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# The U.S. Economy And Monetary Policy in 1982

*By J. A. Cacy, Glenn H. Miller Jr., and Diane Seibert*

There was an unusually large number of significant economic and financial developments in 1982. The most important developments were the continued weakness of business activity in the United States, further disinflation of prices and wages, the strong performance of the U.S. dollar, the emergence of strains in the domestic financial system, and substantial declines in interest rates. This article examines these developments, discusses the performance of monetary policy in 1982, and comments on the outlook for the economy and monetary policy in 1983.

## THE PERFORMANCE OF THE U.S. ECONOMY

The underlying weakness in U.S. economic activity, present since early 1979, continued throughout 1982. At yearend, the recession that began in August 1981 was maintaining its grip on the economy. Real gross national product (GNP) declined during the first three quarters of the year at an annual rate of about 1 percent, compared with a small gain in 1981 and a small decline in 1980.

The pattern of business activity during the year was somewhat uneven. Real GNP dropped

at an annual rate greater than 5 percent in both the fourth quarter of 1981 and the first quarter of 1982. These sharp declines were followed by a small increase in the second quarter of 1982 (Chart 1). The apparent turnaround in real GNP did not mean, however, that the recession ended in the spring of the year. Indeed, final sales—purchases by consumers, homeowners, businesses, and governments of final goods and services—declined in the second quarter, so the rise in output was due to changes in business inventory investment.

The performance of the economy in the third quarter of the year confirmed that the economy was still in recession. Real GNP was up slightly from the second quarter, but final sales dropped further. Even with the personal income tax cut of July 1, real personal consumption expenditures rose slower in the third quarter than in the first half of 1982. Moreover, adjusted for inflation, purchases of consumer durables declined in the third quarter, business fixed investment continued to fall sharply, as it did throughout 1982, net exports dropped sharply, and state and local government purchases continued their mild downward movement of the past couple of years. Federal government purchases rose sizably in the third quarter and residential construction spending showed a small decline.

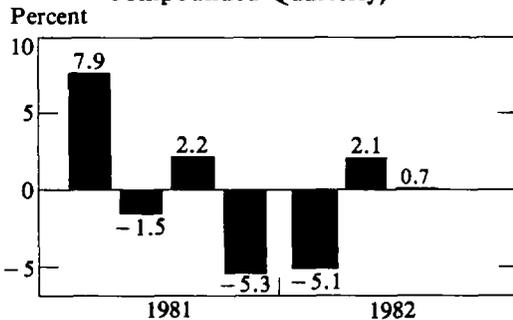
As of December 1982, most monthly data on production, sales, income, and employment

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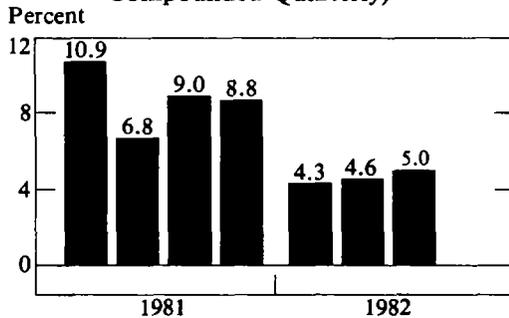
J. A. Cacy is vice president and senior economist, Glenn H. Miller Jr. is vice president and economic adviser, and Diane Seibert is a research associate at the Federal Reserve Bank of Kansas City.

suggest that the economy continued in recession in the fourth quarter of the year. The composite index of coincident indicators, which summarizes the performance of these four measures, fell in October 1982 for the fifteenth month since it reached its July 1981 peak. Industrial production declined in November for the fourteenth of the last 16 months and brought the index of capacity use in manufacturing to its lowest level since the series was begun in 1948. The overall unemployment rate set another new post-World War II record in November at 10.8 percent of the civilian labor force, which emphasized that the economy has a great deal of slack in the form of unused resources.

