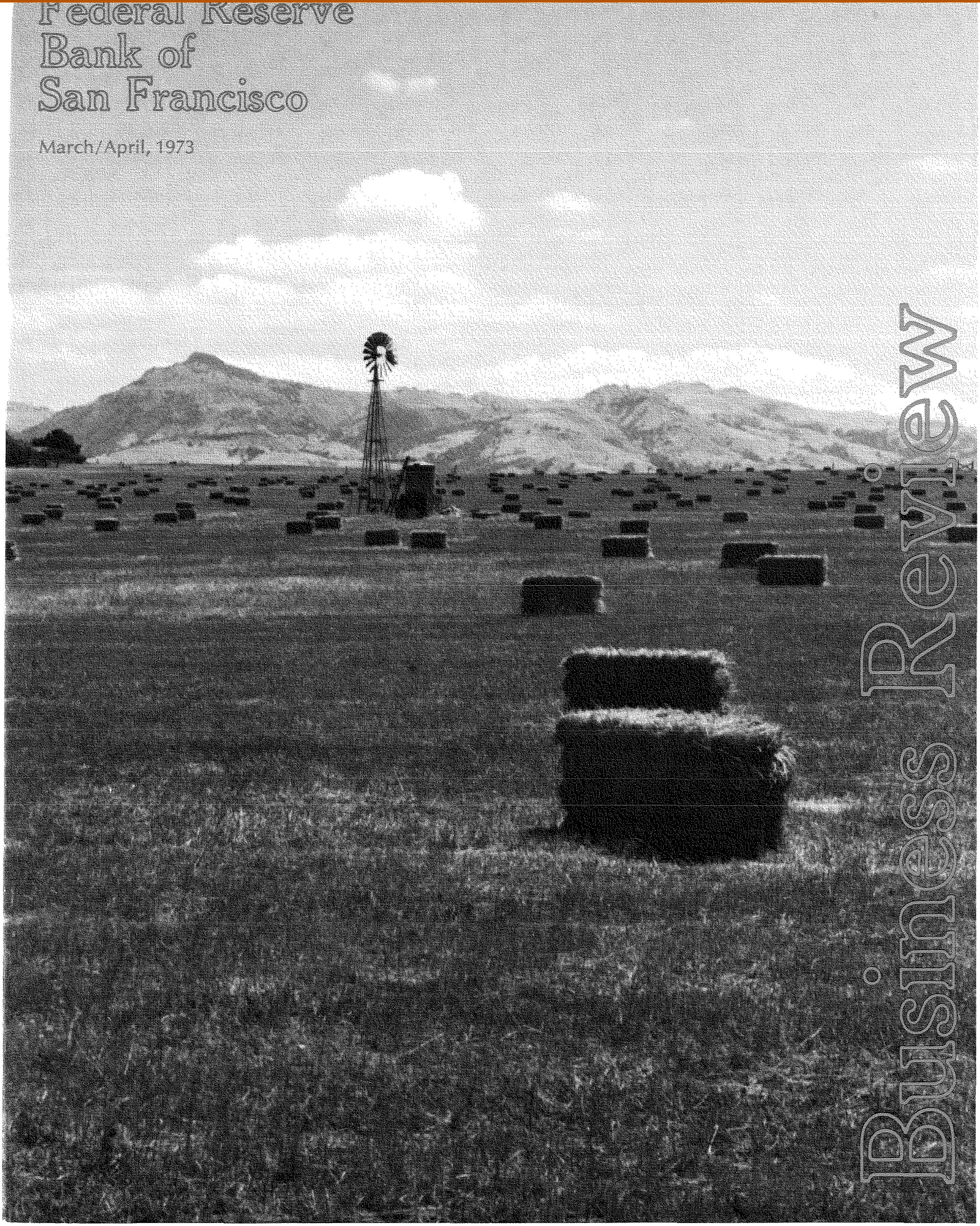
Federal Reserve Bank of San Francisco

March/April, 1973



Business Review

Horn of Plenty

Now that most crops are in the ground, agricultural planners generally agree that a sharp increase in crop production is virtually certain this year—given the usual proviso about the weather, of course. Stimulated by record high prices and heavy worldwide demand, the nation's farmers have risen to the challenge by planting a total of nearly 320 million acres. This 8-percent increase in acreage, although falling below the Administration's original goal, represents the largest annual expansion of the past three decades.

