FEDERAL RESERVE BANK OF CHICAGO

AGRICULTURAL LETTER

ISSN 0002 - 1512

December 14, 1979 Number 1514

RETAIL FOOD PRICE pressures have eased considerably since early spring. From May to October, the index of retail food prices, unadjusted for seasonal variation, rose only 1.7 percent, an annual rate of roughly 4 percent. This contrasts sharply with the 17 percent annual rate of increase during the first five months of the year. Overall, it appears that retail food prices for all of this year will average 11 percent higher than in 1978. For next year, the USDA is projecting an average increase ranging from 7 to 11 percent. Many analysts believe underlying inflationary pressures will hold the increase in the upper half of the USDA's projected range.

Higher prices have been evident for most foods this year. Because of short supplies, the increases have been most apparent in beef prices. Through October, retail beef and veal prices averaged 29 percent higher than a year earlier. Retail prices of fish, eggs, dairy products, and cereal and bakery products have averaged 10 to 12 percent higher. Fruit and vegetable prices have averaged 8 percent higher, as have prices of sugar and sweets. Although below year-ago levels in recent months, pork and poultry prices so far this year have averaged 4 and 6 percent higher, respectively.

During the first part of this year, the pressures on retail food prices came mostly from escalating commodity prices. More recently, overall inflationary pressures on food processing and distribution costs have sustained the uptrend in food prices. Reflecting these developments, the farm value of a fixed market basket of domestically produced foods soared 10 percent in the first four months of the year. Since then, the farm value has declined nearly 8 percent. But the effect of this downturn on retail prices has been offset by the uptrend in processing and distribution costs. Overall, the USDA estimates higher farm values for domestic foods will account for just over a third of this year's projected rise in retail food prices. Marketing costs will account for about 55 percent. Fish and imported food will account for the remaining 11 percent.

There are numerous examples of higher food marketing costs. The third-quarter index of utility costs (fuel, power, and lights) at food marketing firms, for instance, was 24 percent higher than a year ago. Container and packaging costs were up 11 percent. The index of rail freight charges for food products averaged 12 percent above year-earlier levels in the third quarter. In October, rail freight charges jumped 22 percent above a year earlier. Labor costs at food processing and distribution firms will be up 12 percent this year due to higher hourly earnings, sharp increases in fringe benefits, and declining labor productivity. Together, labor, transportation, utilities, and packaging account for over 70 percent of the marketing costs associated with domestically produced foods and nearly half of the total retail expenditures for such foods.

Consumer demand for food has been supported by a number of encouraging developments this year, but inflation and availability and prices of energy have contributed to weakness in some areas. Employment has continued to trend higher and in November was up 2.7 percent from a year ago. The unemployment rate has remained flat, despite concern that it might rise. Although year-to-year gains in per capita disposable incomes have narrowed, preliminary evidence shows the third-quarter gain was still nearly 10 percent. Although inflation has offset virtually all the increase in disposable income, consumer food demand has been partially shielded by sluggish consumer expenditures on durable goods. Government food programs have also supported consumer food demand. Third-quarter figures for the food stamp program, for instance, show the number of people receiving food stamps was up 22 percent from the year before and the value of stamps issued was up 43 percent.

Sluggish sales at eating and drinking places represent one area of softness in consumer food demand. Following gains of about 12 percent in the first quarter, year-to-year increases in retail sales at eating and drinking places were cut to nearly 6 percent in the late spring and summer. The slowing has been attributed to problems in availability and rising prices of gasoline, which altered vacation patterns. More recent evidence suggests the gain has widened to 8 percent the last two months. That is still well below the rise in prices of food consumed away from home, indicating a significant decline in the quantity of food moving through such establishments. Trade reports suggest this decline has been offset by a pickup in the quantity of food purchased in grocery stores. Nevertheless, it would appear that the energy situation has, at least temporarily, shifted consumer food demand, particularly in the amount of preparation consumers want in their food purchases and, to some extent, in the types of food they purchase.

The outlook for food prices is clouded by uncertainties regarding both demand and supplies of food. On the supply side, near-term fundamentals point to continued declines in beef production, offset by expanding pork production and large poultry supplies. Milk production is expected to continue slightly above year-ago levels. Preliminary indications point to a considerably larger citrus crop and adequate supplies of vegetables. However, as happened the past two years, adverse weather conditions can suddenly change these preliminary indications. Overall, the USDA expects generally good supplies of food and only nominal pressures on retail food prices from rising farm values.

