

Nov 7 Prime rate rises to 15.5 percent.

Nov 8 Big Three auto makers announce further layoffs.

Nov 8 Illinois law suspends mortgage usury rate.

Nov 12 Carter bans oil imports from Iran; Iran halts shipments to U.S.

Nov 14 Chicago school financial crisis begins.

Nov 14 U.S. freezes Iranian financial assets.

Nov 16 Prime rate rises to 15.75 percent.

Nov 19 Lane Kirkland is elected president of the AFL/CIO, succeeding George Meany.

Nov 21 Mob burns U.S. embassy in Islamabad, Pakistan, acting on an unfounded rumor.

Nov 26 FNMA auctions conventional mortgage funds at a record 13.35 percent.

Nov 26 Major bank cuts prime rate to 15.5 percent.

Dec 5 IMF auctions gold at $426.

Dec 9 Brazil devalues cruzeiro by 30 percent.

Dec 13 Venezuela and Saudi Arabia raise basic oil price from $18 to $24. (Spot price is $40.)

Dec 13 Canada's Conservative government falls on vote over austere budget.

Dec 14 Financial authorities authorize banks and S&Ls to issue 2½-year certificates with rates tied to yields on Treasury bonds, and no minimum balance, effective January 1.

Dec 14 Major bank cuts prime rate to 15 percent.

Dec 19 Caterpillar strike ends after 79 days; strike continues at International Harvester.

Dec 20 Congress passes bill providing for a $1.5 billion loan guarantee for Chrysler, conditional on other steps.

Dec 20 OPEC nations adjourn meeting at Caracas without agreement on a price for crude oil.

Dec 21 Chicago transit strike ends after four days, with disputed cost-of-living adjustment to be arbitrated.

Dec 21 Chicago school employees are not paid.

Dec 26 Gold closes in New York at $506, first time over $500.

Dec 28 Legislation temporarily overrides court decision banning ATS accounts at banks, and suspends state mortgage usury ceilings, etc.

Dec 30 Soviet troops invade Afghanistan.

Dec 31 Silver hits $35, up from $6 a year earlier.

triggering income losses late in the year among hog and broiler producers.

Monthly choice steer prices at Omaha averaged about $67.65 per hundredweight, compared with $52.34 in 1978. By contrast, hog prices fell from $48.50 per hundredweight in 1978 to an average of $42.50 in 1979.

Milk production increased about 1 percent last year, spurred by a favorable milk/feed price ratio. Milk prices received by farmers averaged more than $12 per hundredweight, 14 percent higher than in 1978. The higher prices resulted mostly from strong commercial demand, but they also reflected higher government support prices.

What lies ahead?

Trends that could develop in the year ahead suggest the need for caution. Consumer demand for food could ease if the economy turns down as expected. Consumers' food budgets would be strained by rising unemployment and continued price increases for energy and other essentials. Although food demand usually weathers recessions fairly well, partly because of food-stamp and other government aid programs, downturns sometimes impact on demand for more preferred foods, such as beef and fresh fruits.

World demands for agricultural commodities will continue strong this year. Much of the strength was undermined, however, by the unexpected embargo on shipments to the Soviet Union imposed in early January. The embargo applies to all agricultural commodities except the unshipped portion of the 8 million metric tons of corn and wheat authorized in the five-year U.S.-USSR grain agreement. The loss in shipments to the Soviet Union will amount to 17 million tons of grain, plus a small amount of soybeans and related products.

Until the embargo, grain and oilseed exports were projected to rise 17 percent in fiscal 1980. The projected increase has been cut in half as a result of the embargo.

The Soviet Union has accounted for a large part of the world market for U.S. grains. For the past two years, corn shipments to the Soviet Union have accounted for more than a fourth of all corn exports and more than 6 percent of corn production. The impact of the embargo on such a large customer is not yet certain. For the short run, it appears the government intends to isolate from free market supplies a large part of the lost Soviet sales. Such actions would reduce the downward pressure on grain prices. For the longer term, production adjustments will likely be necessary if the embargo is not lifted.

Underlying inflationary pressures will continue to swell farmers' operating expenses and may limit the hoped-for easing in retail food prices. With the cost pressures facing food processing and distribution companies, it is doubtful that this year's rise in retail food prices can be held much below the double-digit level. Farmers will find the inflationary pressures most evident in fuel, fertilizer, and interest costs.

The USDA has projected a one-fifth decline in net farm income this year. That projection assumes small gains in marketing receipts and an increase of more than a tenth in production expenses. Few analysts argue about the direction of the change of income, and—in light of recent events—more are beginning to accept the magnitude of the change. Although world events regarding crop production or political developments may alter subsequent projections, it now appears that the agricultural sector will start the 1980s under less favorable conditions.