FEDERAL RESERVE BANK OF CHICAGO

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THE PARTIAL EMBARGO ON GRAIN SHIPMENTS TO THE USSR caught markets by surprise and triggered major confusion as to the ultimate impact on prices and farm income. The embargo was announced on January 4 and was subsequently extended to cover shipments of all other agricultural commodities to the Soviet Union. Programs to counter the impact of lost sales to the Soviet Union were announced this week, although initial details were very sketchy. These programs include CCC intentions to purchase grain or grain contracts, an increase in wheat and corn loan rates, and inducements that will encourage farmers to enroll grain in the long-term grain reserve program.

The embargo was imposed in retaliation for the Soviet Union's invasion of Afghanistan and the potential shift in world power that invasion threatens for much of the oil-rich, but politically unstable, Middle East. The embargo halts shipments of all agricultural commodities to the Soviet Union except the unshipped portion of the 8 million metric tons of corn and wheat purchases authorized in fiscal 1980, the fourth year of the five-year U.S./USSR grain agreement. The 17 million metric tons of additional Soviet purchases of corn and wheat that had been granted October 3 in governmental negotiations between the U.S. and the USSR will be lost if the embargo is not lifted. In short, grain shipments to the Soviet Union during fiscal 1980 will probably be less than a third of the 25 million tons previously expected. Shipments of soybeans and products will be a million tons or more below previous estimates. The embargo also threatens the loss of some reportedly large broiler sales to the Soviet Union.

The issues are further clouded by the longshoremen's refusal to load any Soviet flagship, as well as any cargo in any ship destined for the Soviet Union. The Soviet shipping fleet serves many countries with many types of cargo. If unchecked, the longshoremen's actions would preclude shipment of the approximately 3 million tons of grain that is not covered by the embargo. Their refusal to load any Soviet ship could also disrupt the movement of agricultural commodities to other countries, although reports indicate little grain moves to third countries in Soviet flagships.

Based on the roughly 5 million metric tons shipped at the time of the embargo and assuming the longshoremen will relent and eventually load the remaining 3 million tons permitted, it would appear that the lost Soviet shipments are equivalent to about 475 million bushels of corn and 185 million bushels of wheat. If none of the lost Soviet sales are made up in sales to other countries, earlier projections of a 17 percent increase in corn exports for the 1979/80 marketing year will be revised downward to a 5 percent decline from the 2.1 billion bushels exported the previous year. Similarly, if none of the lost Soviet sales are not made up in shipments to other countries or through increased domestic utilization, carryover stocks of corn next September could be up nearly 50 percent from the 1.3 billion bushels of carryover last September and, relative to annual utilization, the largest in years. That contrasts with earlier expectations of an 11 percent increase in carryover stocks.

Aside from the longshoremen question, these measures of utilization and carryover stocks probably represent the worst of the possible results of the lost Soviet corn sales. The lower prices and the increased availability that will stem from the lost Soviet sales will likely trigger some increase in domestic utilization and in sales to other countries. But the extent of the price reduction, and hence the potential increase in domestic utilization and new export sales, depends largely on the outcome of the government's efforts to mop up the supplies freed-up by the embargo. Some of these supplies will probably be absorbed in the farmer-held grain reserve. Announcement of a slight increase in storage payments covered by the government and the elimination of interest charges on loans covering newly enrolled grain will attract some participants. But most of the supplies will likely be absorbed in some manner by the CCC.

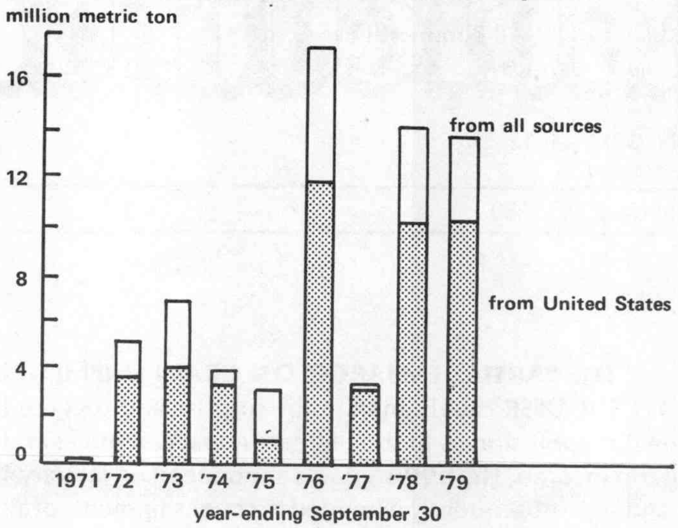
Announcements of how the government would absorb the lost Soviet grain sales and, if necessary, the grain sales that might be lost because of the longshoremen's refusal to load ships indicate a clear intent to protect market prices from the freed-up stocks. Talk of purchasing 14 million metric tons of grain and soybeans at a possible cost of $2 to $2.5 billion would seem to underscore the government's intentions. Details of how the grain is to be purchased, however, have been very sketchy.