**Chart 1**  
**CHANGE IN REAL GNP**  
 (Seasonally Adjusted Annual Rates  
 Compounded Quarterly)



**CHANGE IN GNP DEFLATOR**  
 (Seasonally Adjusted Annual Rates  
 Compounded Quarterly)



Most of the good news about the performance of the U.S. economy in 1982 lies in the substantial disinflation in prices and wages. This development is closely related to the continued weakness of the economy and to the slack in resource use.

Disinflation shows up clearly in all the major price indexes. The GNP deflator rose at an annual rate of about 4.6 percent through the first three quarters of 1982, after rising more than 9 percent in 1981 (Chart 1). Monthly measures of price change show a similar pattern. The increase in the index of wholesale prices of finished goods (PPI) rose only 3.7 percent from November 1981 to November 1982, compared with a rise of 7.2 percent in the preceding 12 months. The consumer price index (CPI) increased 4.6 percent from November 1981 to November 1982, about half the 9.6 percent increase in the previous year. Producer prices and consumer prices benefited in 1982 from only modest increases in food and energy prices.

The slowdown in price inflation has been reflected in a slowdown in the growth of labor compensation, which, in turn, supports the slowing in inflation. For example, the index of average hourly earnings of production workers in the private nonfarm economy rose at a 5.9 percent annual rate in the first nine months of 1982, after an increase of 8.2 percent in 1981.

### THE PERFORMANCE OF THE U.S. DOLLAR

Against the background of a weakening world economy and growing international tensions, the U.S. dollar remained very strong throughout 1982. Except for a few transitory declines, the weighted average of the exchange value of the dollar increased throughout 1982, reaching its highest level in 13 years toward yearend (Chart 2).

Relatively high U.S. interest rates and expectations of continuing high rates contributed to

the strength of the dollar in the first quarter of 1982. Expectations of continuing high U.S. interest rates reflected concerns about the growing U.S. federal budget deficit and the possible reaction of the Federal Reserve to the sharp increase in M1 that occurred in early January. The value of the dollar declined briefly in mid-April as these concerns abated somewhat, but then regained strength after mid-May due to rising U.S. interest rates and the Iran-Iraq and Israel-Lebanon conflicts.

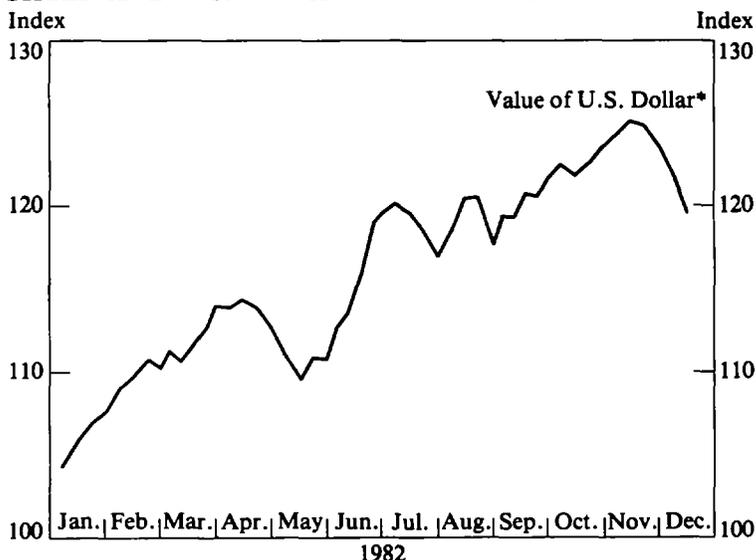
The value of the U.S. dollar increased steadily between late August and mid-November, despite declines in U.S. interest rates. Even with a decline near yearend, the dollar remained stronger at the end of 1982 than at the beginning of the year. The drop in U.S. interest rates was accompanied by a commensurate decline in foreign interest rates and progress against inflation in the United States. Thus, relatively high real U.S. interest rates (rates adjusted for infla-

tion) may have contributed to the strong demand for the dollar. Adding to the strength of the dollar was the further weakening of major European economies, highlighted by the failure of a large industrial company in Germany and a large bank in Italy. Economic crisis in Mexico, the collapse of the Mexican peso, and continued fighting in the Middle East strengthened investors' preference for the dollar as a safe-haven currency.

