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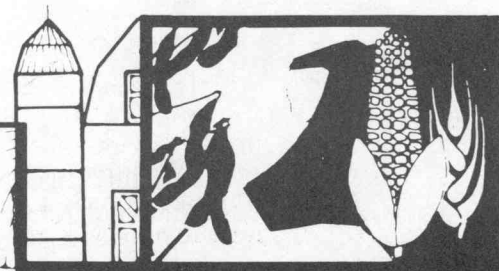
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LETTER



MILK PRODUCTION is still on the rise, holding prices close to support levels. In January and February, milk production—adjusted for this year's extra "leap" day—was up 2.7 percent from a year before. This extends the large gains recorded in the latter part of 1979 that helped boost milk production for the year 1.7 percent to a 14-year high. The rise in production in recent months has exceeded the growth in commercial use of milk and dairy products, resulting in larger government purchases to maintain support prices. In light of prospects for continued gains in production, uncertainty about further growth in commercial sales, and a pending boost in the support price, it appears government purchases this year will be well above last year's relatively low level.

Milk production in district states—which rose 2 percent last year—is also on the increase. Since September, milk production in the five district states has exceeded year-earlier levels by 2.7 percent. That has been slightly less than the increase nationwide. Production in Wisconsin has been up the most during this period, rising nearly 4 percent. Wisconsin dairy farmers account for nearly a fifth of milk production nationwide and over three-fifths of the production in the five district states.

The increase in milk production reflects the generally favorable returns to dairy farmers the past couple of years. Last year, cash receipts to dairy farmers rose to \$14.7 billion, up 15.5 percent from the year before and 29 percent from three years earlier. Higher milk prices accounted for most of the increase, although larger marketings of milk also contributed. Milk prices received by farmers averaged \$12.04 per hundredweight last year, 14 percent more than in 1978.

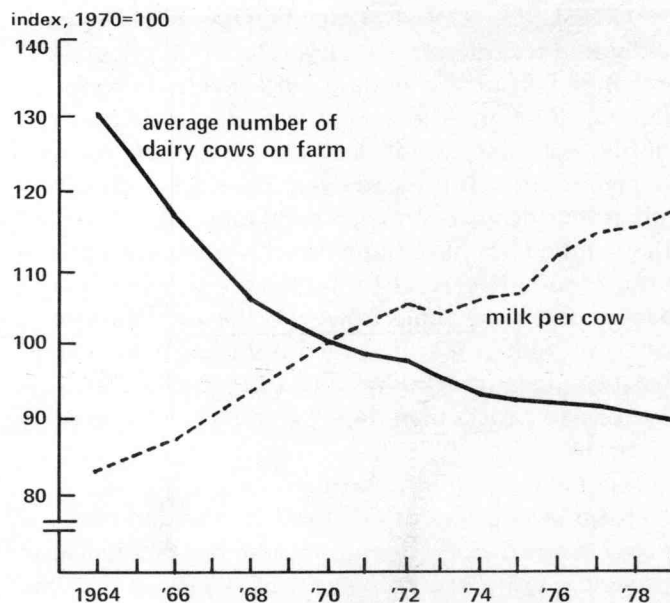
Year-to-year gains in farm level prices have narrowed to 8 percent in recent months as gains in production have outstripped commercial use and held prices at about the support level. However, the support price will be raised on April 1, to reflect changes in the index of prices paid by farmers since last September. The USDA expects the April 1 increase to boost the support price of

manufacturing grade milk 7.6 percent above the current level of \$11.22 per hundredweight and 15 percent above the level set in April a year ago. Another boost in the support price will likely become effective on October 1. That increase is mandated by last year's legislation requiring milk prices be supported at a minimum of 80 percent of parity through September 1981.

The outlook is strongly influenced by these prospective increases in the support price. Regardless of the balance between production and commercial use, increases in the support price will hold milk prices well above year-earlier levels. The USDA projects year-to-year gains in milk prices will widen from the recent 8 percent to 10 percent in the second quarter. The margin may be even wider in the second half, holding the average rise for all this year at slightly more than a tenth.