Under one alternative being discussed, the CCC would apparently offer to buy the cash purchase contracts that grain exporting firms had previously negotiatied to cover export commitments to the Soviet Union. In contrast to their intentions of taking delivery on the wheat contracts, the CCC may or may not take delivery on the corn contracts. For corn, the CCC apparently intends to resell the contracts if, prior to the delivery date specified in the contracts, prices rise above $2.40 per bushel. (The $2.40 per bushel is apparently the calculated farm price just prior to the embargo.) If sold, the amount of corn specified on the contract would still be available as part of free market supplies. If the contracts are not sold, the CCC will take delivery of the corn. In that case, the CCC stocks would be well insulated from free market supplies unless prices were to rise to much higher levels. Statutes prohibit the sale of CCC grain at prices less than 150 percent of the loan rate whenever the three-year grain reserve program is operating. With the new $2.10 per bushel corn loan rate, this implies CCC stocks could not be sold at prices below $3.15 per bushel.

Preliminary implications are that, in the short-run, this program may offset much of the price-depressing effects of the Soviet grain embargo. At the same time, it adds a new wrinkle to the corn pricing structure. In addition to the new voluntary release and call prices associated with the farmer-held corn reserve ($2.63 and $3.05 per bushel, respectively) farm prices will be sensitive to the $2.40 level that will trigger corn contract sales by the CCC and the $3.15 level that will trigger cash sales by the CCC.

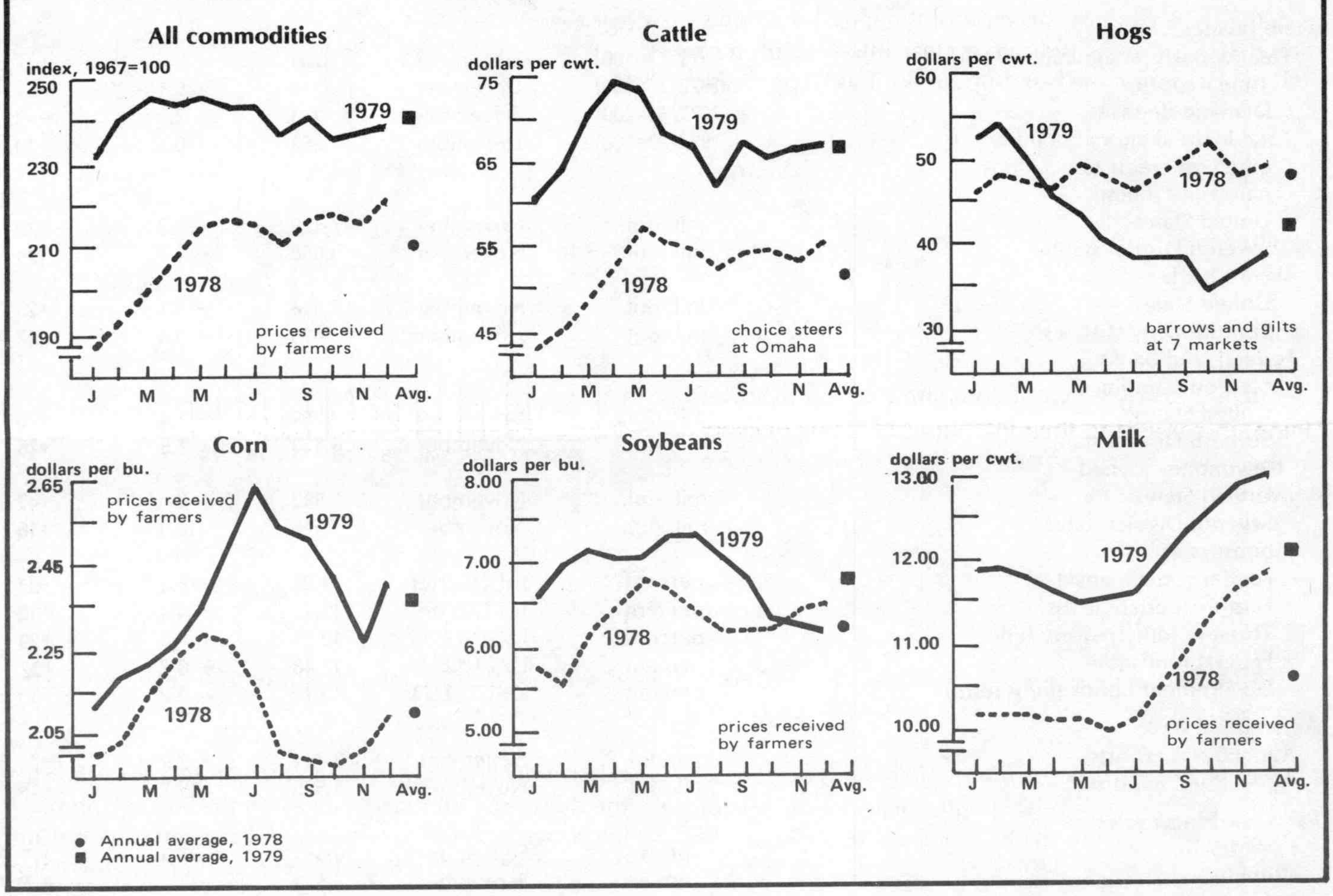
For the Soviet Union, the embargo will force some liquidation of livestock. Over the short run, however, the liquidation will probably be much less than that which followed the disastrous Soviet harvest in 1975. Some officials have suggested the Soviets may be able to offset 3 or 4 million metric tons of the lost imports from the United States. But even assuming they offset none of the loss, utilization of grain in the USSR might still ap-