### STRAINS IN THE DOMESTIC FINANCIAL SYSTEM

While the international scene was plagued with economic crises, the United States also had economic and financial difficulties. As noted by Federal Reserve Chairman Paul A. Volcker in his midyear report to Congress, ". . . when inflation cost trends remain entrenched, the process of slowing monetary growth can entail economic and financial stresses. These strains

**Chart 2**  
**WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR**



\*Index of weighted-average exchange value of U.S. dollar against currencies of major trading partners. March 1973 = 100. Weights are 1972-76 global trade of each of the 10 countries.

**Table 1**  
**SELECTED INTEREST RATES**  
(Averages for Periods Indicated)

Period	Bank Prime Loan	3-Month Treasury Bills	Federal Funds	U.S. Govt. 20-Year Bonds	Recently Offered Aaa Utility Bonds
1979	12.7	10.1	11.2	9.3	10.0
1980	15.3	11.4	13.4	11.4	12.7
1981: H1	19.1	14.6	17.2	13.1	14.8
H2	18.7	13.4	15.6	14.3	16.3
1982: H1	16.4	12.6	14.4	14.0	15.6
Q3	14.7	9.3	11.0	12.9	14.6
Oct.	12.5	7.7	9.7	11.0	12.3
Nov.	11.9	8.1	9.2	10.6	11.9

[are] reflected in reduced profits, liquidity problems, and balance sheet pressures . . . .”<sup>1</sup>

Strains in the domestic financial system were especially evident during 1982. The U.S. government securities market was somewhat unsettled in May and June by the problems of two small securities dealers. Drysdale Government Securities failed to pay accrued interest payments to the original owners of securities it had borrowed. However, acting as an intermediary in the transactions, Chase Manhattan Bank eventually repaid the original owners on behalf of Drysdale. In late May, Marine Midland Bank temporarily discontinued securities clearing operations for Comark, a small government securities dealer, until it felt sure there was no immediate potential for a substantial loss.

While these events disturbed the securities market, there was no major panic, as many had feared. The spread between U.S. Treasury bill yields and private yields widened, as nervous market participants sought higher quality.

<sup>1</sup> “Midyear Report to Congress on Monetary Policy Objectives for 1982,” testimony by Paul A. Volcker, Chairman of the Board of Governors of the Federal Reserve System, July 20, 1982.

Also, smaller dealers had some difficulty obtaining financing and were charged a greater risk premium than were larger dealers. Nevertheless, major government securities dealers had no difficulty obtaining financing and no problems were posed for Treasury auctions or Federal Reserve open market operations.

The financial system was under further stress after midyear. The failure of Oklahoma City’s Penn Square National Bank in July increased concerns, and the subsequent failures of Abilene National Bank and Lombard-Wall, a government securities firm, added to the uneasiness. Consequently, the spread between Treasury bill yields and private yields widened even further in September. The economic troubles of Mexico and concomitant collapse of the peso heightened concern in domestic financial markets as a result of the exposure of domestic banks to possible losses on foreign loans. Meanwhile, domestic business failures contributed to concerns about the exposure of banks to potential losses on domestic loans. While the economic and financial strains of 1982 resulted in failures for some private firms, banks, and individual market participants, there were no major disruptions of the financial system as a whole.