Higher milk prices and prospects for stable feed costs are expected to result in favorable operating

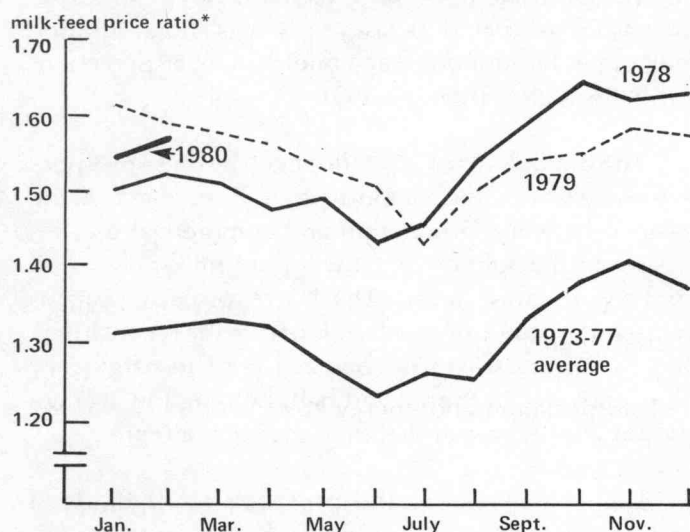
The downturn in dairy cow numbers has slowed, but milk per cow continues to rise



margins for dairy farmers again this year. Last year, the milk-feed price ratio (pounds of 16 percent protein ration equal in value to one pound of milk) averaged 1.55. That was slightly above the high of the previous year and nearly a fifth above the average annual ratio the five years before 1978.

Prospects for favorable operating margins and an increased number of dairy heifers held for herd replacements point to continued gains in milk production. High feeding margins encourage heavier concentrate feeding. That in turn tends to boost milk production per cow. Last year, milk per cow increased 2.3 percent to an annual average of 11,471 pounds. Simultaneously,

The milk-feed price ratio for dairy farmers has held at a high level the past two years



* Pounds of 16 percent protein ration equal in value to one pound of milk.

PRESSURES ON RETAIL FOOD PRICES have moderated recently. In January, retail food prices were unchanged from the ending 1979 level, allowing for seasonal variation. And in February, wholesale prices of finished consumer foods declined for the second consecutive month. These early-year developments, along with promising near-term prospects for food commodity prices at the farm offer hope that this year's average rise in retail food prices will be less than the 10.9 percent last year. At the same time, however, the escalating costs associated with processing and distributing food beyond the farm gate suggest this year's rise in retail food prices is not likely to be less than the 8 percent rise projected by the USDA.

Farm level prices of raw food commodities are expected to be a major moderating influence on retail food prices this year. According to USDA projections, the

cow numbers declined only about 0.5 percent last year. If preliminary estimates showing the inventory of replacement heifers up 6 percent from a year ago and the highest since 1967 are correct, it is likely this year's decline in cow numbers will also be well below normal.

Although year-to-year gains in milk production may narrow from recent levels—particularly in the second half when production will be compared to the sharply rising levels of a year earlier—the USDA now expects milk production for all this year might be up 2 percent. This much of an increase is likely to outstrip demand. Last year, commercial use of milk rose 1.2 percent to a new high. But sales may be lackluster this year. Higher retail prices for milk and dairy products may soften consumer demand. The expected downturn in the overall economy, along with further large general price increases, could also soften consumer demand. And the competitive balance in prices of alternative protein sources may shift more toward meats and eggs this year. These developments could well hold this year's rise in commercial use somewhat below the 1 percent annual rate that characterized the past decade.

