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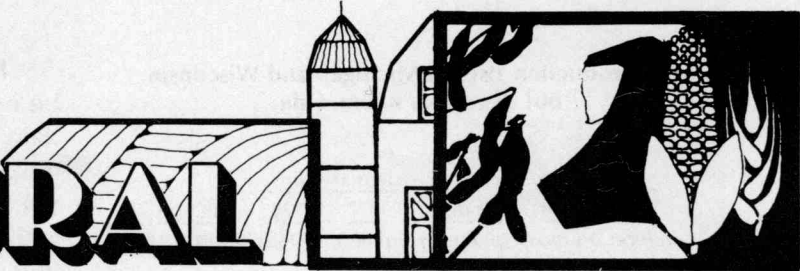
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FEDERAL RESERVE BANK OF CHICAGO

AGRICULTURAL



June 16, 1978

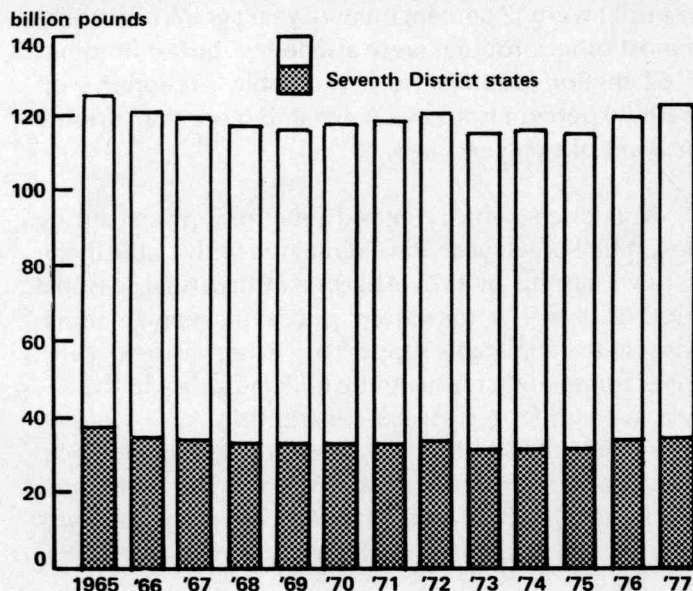
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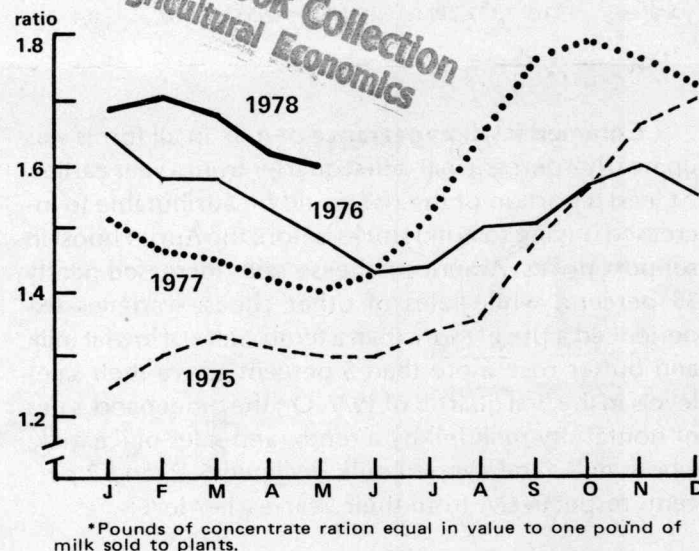
MILK PRODUCTION in the first five months of 1978 approximately equaled the year-earlier level. February marked the end of 29 consecutive months of year-to-year gains in milk production as March, April, and May each registered slight declines in milk output. The recent declines stemmed from fewer cows. In addition, milk output per cow did not show the increases expected from improvements in the milk-feed price ratio. Although the milk-feed price relationship is expected to remain favorable throughout much of 1978, high cattle prices provide an inducement for further culling of dairy herds, suggesting that milk output for the year may closely approximate last year's total. With demand for milk stronger than expected, purchases by the Commodity Credit Corporation (CCC) could be nearly a third less than last year.