## INTEREST RATES IN 1982

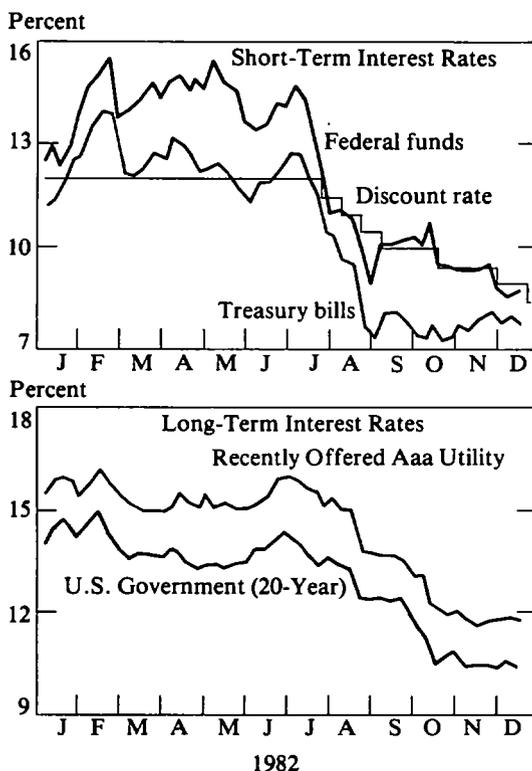
One of the year's most important developments was the significant declines in interest rates after midyear. There was some decline in interest rates in the first half of the year (Table 1). Long-term rates were slightly lower than in the last half of 1981, while short-term rates showed a greater decline. These average declines on a half-year basis show up despite a small runup in all rates early in the year (Chart 3).

Interest rates dropped sharply in July and August and averaged substantially lower in the third quarter than in the first half of the year. Again, the fall was greater in the short-term rates than in long-term rates. The decline in short-term market rates, such as 3-month

Treasury bills and federal funds, was more than three percentage points, while long-term rates, such as 20-year governments and Aaa utilities, dropped about one percentage point. Further declines from third-quarter levels occurred in October and November for most short- and long-term interest rates.

Nominal interest rates, such as those shown in Table 1, include an inflation premium that reflects the expected rate of inflation. A "real" interest rate that adjusts for the inflation premium in the nominal rate can be calculated by subtracting an estimated expected rate of inflation from the nominal interest rate. Even adjusted for inflation, as measured by the GNP deflator, interest rates were very high in 1981. The real prime rate, for example, averaged over 10 percent for the year, nearly twice the average

**Chart 3**  
**SELECTED INTEREST RATES IN 1982**



**Table 2**  
**NOMINAL AND REAL PRIME RATE**  
(Averages for Periods Indicated)

Date	Nominal	Real
1979	12.7	4.7
1980	15.3	5.5
1981: H1	19.1	10.5
H2	18.7	10.1
1982: H1	16.4	12.0
Q3	14.7	10.1
Q4	12.0	7.0

Note: The real prime rate is defined in this table as the nominal prime rate minus the rate of inflation as measured by the change in the GNP implicit price deflator. The table assumes that the change in the GNP deflator for the fourth quarter of 1982 will be 5.0 percent, the same as for the third quarter.

real prime rate in 1980 (Table 2). The real prime rate increased in the first half of 1982 as inflation declined more than nominal interest rates. But the sharp declines in interest rates in the third quarter, along with a slight increase in the inflation rate, brought a substantial reduction in the average real prime rate for the third quarter of 1982. With the nominal prime rate estimated to average around 12 percent in the fourth quarter of inflation rate expected to be about the same as the 5 percent reported for the third quarter, the real prime rate declined further in the fourth quarter to an estimated 7 percent.

Several factors combined to lower nominal interest rates in 1982 and sharply lower rates after midyear. Real economic activity continued very weak, putting downward pressure on interest rates. Substantial disinflation of prices lessened the demand for money and reduced inflationary expectations, which reduced the inflation premium in interest rates.