With prospects of production outstripping commercial use, it appears that government purchases of manufactured dairy products will be up sharply this year to hold prices at support levels. Last year, net removals of milk through government support purchases fell a fourth below the year-earlier level. However, purchases since last fall have been sharply higher than a year ago, reaching a fivefold increase in the first two months of this year. With milk production on a seasonal upswing, government purchases will remain large in the second quarter.

farm value of domestically produced foods during the first half of this year is expected to average 1.7 percent less than the highs recorded last year. These prospects reflect the likelihood of generally adequate supplies of domestic food products. Large gains in pork and poultry production are offsetting declines in beef, holding total meat supplies well above year-earlier levels. As a result, the index of farm-level prices of meat animals in January and February averaged 3 percent below the rapidly rising levels of a year before. Year-to-year gains in meat production may narrow in the months ahead, but per capita supplies will hold at very high levels. Hence, livestock and poultry prices are expected to exert only minimal pressures on retail food prices, although the pressures may be stronger in the second half.

Fruit and vegetables supplies are also expected to be in fairly good balance with demand for the near-term,

despite recent threats from rains in California and the early-March freeze in Florida. Contrary to initial reports, the permanent damage to supplies caused by these recent weather conditions appears moderate. Wholesale prices of fresh fruit and vegetable prices in February were well below year-earlier levels and wholesale prices of processed fruits and vegetables were up only 2 percent from a year earlier.

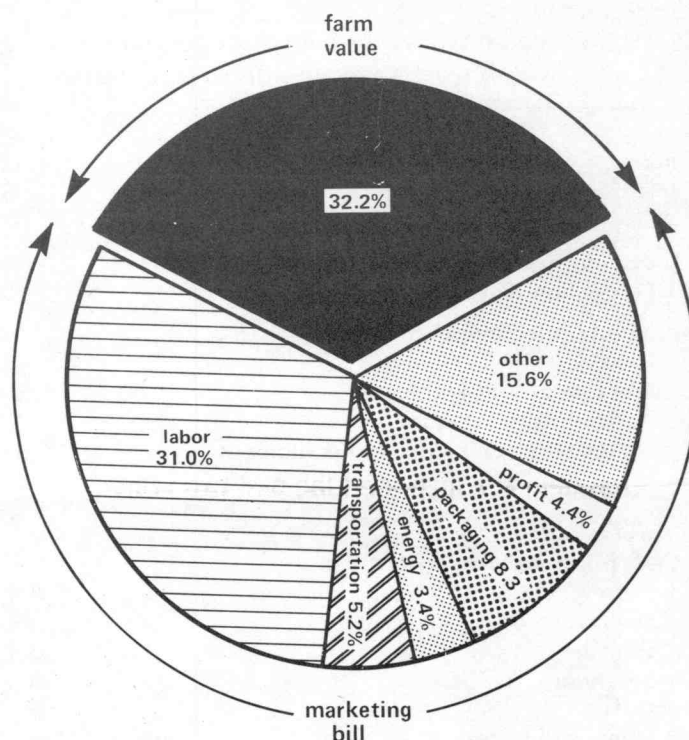
Bakery products and dairy products represent two domestically produced food categories in which farm prices continue to exert pressure at the retail level. Wheat prices in February were up 25 percent from a year before, accounting for a proportionately large share of the 13 percent year-to-year rise in wholesale bakery products prices in February. Despite increased supplies, farm-level milk prices are expected to rise a tenth or more this year, partly because of the legislative mandate that raises the support price semiannually. Retail prices of milk and dairy products may be up by a similar amount this year.

Despite the expected moderation from raw food commodity prices, escalating costs of processing and distributing food will result in considerable pressure at the retail level. These costs, typically referred to as the "marketing bill," rose more than 12 percent last year and accounted for over two-thirds of the \$239 billion in retail expenditures for domestically produced food products.