The United States accounts for most of the Soviet Union's feed grain imports



proximate 215 million metric tons. Of that, 115 million tons might be available for livestock feeding after deducting the normal quantities used for food, industrial, and seed purposes, as well as dockage and waste. That would be 8 percent less than the amount of grain utilized for feed in 1978/79 but still more than in years prior to 1977/78. Moreover, it represents less than half the relative decline in feed usage during the year following the disastrous 1975 crop harvest in the Soviet Union. An important difference between the current situation and the 1975 developments, however, pertains to the timing of the liquidation. In 1975, most of the liquidation occurred in the first half of the marketing year as soon as the Soviets realized the harvest would be sharply lower. The liquidation of livestock this time around will occur in the second half of the marketing year because the shortages did not become evident to the Soviets until last week. For a given amount of grain, the later liquidation begins, the greater the liquidation has to be

Estimates of Soviet livestock inventories at the beginning of 1979 showed year-to-year gains of 1.5 percent for cattle, 6 percent for hogs, 1.5 percent for sheep, and 6.7 percent for poultry. With the exception of sheep, inventories of each were at record levels, in part reflecting the Soviet's strongly held goals of greatly improving consumers' meat consumption. The limited evidence on slaughter suggests that Soviet livestock numbers increased again last year. But in light of the embargo, and assuming the Soviet Union will only be able to offset a portion of the lost imports from the United States, some liquidation will be required to stretch the available grain supplies. In the short run, however, the extent of the liquidation will probably be substantially



1979 farm commodity prices in perspective

less than that which occurred in 1975 when Soviet hog numbers were reduced a fifth and poultry numbers fell 7 percent.

Aside from these more short-run considerations, the latest developments raise a number of questions regarding longer-term developments. If the Soviet Union does not pull out of Afghanistan, what are the implications for grain sales to the Soviet Union in 1980/81 and later years? In the past four fiscal years, grain imports from all sources by the Soviet Union have averaged 19 million metric tons. U.S. feed grains accounted for roughly 50 percent of the total. That is equivalent to nearly 375 million bushels of corn. In three of the past four years, corn exports to the Soviet Union accounted for a fourth or more of total U.S. corn exports. These are significant numbers in terms of the potential long-range implications of the latest developments. And in terms of pricing implications, corn markets will soon be considering export prospects for 1980/81.

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Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from Prior period	Percent change from Year ago
Farm finance					
Total deposits at agricultural banks†	1972-73=100	December	201	– 0.6	+ 7
Time deposits	1972-73=100	December	242	– 0.1	+11
Demand deposits	1972-73=100	December	133	– 2.0	– 2
Total loans at agricultural banks†	1972-73=100	December	258	+ 0.3	+10
Production credit associations					
Loans outstanding					
United States	mil. dol.	November	17,520	+ 0.2	+20
Seventh District states	mil. dol.	November	3,658	+ 1.7	+24
Loans made					
United States	mil. dol.	November	2,516	+ 3.1	+28
Seventh District states	mil. dol.	November	475	+ 0.4	+17
Federal land banks					
Loans outstanding					
United States	mil. dol.	November	29,259	+ 1.4	+20
Seventh District states	mil. dol.	November	6,610	+ 1.5	+26
New money loaned					
United States	mil. dol.	November	532	– 2.0	+42
Seventh District states	mil. dol.	November	116	–18.0	+16
Interest rates					
Feeder cattle loans††	percent	3rd Quarter	11.24	+ 5.6	+21
Farm real estate loans††	percent	3rd Quarter	11.12	+ 4.4	+18
Three-month Treasury bills	percent	12/20-12/26	12.01	+ 7.0	+29
Federal funds rate	percent	12/20-12/26	13.48	+ 8.2	+32
Government bonds *(long-term)*	percent	12/17-12/21	10.12	– 2.2	+13
Agricultural trade					
Agricultural exports	mil. dol.	November	3,784	+ 7.9	+35
Agricultural imports	mil. dol.	November	1,525	+19.7	+19
Farm machinery sales					
Farm tractors	units	September	10,631	+32.5	+ 7
Combines	units	September	5,579	+77.2	+ 7
Balers	units	September	1,819	–23.3	–11

†Member banks in Seventh District having a large proportion of agricultural loans in towns of less than 15,000 population.

††Average of rates reported by District agricultural banks.

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