These crops won't be harvested until next fall, however, so obviously they are not much help in the immediate food crisis. Even so, they should cause a significant shift in the demand-supply equation when they finally reach market.

Viewing the recent upsurge in food prices and the peak levels of farm income, some observers contend that the decades-old problem of excess capacity has now been solved, thereby permitting the dismantling of government production controls. However, skeptics argue in rebuttal that the present situation is only temporary, and that farmers still have more capacity than the market can absorb at reasonable prices. Some light may be thrown on this controversy by a review of the market factors which have stimulated the recent price upsurge, and thus called for such a major shift in supply.

Explosion in prices

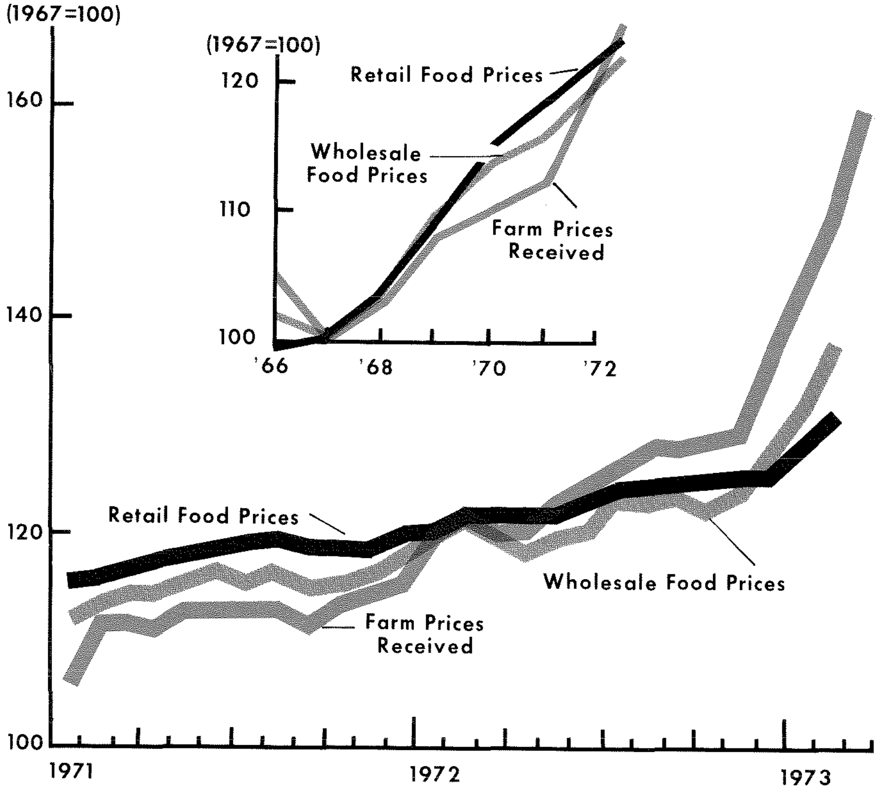
The recent explosion in farm prices has brought near-record increases in wholesale and retail indexes in its wake, and has placed in jeopardy the Administration's anti-inflation program. But perhaps luckily for consumers, the farm-price index has far outstripped the other indexes in recent months, in contrast to the usual price relationships.

Historically, the food component of the consumer price index has advanced at a much faster rate than the farm-price index—with, for example, an increase of 3.4 percent as against 1.8 percent in 1971. In some years, such as 1967, the retail price of food even rose in the face of declining farm prices. This situation reflects the long-term decline in the relative importance of farm products in finished food items. It is also attributable to the increase in the marketing price spread, as farm products are transported, processed and packaged to satisfy the ever-rising demand for quality food services.