Despite year-to-year declines in milk production in each of the past three months, production through May was off less than 1 percent from the level for the first five months of 1977. The USDA expects 1978 milk output to total close to the 123 billion pounds of last year, the highest level since 1965.

U.S. milk production rose to 12-year high in 1977



Favorable milk-feed price ratio* likely for most of 1978



Among district states, Wisconsin and Michigan have bucked the national trend, both having increased milk production in the first five months by roughly 1 percent. Iowa, Illinois, and Indiana reduced milk production 6, 5, and 3 percent, respectively, cutting overall production in the five-state area less than 1 percent below that of the corresponding period last year.

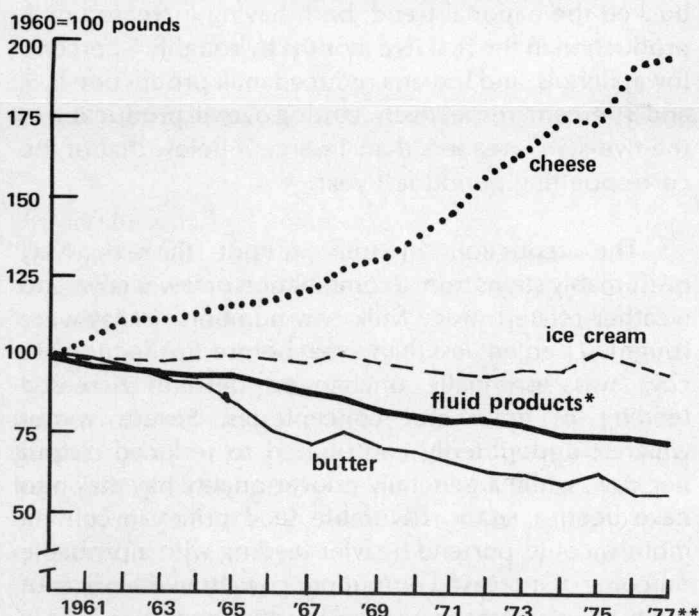
The reduction in milk output through May presumably stems from a combination of fewer cows and weather-related stress. Milk cow numbers in May were roughly 1 percent less than a year before. Production per cow was essentially unchanged despite increased feeding of grain and concentrates. Severe winter weather undoubtedly contributed to reduced output per cow, while a generally poorer quality hay may also have been a factor. Favorable feed prices in coming months could portend heavier feeding with a probable outcome of increased output per cow. But with prices of utility cows at Omaha nearly a fourth higher than in May 1977, the incentive for herd culling could offset the gains in per cow production, holding total production for the year near the level of 1977.

Milk production rises in Michigan and Wisconsin but decreases nationwide

	May		Change	January-May		Change
	1977	1978		1977	1978	
	(million pounds)		(percent)	(million pounds)		(percent)
Illinois	227	211	-7.0	1,049	992	-5.4
Indiana	210	200	-4.8	945	917	-3.0
Iowa	385	368	-4.4	1,797	1,698	-5.5
Michigan	414	415	+0.2	1,949	1,968	+1.0
Wisconsin	1,998	2,020	+1.1	9,023	9,154	+1.5
District states	3,234	3,214	-0.6	14,763	14,729	-0.2
United States	11,373	11,219	-1.4	51,953	51,762	-0.4

Commercial disappearance of milk in all forms was up nearly 4 percent in the first quarter from a year earlier. At least a portion of the rise could be attributable to increased buying to build stocks before the April 1 boost in support prices. American cheese sales increased nearly 15 percent, while sales of other cheese varieties experienced a rise of more than a tenth. Sales of lowfat milk and butter rose more than 5 percent above their sales levels in the first quarter of 1977. On the other hand, sales of nonfat dry milk fell by a tenth, and sales of ice milk, whole milk, and canned milk declined 6, 2, and 2 percent, respectively, from their year-earlier levels.

Per capita consumption of cheese rose in 1977 while most dairy products trended lower



*Milk equivalent (fat solids basis) of whole milk, cream items, and skim milk.

**Preliminary.

Per capita consumption of fluid milk this year may be nominally less than last year, but consumption of all dairy products could rise slightly above the 552 pounds milk equivalent of 1977. According to USDA projections, the average consumer is expected to use more cheese and lowfat milk in 1978, about the same amount of butter, and slightly less whole milk. USDA donations of dairy products are expected to be only marginally greater than in 1977.

