FEDERAL RESERVE BANK OF CHICAGO

AGRICULTURAL LETTER

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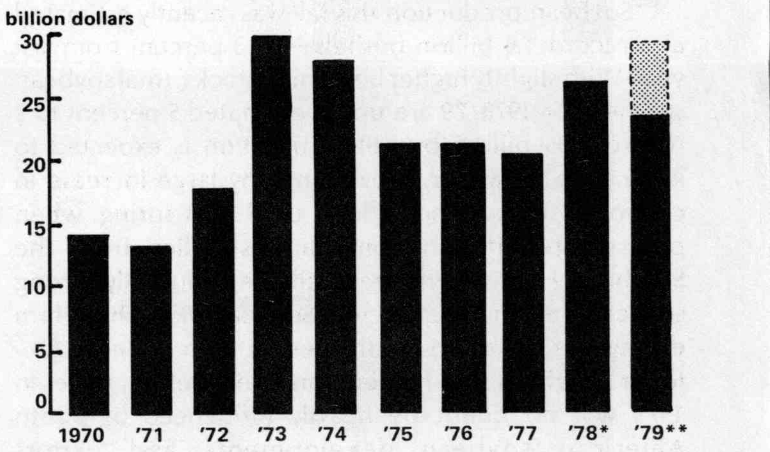
THE AGRICULTURAL OUTLOOK for 1979 was summarized by the U.S. Department of Agriculture in recent Washington meetings. The tone of the conference reflected the surprising strength in the agricultural sector this year and forecasted another strong performance next year. Somewhat guarded optimism for the income prospects of crop farmers was overshadowed by a general concensus that livestock producers will experience another banner year for earnings. Further advances in production costs, however, are expected to about offset the higher gross returns to farming, leaving net income in 1979 near the level estimated for 1978.

Net farm income before inventory adjustment is now expected to total about $26 billion this year—nearly 30 percent more than in 1977 and exceeded only in 1973 and 1974. The surge in income this year primarily reflects the strength in the livestock sector and higher government payments to farmers. The index of prices received by farmers in 1978 will average a record high. Paced by an estimated 23 percent rise in livestock prices, the index for all farm products is expected to surpass the 1977 level by more than 14 percent. Cash receipts to farmers are expected to total a record $109 billion this year. Livestock receipts will likely account for $58 billion of the total—an increase of more than a fifth. Receipts to crop farmers are estimated at $51 billion for 1978, up only slightly from last year.

Exports of farm products in fiscal 1979 are expected to rise 6 percent above the record $27.3 billion estimated for the year ended September 30, 1978. Last year's exports represented production from the equivalent of 31 percent of the harvested acreage, which underscores the significance of the world market to the U.S. farm economy. Moreover, the record agricultural trade surplus in fiscal 1978 of nearly $14 billion was particularly important in reducing the overall trade deficit. Next year the agricultural trade surplus is expected to total nearly $15 billion. The strength in 1978/79 farm exports will stem from higher average prices. Export volume may decline slightly in light of the current evidence that the 1978/79 world grain harvest will be up 7 percent to a record 1.4

Net farm income may be about the same in 1979



*USDA estimate.
**USDA forecast.

billion metric tons. However, crop production in the Southern Hemisphere, world economic developments, trends in the value of the dollar, and decisions in current trade negotiations all represent major unknowns that could impact on U.S. agricultural exports in 1979.

Wheat production fell to 1.8 billion bushels in 1978—down 12 percent from the year before to the lowest level since 1973. Heavy participation in the set-aside program and wet planting conditions in some areas accounted for much of the decline. Expectations for slightly higher wheat exports would partially counterbalance the prospects for reduced domestic usage, resulting in total disappearance near the 1977/78 level. Carryover stocks next June are expected to be down about a tenth from the 1.2 billion bushels of last year. Farm wheat prices in the 1978/79 marketing year are likely to average 20 to 30 percent above the $2.30 per bushel average last year. In addition, eligible wheat farmers will receive substantial deficiency payments again this winter. Aside from the two principal factors behind the downturn in production, the movement of over 400 million bushels of wheat into the farmer-owned grain reserve and the heavy export volume have contributed to the recovery in prices.