Prospects that the overall inflation rate will remain at 10 percent or higher next year, however, portend substantial pressures from processing and distribution costs. Labor costs will be greatly affected by the contract settlements for food workers renegotiated in the past few months and the substantial number of employees covered by contracts scheduled for renegotiation in 1980. In addition, cost-of-living provisions—which cover 75 percent of foodstore workers and 36 percent of food manufacturing workers with major collective bargaining contracts—will add to labor costs. Other pressures on labor costs will come from catch-up among nonunion food workers and from the nearly 7 percent rise in the minimum wage scheduled to become effective January 1. Food service workers are one of the largest groups of employees directly affected by minimum wage standards.

Although estimates of potential increases in energy prices vary widely, it seems clear that the rise will continue, and probably at a significant rate. This will have direct consequences on transportation and utility costs for food related firms.

The strength in consumer demand may well ease in the year ahead if the economic downturn materializes as expected. Consumers' food budgets could be squeezed by the income effect of the downturn and the escalating prices of energy-related expenditures. Although food demand usually weathers recessions fairly well, such items as beef, fresh fruit, and vegetables, and other "luxury" type foods can be influenced.

Overall, the USDA estimates that retail food prices will rise 8 percent next year. However, that projection is based on assumptions of favorable weather and only modest gains in prices of raw farm products. In light of the strong pressures on processing and distribution costs, any departure from these assumptions could easily hold next year's gain closer to the double-digit level.

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AGRICULTURAL EXPORTS set new highs in both the volume and value of shipments in the fiscal year that ended September 30, 1979. The volume of exports rose 4 percent to 137 million metric tons. Higher average prices boosted the value of exports 17 percent to $32 billion, marking the tenth consecutive year-to-year increase. Agricultural imports also rose 17 percent. Even so, the value of exports exceeded imports by almost $16 billion, surpassing the record agricultural trade surplus of the previous year by 18 percent. A strong foreign demand, heightened by production shortfalls in some parts of the world, contributed significantly to last year's record exports and underlies prospects for further strength this year. The USDA expects fiscal 1980 to mark another year of record-breaking farm exports with a corresponding increase in the agricultural trade surplus.

The leading, single contributor of agricultural foreign exchange earnings last year was again corn. Nearly 54 million metric tons of corn, valued at more than $6 billion, were exported. The Soviet Union, Japan, China, Spain, and Korea—the five leading importers of corn last year—accounted for slightly more than half the total, with the nine member countries of the European Community (EC) accounting for another 18 percent. The second largest foreign exchange earner was soybeans, with 20 million metric tons of exports generating $5.4 billion. More than 85 percent of the soybean shipments went to the EC, Japan, Spain, Taiwan, Mexico, and the Soviet Union. The second largest export commodity in volume of shipments was wheat, which ranked third in generating exchange revenues. Wheat exports are not heavily concentrated among just a few importing countries, as was the case with corn and soybeans, however. The ten largest single-country importers of U.S. wheat together with purchases by the EC accounted for less than two-thirds of the wheat exports.

As in past years, Japan was the biggest single customer of U.S. farm products last year, purchasing more than $5 billion worth of commodities, a fifth more than a year earlier. Almost three-fifths of U.S. foreign exchange earnings from agricultural exports last year came from purchases by the EC and the five leading individual buyers: Japan, the Soviet Union, Canada, Korea, and Spain. Five other countries—all centrally planned—more than doubled their previous year's level of U.S. agricultural purchases in fiscal 1979: Yugoslavia, China, Czechoslovakia, East Germany, and Romania.

Of the total value of agricultural imports last year, 56 percent was accounted for by goods classified as supplementary, meaning those that compete directly with goods produced in the United States. The rest was in complementary products, essentially those the United States does not produce itself. More than half the value of complementary imports last year was for coffee. The average price of green coffee imports in fiscal 1979 was down 16 percent from a year before. So, while the United States imported a fourth more coffee last year, the total cost was up only 5 percent. Among imports of supplementary products, beef and veal set the pace due to a 50 percent year-to-year increase in the average unit price. Together with a larger quantity of imports, this higher average price led to a 75 percent increase in the value of beef and veal imports last year.