Over 70 percent of the food marketing bill reflects costs of labor, transportation (excluding local hauling charges), packaging materials, and energy. Labor costs rose 11 percent last year and the increase this year may be equally as big. About a fourth of food industry union workers are covered by clauses that provide cost-of-living adjustments (COLA) to wages. Large gains in consumer prices since late 1979 will ensure substantial wage increases for most food workers covered by COLA clauses. In addition, the large gains in consumer prices, the more flexible voluntary wage guidelines for this year, and the desire to "catch-up" will probably result in larger wage increases for other food workers, union and nonunion.

Food packaging costs rose 12 percent last year and—according to the USDA—may be up a tenth again this year. Although the rise in prices of glass containers and paper products may slow, sharply higher petroleum

Components of farm food expenditures, 1979
(\$238.8 billion)



prices will continue to push the cost of plastic packaging materials higher.

Transportation and energy costs together account for about 13 percent of the marketing bill. Last year, transportation costs rose 14 percent and energy costs rose an estimated 19 percent. Because of the close tie between these costs and petroleum prices, there is much uncertainty about the likely rise in transportation and energy costs this year. But most analysts believe the increase will be substantial.

Pressures on retail food prices are also apparent for a number of imported foods, particularly sugar. During the past three months, wholesale prices of refined sugar soared nearly 50 percent. Although the uptrend may abate in the months ahead, sugar prices will average substantially higher this year. Because sugar and sweeteners are added to many other food products, the higher prices will affect retail food prices directly and indirectly.

Gary L. Benjamin

Selected agricultural economic developments

| Subject | Unit | Latest period | Value | Percent change from | |
|-------------------------------------------------|----------------|---------------|-------|---------------------|----------|
| | | | | Prior period | Year ago |
| Index of prices received by farmers | 1967=100 | February | 238 | + 0.8 | - 1 |
| Crops | 1967=100 | February | 219 | - 0.5 | + 1 |
| Livestock | 1967=100 | February | 256 | + 1.6 | - 3 |
| Index of prices paid by farmers | 1967=100 | February | 271 | + 0.7 | +13 |
| Production items | 1967=100 | February | 266 | + 1.1 | +13 |
| Producer price index* (finished goods) | 1967=100 | February | 235 | + 1.4 | +13 |
| Foods | 1967=100 | February | 232 | + 0.1 | + 3 |
| Processed foods and feeds | 1967=100 | February | 233 | + 2.0 | + 6 |
| Agricultural chemicals | 1967=100 | February | 243 | + 2.0 | +20 |
| Agricultural machinery and equipment | 1967=100 | February | 249 | + 0.6 | +11 |
| Consumer price index** (all items) | 1967=100 | January | 233 | + 1.4 | +14 |
| Food at home | 1967=100 | January | 241 | + 0.8 | + 8 |
| Cash prices received by farmers | | | | | |
| Corn | dol. per bu. | February | 2.36 | - 3.7 | + 8 |
| Soybeans | dol. per bu. | February | 6.14 | - 3.9 | -12 |
| Wheat | dol. per bu. | February | 3.75 | + 0.3 | +25 |
| Sorghum | dol. per cwt. | February | 4.14 | + 3.2 | +17 |
| Oats | dol. per bu. | February | 1.36 | - 2.2 | + 9 |
| Steers and heifers | dol. per cwt. | February | 70.80 | + 4.0 | + 6 |
| Hogs | dol. per cwt. | February | 37.20 | + 2.5 | -30 |
| Milk, all sold to plants | dol. per cwt. | February | 12.80 | 0 | + 8 |
| Broilers | cents per lb. | February | 25.4 | - 6.6 | -12 |
| Eggs | cents per doz. | February | 50.8 | -10.6 | -15 |
| Income (seasonally adjusted annual rate) | | | | | |
| Cash receipts from farm marketings | bil. dol. | 4th Quarter | 132 | + 1.8 | +11 |
| Net farm income | bil. dol. | 4th Quarter | 33 | + 5.5 | + 3 |
| Nonagricultural personal income | bil. dol. | February | 2,004 | + 0.5 | +11 |

*Formerly called wholesale price index.

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