Corn production this year is estimated at a record 6.9 billion bushels. Despite stronger domestic feed demand for corn and prospects for export volume averaging near last year's record level, carryover stocks in October 1979 are forecast at 1.5 billion bushels—up a third and the largest carryover in 15 years. Corn prices to farmers, nevertheless, have shown surprising strength this fall, reflecting the strong pace in exports, the accumulation of 525 million bushels of corn in the grain reserve, the first U.S. corn purchases by China in four years, expanded farm storage capacity, and increased livestock and poultry feeding. Corn prices in the 1978/79 marketing year are expected to average between $2.00 and $2.15 per bushel, compared to $2.03 in 1977/78.

Soybean production this fall was recently estimated at a record 1.8 billion bushels—up 3 percent from last year. With slightly higher beginning stocks, total soybean supplies for 1978/79 are up an estimated 5 percent to a record 1.95 billion bushels. Utilization is expected to keep pace, however, preventing any large increase in carryover stocks. And at least until next spring, when progress reports on competing supplies from the Southern Hemisphere are available, unusually strong soybean demand is expected. Soybean prices held firm during the fall harvest with average farm prices in October roughly a fifth higher than a year before. Prices in 1979 will no doubt be heavily influenced by South American soybean developments and export movements. However, the USDA currently expects soybean prices in the 1978/79 marketing year will average about 70 cents per bushel above the $5.80 average of the previous year.

Red meat supplies are expected to decline further in 1979, following the estimated 3 percent reduction this year. Coupled with prospects for continued strength in the demand for meat next year, this will likely mean higher livestock prices, portending the brightest prospects for producers in several years. Beef production next year is projected to decline 4 to 6 percent, with another drop likely in 1980. Pork production, after failing to expand as projected this year, is expected to rise 4 to 6 percent in 1979. Competing supplies of poultry will likely increase sharply again next year. Broiler production—up 7 percent in 1978—could rise another 8 to 10 percent, while turkey production could expand by a tenth or more. Per capita consumption of red meats will be down next year with part of the drop offset by increased consumption of poultry. Total per capita consumption of red meats and poultry is expected to average between 236 and 247 pounds (carcass weight) next year, compared to an estimated 243 pounds in 1978 and 247 pounds in 1977.

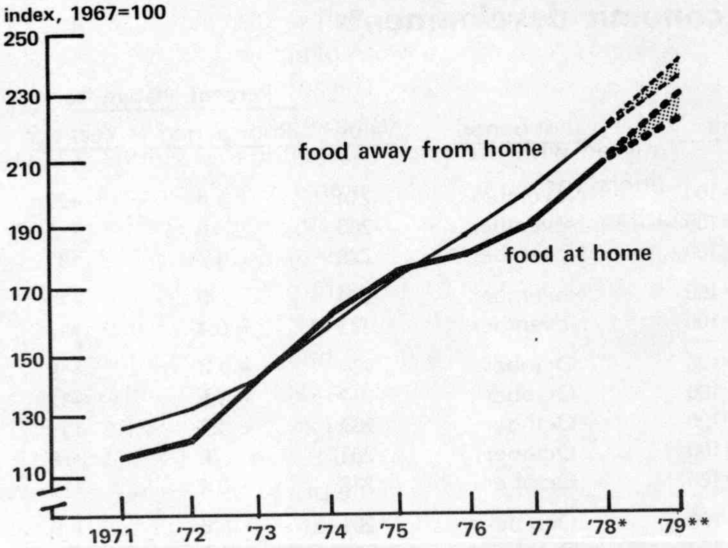
The inventory of all cattle and calves January 1, 1979, will show a continuation of the liquidation that has been under way since 1975. The inventory is expected to total around 111 million head. That would mark a 16 percent reduction in cattle numbers over the last four years—the sharpest drop on record. The additional reduction in the cow herd this year implies a smaller 1979 calf crop. This, coupled with prospects that cattlemen will hold back heifers for herd replacements next year, suggests a further shrinkage in the supply of feeder cattle. Aggressive bidding for feeder cattle again in 1979 is expected to narrow profit margins of feedlot operators. Choice yearling feeder steers at Kansas City will probably average in the high $50s per hundredweight this year—up nearly 45 percent from last year. Continued advances are forecast for 1979, pushing the average for such yearlings perhaps to the mid- to high $60s. A similar scenario applies to fed cattle prices. Choice 900 to 1,100 pound steers at Omaha this year will probably average 30 percent above the 1977 average of $40.38 per hundredweight and expectations for a continued uptrend could boost the 1979 average to the upper $50s.