The outlook for agricultural exports in the current fiscal year is especially bright. The USDA expects export tonnage will rise 16 percent to 160 million metric tons. In value terms, agricultural exports are expected to rise one-fifth to $38 billion. Prospects for a modest rise in imports suggest the United States could have an agricultural trade surplus of nearly $20 billion. Among the major factors on which these projections hinge are: the level of economic activity in importing countries, the size of forthcoming crop harvests in the Southern Hemisphere, the amount of Soviet imports, foreign exchange rates, and the ability of the U.S. transportation system to meet the export demand.

Some of the concerns about the ability of the transportation system to handle this year's projected export volume have been ameliorated in recent weeks. Weekly grain export inspections have been very strong, averaging nearly 30 percent above year-earlier levels since October 1. The bulk of this increase in export shipments was accounted for by a 43 percent increase in corn export inspections.

Iran represents one exception to the otherwise strong export outlook. In fiscal 1979, Iran was the 16th largest purchaser of U.S. farm exports, spending $490 million primarily on grains and oilseeds. This included 12 million bushels of corn, 30 million bushels of wheat, 333 thousand metric tons of rice, and 262 thousand metric tons of soybean products. At the time of the November 4 takeover of the U.S. Embassy in Tehran by Iranian students, there was very little in the way of unfilled Iranian grain and oilseed orders from the United States. Since the takeover, the International Longshoremen's Association and the Transport Workers Union of America have refused to load cargos (agricultural and nonagricultural) destined for Iran. In an unprecedented move, farm groups have supported these boycott actions. Moreover, legislation has been introduced in Congress to impose a total embargo on Iran.

Agricultural exports to Iran this year likely to be well below year-ago levels

	Wheat[2]	Rice[3]	Corn[4]	Soybean cake, meal, and oil[4]
	(thousand metric tons)			
1974/75	1,644	425	136	106
1975/76	127	161	111	77
1976/77	1,154	461	156	92
1977/78	1,030	344	185	164
1978/79	1,034	358	240	150
1979/80[1]	237	27	129	9
Unfilled orders as of Nov. 25, 1979	0	35	0	48

[1]Through November 25, 1979.
[2]Marketing year begins June 1.
[3]Marketing year begins August 1.
[4]Marketing year begins October 1.

According to estimates by the USDA, Iran purchased roughly a fourth of its required agricultural imports from the United States last year. Iran typically imports 80 percent of its vegetable oil needs, 55 percent of its feed grain needs, 36 percent of its rice needs, and 20 percent of its wheat needs. Of these estimated import needs, the United States had been supplying 70 percent of the vegetable oil, 25 percent of the feed grains, 75 percent of the rice, and 80 percent of the wheat. It now seems highly improbable that the United States will maintain these shares in fiscal 1980.

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Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from	
				Prior period	Year ago
Farm finance					
Total deposits at agricultural banks†	1972-73=100	November	203	+ 0.2	+ 7
Time deposits	1972-73=100	November	243	+ 0.2	+11
Demand deposits	1972-73=100	November	135	+ 0.1	− 3
Total loans at agricultural banks†	1972-73=100	November	258	+ 0.4	+11
Production credit associations					
Loans outstanding					
United States	mil. dol.	October	17,491	+ 0.2	+19
Seventh District states	mil. dol.	October	3,597	+ 1.6	+24
Loans made					
United States	mil. dol.	October	2,441	+29.9	+35
Seventh District states	mil. dol.	October	474	+20.8	+38
Federal land banks					
Loans outstanding					
United States	mil. dol.	October	28,859	+ 1.5	+19
Seventh District states	mil. dol.	October	6,513	+ 1.9	+26
New money loaned					
United States	mil. dol.	October	543	+31.8	+41
Seventh District states	mil. dol.	October	142	+34.6	+46
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	11/29-12/5	11.58	− 4.8	+30
Federal funds rate	percent	11/29-12/5	13.76	− 0.1	+39
Government bonds *(long-term)*	percent	12/3-12/7	10.07	− 4.6	+15
Agricultural trade					
Agricultural exports	mil. dol.	October	3,508	+28.3	+32
Agricultural imports	mil. dol.	October	1,273	+ 0.8	+ 4
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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