Over the past year, however, farm prices jumped 33 percent (March to March), with half of that gain occurring in the last quarter alone. (That was the largest quarterly increase since 1946.) Throughout this period, most nonfarm products were subject to control while farm products were not, so that retail prices failed to reflect the full increase in farm prices. Even so, retailers couldn't absorb the entire increase, and surging farm prices thus meant a substantial boost in consumer prices. Moreover, because of response lags, the latest acceleration in farm prices should affect the retail and wholesale indexes for some time to come. This may have been involved in the President's decision to impose ceilings on retail meat prices in early April.

Changes in the market

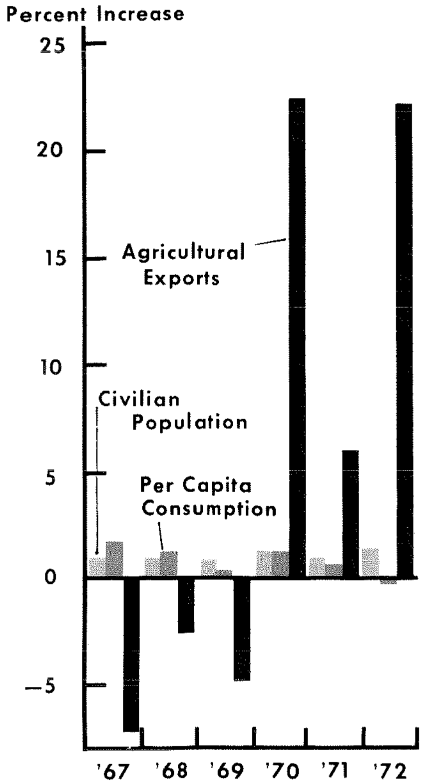
The price situation in 1973 reflects the dramatic changes which took place in the market in 1972. This was a period of declining grain production,



Farm prices jump 33 percent over past year, but retail index (despite recent upsurge) fails to reflect full rise in farm prices

because of reduced acreage and assorted weather problems, but also a period of very exuberant demand. Domestic demand increased on the basis of the natural growth of population and the strong expansion of the national economy. At the same time, foreign demand soared to spectacular levels.

Over the past decade as a whole, domestic demand has grown at a fairly stable pace, reflecting the slow growth of the civilian population—roughly 1 percent annually—as well as the generally strong growth of personal income. However, the rise in per capita incomes has helped bring about a shift in consumption patterns, in view of the low income elasticity of demand for starchy food and the high elasticity of demand for meat and other protein products. This



Domestic demand factors rise at stable pace, while exports zoom

factor, of course, has been involved in the recent pressure on meat prices.

Foreign demand, in contrast, has been an increasingly important, but unstable, element in the market for U.S. farm products.

Over the 1963-72 period, agricultural exports increased at a 7-percent annual rate, but the rate has accelerated in the last several years, because of the Russian demand for food grains, as well as the Japanese and West European demand for feed grains to support their growing livestock industries. Exports rose 22 percent in 1972 alone, to $9.4 billion, as foreign customers absorbed three-fourths of the 1972 wheat crop and one-half of the year's soybean production, as well as a substantial share of feed-grain output.

Over the past decade, wheat exports have increased modestly, but feed-grain exports have almost doubled and soybean exports more than tripled. A sharp expansion in physical volume has accounted for most of the increase in dollar volume of exports, although rising prices have also played a role.

Attacking shortages

In the present tight supply situation, the Administration has begun to sell grains from government stocks and has lifted import quotas on meat and dairy products—and in particular, has released production restraints on 1973 crops. In the case of wheat, the Administration in January eliminated the "set aside" requirement under this year's production program. The order came too late to have any effect on winter wheat, which comprises almost three-fourths of total wheat acreage, but it gave farmers an opportunity to expand their spring wheat acreage and to produce corn and soybeans on their remaining idled land.