Government support purchases in the first five months of 1978 were sharply below the pace of a year ago due to the unexpected surge in commercial use. During the January-May period, USDA purchases totaled 2.4 billion pounds (milk equivalent) of dairy products—36 percent less than in the same period a year earlier. Even so, the level of purchases in the five months was still double that of all 1976, and projections for government purchases in the rest of the year suggest government removals in 1978 will be high by historical comparisons. They could, nevertheless, average a third less than in 1977.

Despite the reduction in CCC purchases so far this year, government stocks of dairy products continue to grow. Uncommitted CCC stocks of butter on May 1 were double their year-ago level, while inventories of nonfat dry milk were up a fifth. Government donations have kept cheese holdings near last year's level and are expected to prevent any major buildup from occurring this year. An expected increase in utilization of nonfat dry milk would hold inventory levels near a year earlier but stocks of butter are likely to rise substantially.

Commercial stocks of dairy products at the end of the first quarter were 6 percent below a year earlier but nevertheless did show an increase from the year-end 1977 level. Manufacturers' holdings of American cheese on April 1 were 17 percent below a year ago. While stocks of most other products were also lower, butter holdings of 62 million pounds were a notable exception—up nearly 40 percent from a year ago and more than double the level of two years ago.

Milk prices, which trended generally upward during the last half of last year, have remained fairly stable in the first five months of 1978. Absence of the usual seasonal price decline has permitted prices to average much closer to the applicable support price than last year. Farm prices for manufacturing grade milk (adjusted to the annual average fat test of 3.67 percent) in April were 16 cents below the \$9.43 per hundredweight support price. A year earlier, farm prices were 35 cents below the support level of \$9 then in effect. The cheese industry was experiencing difficulties a year ago in producing barrel

cheese to conform with USDA specifications. There appear to be no such problems developing this year, however. In conjunction with a 10 cents per hundredweight increase in the manufacturing margin and a narrowing of the previous disparity in purchase prices of butter in various parts of the country, prospects for dairy farmers receiving prices near the support level for the remainder of the year appear greatly enhanced relative to last year's experience.

Retail dairy prices are expected to average 4 to 6 percent higher than in 1977—a significant rise from the consumer's standpoint in light of the large government stocks of dairy products but less than the projected increases in either all foods or the Consumer Price Index.

CATTLE PRICES dipped sharply last week, partly in response to the increasing likelihood of a relaxation in beef import quotas. As announced late last week, beef import quotas were relaxed to allow an additional 200 million pounds (15 percent) of beef imports this year. The announcement was made in an effort to curb further increases in retail beef prices, which have reached record highs. Most observers agree that the increased imports will not materially alter the fundamental supply-demand balance for beef this year. Nevertheless, it does appear, at least for now, that the action has broken the sharp rise in cattle prices—and has stirred animosity among cattlemen.

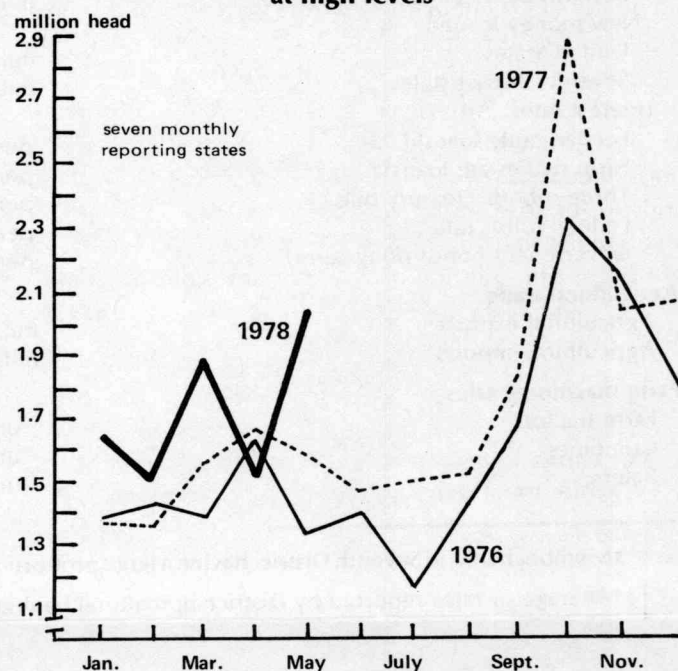
During the first five months of the year, choice steer prices at Omaha rose from \$44 to \$60 per hundredweight and averaged roughly a fourth higher than a year earlier. Fed cattle slaughter during the period was at record levels, more than 7 percent greater than last year. However, reduced slaughter of cows and nonfed steers and heifers coupled with lighter carcass weights offset the effects of the increased fed cattle marketings. Total beef production through May was roughly 2 to 3 percent less than last year. Nevertheless, even after accounting for a nearly 2 percent decline in pork production, rising consumer incomes, and higher levels of employment, the sharp runup in cattle prices has been hard to reconcile. The likelihood of rising consumer resistance to high beef prices suggests that cattle prices for the next few months may drop below recent highs. If so, the drop will be despite normal seasonal strength in demand during the summer.