Hog producers failed to increase production in 1978 as much as had been expected a year ago. Weather and disease problems have been cited as possible explanations, along with such factors as the nitrite issue, environmental concerns, and structural changes in the industry. Presumably, some or all of these factors could still be prevalent in 1979. Producer farrowing intentions—and the likelihood that producers may feed to heavier weights to take advantage of favorable feed prices—suggest pork production will rise at least moderately in 1979. But with higher consumer incomes and less beef next year, hog prices are expected to average near 1978 levels. Barrows and gilts at seven markets will likely average slightly above $48 per hundredweight this year—up almost a fifth from 1977.

Milk production in 1979 will probably be about the same as the 122 billion pounds estimated for this year. Despite higher milk-feed price relationships most of this year, 1978 milk production failed to expand as expected. High prices for slaughter cows and improved employment opportunities off the farm were cited as contributing to this year's 1 percent decline in production. Farm milk prices this year will average nearly 8 percent higher than in 1977 and are expected to average 6 to 10 percent higher next year.

Retail food prices, according to current estimates, averaged a tenth higher this year. A number of factors contributed to the sharp uptrend. A strong recovery in demand was the major factor pushing meat prices upward by a fifth. Fruit and vegetable prices surged in the wake of a host of weather-related supply disruptions. Government policies contributed to marked increases in retail prices of dairy products and sugars and sweets.

Food prices to rise 6 to 10 percent next year

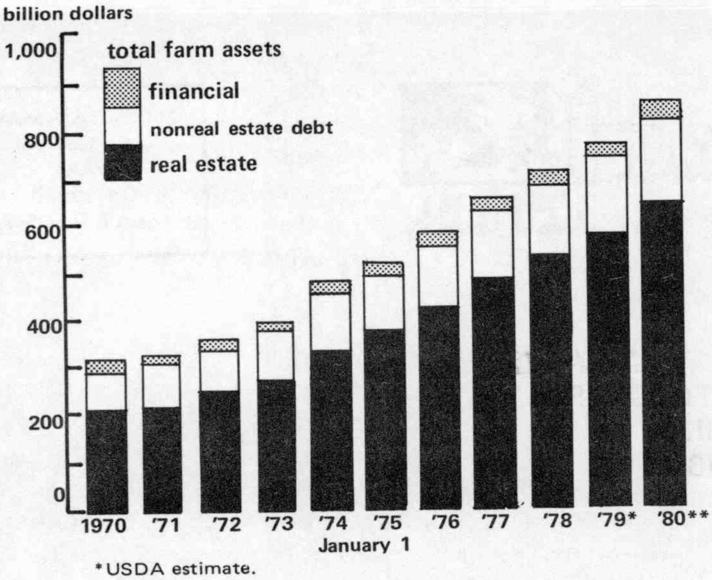


*USDA estimate.
**USDA forecast.

Food price pressures may ease somewhat next year, but probably not enough to significantly counteract the economy's overall high inflationary pressures. Retail prices of livestock products will continue to trend higher. In addition, increased costs of processing and distribution will add significant pressures to food prices. Currently, the USDA estimates retail food prices in 1979 will average 6 to 10 percent above this year.

The financial outlook for farmers in 1979 is generally favorable. Higher farm and nonfarm incomes this year have contributed to a marked easing in the refinancing and repayment concerns so evident a year ago. In addition, farmland values have increased more than expected this year, providing a bigger equity cushion to owner operators. These trends are expected to continue next year.