In the case of feed grains—a key influence on livestock output—the Administration has revised provisions several times since last December. Originally, it had ordered a set aside of 25 million acres—compared with the 1972 figure of 37 million acres—but by March it had cut the requirement for idled land to only 9 million acres. The latest reduction occurred when the March projection of 1973 corn output (5.8 billion bushels) turned out to be 4 percent below the target figure for that crop.

Clearly, a sharp expansion of crop acreage is in store, because of favorable price trends for most crops and the Administration's efforts to ease planting restrictions. As noted at the outset, planted acreage is likely to approach 320 million acres,

Heavy worldwide demand spurs U.S. farmers to plan for record grain harvests

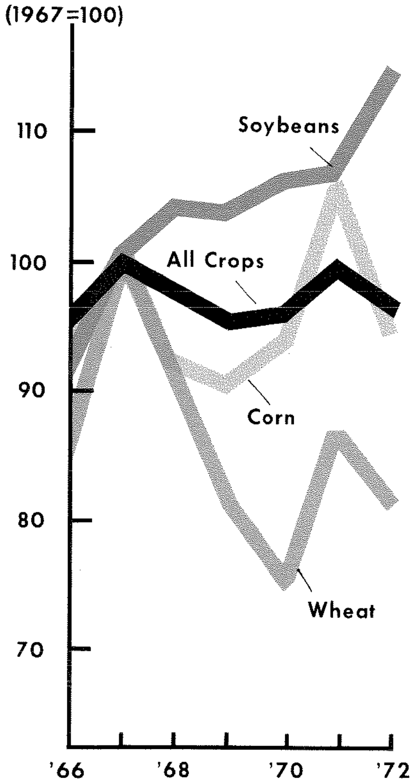
significantly higher than the range of 291 to 306 million acres maintained throughout the past decade. However, this anticipated increase represents only a little over one-half of the 40 million acres released from set-aside requirements.

Some farmers may be avoiding heavier plantings, possibly because of shortages of seed, fuel and fertilizer—but possibly also because of fears of a price decline, such as occurred in other years (such as 1967) when plantings expanded rapidly. In those earlier years of government-sponsored production increases, the nation's farmers produced with their expanded cropland far more than domestic and foreign markets could absorb. (For example, crop prices declined 5 percent in 1967.) Unlikely as that prospect might seem in the present period of intensely heavy demand, the possibility may have led some farmers to plant rather conservatively when they went into the fields this spring.

Gains in major crops

Nonetheless, growers' intentions for 1973 plantings (as of March 1) indicate acreage increases for practically every major crop except cotton, with soybeans, wheat and corn accounting for most of the gain. If actual plantings match intentions, the 1973 soybean crop could reach a record 1.5 billion bushels, and the wheat crop could total a record 1.7 billion bushels. In the case of corn, the latest revision in the feed-grain program should help to boost output to near the USDA target of 6.0 billion bushels.

As a consequence of the heavy worldwide demand for high-protein feeds, U.S. soybean production has jumped 83 percent over the past decade. The market remains under pressure this year, partly because of substantial Russian purchases and partly because of shortages of competing products such as Peruvian fishmeal. Yet, despite the heavy demand expected from foreign and domestic sources, the projected supply of 1.5 billion bushels could permit an increase in the carryover into next year, and thereby permit some easing of the pressure on soybean prices.



Projected '73 rise in acreage scheduled to offset earlier decline

On the heels of a 35-percent increase in production over the past decade, the 1973 wheat harvest is expected to be 14 percent larger than last year, reflecting a rise in the winter-wheat crop as well as a sharp upsurge in spring-wheat plantings. This supply should outpace the projected increase in demand, and thus permit a 20-percent increase in carryover (to 540 million bushels) in the 1973-74 marketing year. Thus, with a record crop in prospect, wheat prices could lose some of their present vigor, although still remaining above the levels of other recent years.

With the help of sharply rising yields per acre, corn production has risen 36 percent on declining acreage over the past decade. This year's expected increase could make up for last year's 3-percent decline, and thus permit some carryover despite the very strong demand from domestic and (especially) foreign sources. In this event, some easing of prices could develop during the 1973-74 marketing year.

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