Even though fed cattle marketings in the first five months were nearly 7 percent higher than during the same period in 1977, placements on feed were up 14 percent. As a result, cattle on feed in the seven major feeding states on June 1 numbered 8 million head, a

In general, retail prices of butter, ice cream, and processed American cheese are apt to rise more than the average, and fluid milk prices less.

The outlook for dairy farmers appears very favorable throughout 1978 in light of the April 1 increase in the support price for manufacturing grade milk. The support price will be \$9.43 until at least October. Prospects for farm prices averaging near the support level have been enhanced by the larger-than-expected rise in commercial disappearance. The strong demand, coupled with lower feed costs and the likelihood that production per cow will resume its upward trend, suggests dairy earnings in 1978 will show a significant improvement over the record receipts of last year.

Placements on feed continue at high levels



year-to-year increase of 14 percent. The large increase in feedlot inventories suggests fed cattle marketings will continue to register gains in the months ahead. The return to profitability in the cattle feeding industry last winter has no doubt siphoned numerous feeder cattle away from pastures and into feedlots. In light of the substantial increase in grain prices since their lows of last fall and the sharp runup in feeder cattle prices, profit margins have already narrowed appreciably. Coupled with the improved grazing conditions this year and the dwindling supply of feeder cattle, the large increases in placements of recent months are likely to dissipate.

Don A. Langford
Agricultural Economist

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	May	179	0.0	+ 8
Time deposits	1972-73=100	May	210	+ 0.6	+10
Demand deposits	1972-73=100	May	128	- 1.6	+ 4
Total loans at agricultural banks†	1972-73=100	May	212	+ 1.0	+14
Production credit associations					
Loans outstanding					
United States	mil. dol.	April	13,630	+ 1.5	+ 5
Seventh District states	mil. dol.	April	2,655	+ 0.3	+ 9
Loans made					
United States	mil. dol.	April	2,028	-16.0	+ 8
Seventh District states	mil. dol.	April	454	-23.5	+13
Federal land banks					
Loans outstanding					
United States	mil. dol.	April	22,481	+ 1.1	+15
Seventh District states	mil. dol.	April	4,688	+ 1.8	+20
New money loaned					
United States	mil. dol.	April	376	-23.4	- 7
Seventh District states	mil. dol.	April	108	-35.2	+ 3
Interest rates					
Feeder cattle loans††	percent	1st Quarter	8.88	+ 0.7	+ 2
Farm real estate loans††	percent	1st Quarter	9.04	+ 0.6	+ 1
Three-month Treasury bills	percent	6/1-6/7	6.61	+ 3.6	+31
Federal funds rate	percent	6/1-6/7	7.47	+ 2.8	+41
Government bonds (long-term)	percent	6/5-6/9	8.47	+ 0.8	+10
Agricultural trade					
Agricultural exports	mil. dol.	April	2,508	- 0.4	+14
Agricultural imports	mil. dol.	April	1,309	- 6.1	- 7
Farm machinery sales					
Farm tractors	units	March	14,160	+83.7	- 9
Combines	units	March	919	+ 9.4	-16
Balers	units	March	637	+63.8	-43

†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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