Farm asset values to continue steady uptrend in 1979



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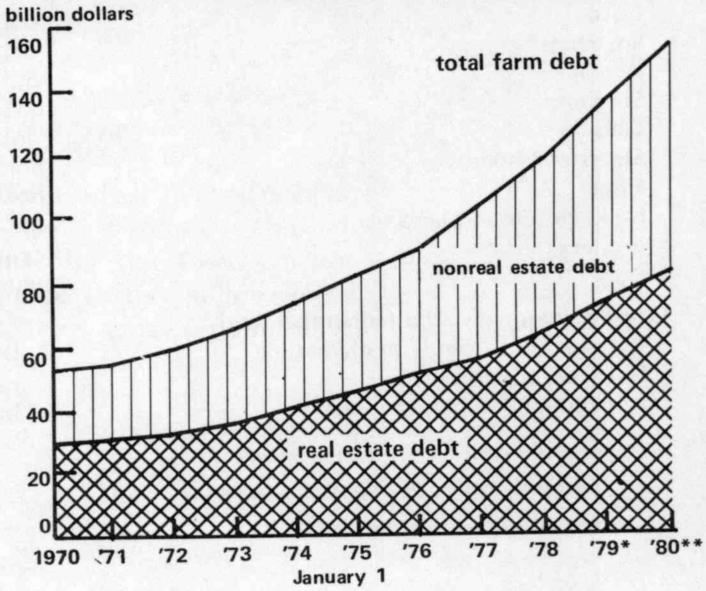
Farm real estate values are expected to be up about a tenth by the end of this year, and a similar increase is projected for 1979. Real estate assets are projected to account for 74 percent of total farm assets of $850 billion by the end of next year. The value of nonreal estate assets at that time are projected at $183 billion, while financial assets are expected to approach $40 billion—increases of 12 and 6 percent, respectively.

Farm borrowings are likely to register another significant increase during 1979. Farm debt is expected to reach $136 billion by the end of this year, marking an annual rise of 14 percent and a two-year increase of 32 percent. The USDA projects farm debt will rise another 14 percent next year and surpass the $153 billion mark. Real estate debt—currently estimated at $72 billion by year-end—could increase more than $9 billion in 1979.

Farm debt expected to rise 14 percent in 1979



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Most farm lenders will no doubt experience continued strength in farm loan demand in 1979. Federal land banks and insurance companies are expected to show the largest gains in real estate lending since both have access to plenty of loanable funds. Rural banks will enter 1979 with very tight liquidity positions and concerns about the availability of funds for lending. Nevertheless, borrower repayment capacity is likely to be a limiting factor in more cases next year than the lack of loanable funds. New lending authority extended to the Farmers Home Administration under the 1978 Agricultural Credit Act could provide a valuable source of funds in certain instances. Rising interest rates experienced this year will likely continue into 1979.

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Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from: Prior period	Percent change from: Year ago
Index of prices received by farmers	1967=100	November	214	− 1.4	+20
Crops	1967=100	November	200	0	+ 9
Livestock	1967=100	November	228	− 1.7	+31
Index of prices paid by farmers	1967=100	November	224	0	+11
Production items	1967=100	November	223	+ 0.4	+12
Producer price index* *(finished goods)*	1967=100	October	200	+ 1.4	+ 9
Foods	1967=100	October	212	+ 1.5	+12
Processed foods and feeds	1967=100	October	209	+ 1.7	+13
Agricultural chemicals	1967=100	October	202	0	+ 6
Agricultural machinery and equipment	1967=100	October	218	+ 0.4	+ 8
Consumer price index** *(all items)*	1967=100	October	201	+ 0.8	+ 9
Food at home	1967=100	October	215	+ 0.6	+12
Cash prices received by farmers					
Corn	dol. per bu.	November	2.03	+ 3.0	+ 8
Soybeans	dol. per bu.	November	6.31	+ 0.8	+12
Wheat	dol. per bu.	November	3.05	+ 2.0	+24
Sorghum	dol. per cwt.	November	3.45	+ 2.7	+14
Oats	dol. per bu.	November	1.16	+ 7.4	+ 5
Steers and heifers	dol. per cwt.	November	55.40	− 2.1	+46
Hogs	dol. per cwt.	November	46.70	− 8.6	+24
Milk, all sold to plants	dol. per cwt.	November	11.50	+ 1.8	+13
Broilers	cents per lb.	November	24.7	− 0.4	+16
Eggs	cents per doz.	November	56.8	+ 8.6	+11
Income *(seasonally adjusted annual rate)*					
Cash receipts from farm marketings	bil. dol.	3rd Quarter	110	+ 0.5	+20
Net realized farm income	bil. dol.	3rd Quarter	26	0	+59
Nonagricultural personal income	bil. dol.	October	1,721	+ 1.2	+12

*Formerly called wholesale price index.

**For all urban consumers.

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