The effect of federal budget deficits on interest rates is less clear. The unified budget deficit was about \$110 billion for fiscal 1982,

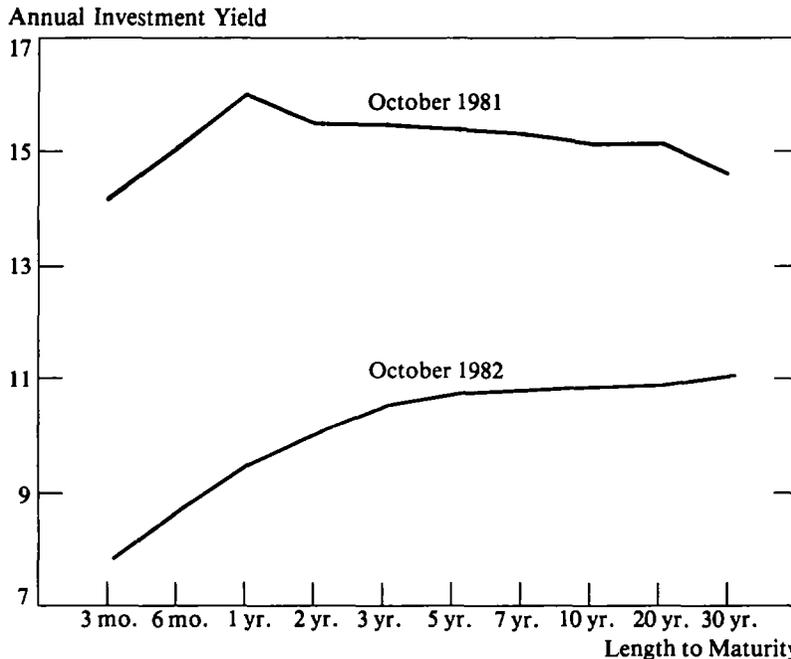
and projections show it substantially higher for fiscal year 1983. By leading to large credit demands by the Treasury, such deficits tend to put upward pressure on interest rates. However, because of the tax increase in 1982 and a perceived commitment to slowing in federal spending, the public and financial markets may have a perception of progress on the deficit problem. Such a view may have mitigated the upward pressure on interest rates. Yet, more progress in reducing the deficit would almost certainly have meant even lower interest rates in 1982, and the expectation of larger deficits in the future remains a factor in keeping rates high.

Aside from the decline in the general level of interest rates, there were two other noteworthy interest-rate developments in 1982. One was a significant change in the shape of the interest rate yield curve. Another was a marked widening in the spread between interest rates on private and public debt instruments as market uncertainty increased.

The interest rate yield curve is used to compare market rates of interest at various lengths of maturity. The curve is a smooth line drawn through several values observed at a particular time. Chart 4 shows two yield curves, one for October 1981 and one for October 1982. In October 1981, Treasury interest rates rose with increasing maturities up to one year and then declined as maturities lengthened beyond a year. The upward-sloping portion of the curve suggests that investors had a strong desire for liquidity, while the downward-sloping portion reflects market expectations for declining interest rates over the longer horizon.

The yield curve for October 1982 is not only considerably lower, reflecting the overall lower level of interest rates, but also has a significantly different shape. This type of yield curve is referred to as an upward-sloping yield curve because the interest rate increases with the

**Chart 4**  
**YIELD CURVES FOR TREASURY SECURITIES**



length to maturity. An upward-sloping yield curve, which has historically been considered typical, can reflect one or both of two factors—increased premiums paid to induce investors to hold securities longer (in other words, a demand on the part of investors for liquidity) and market expectations of future increases in interest rates.<sup>2</sup> The emergence in 1982 of a positively sloped yield curve is viewed by many as a welcome return to more normal interest rate relationships.

With regard to the second development, the spread between interest rates on private and public debt instruments is often seen as in-

<sup>2</sup> This is because an investor expecting short-term interest rates to increase would not purchase a long-term security unless its rate exceeded the current short-term rate. He would have to earn (at least) the average of the expected short-term rates in order to invest in a long-term security.

dicating the riskiness of private instruments. While U.S. government securities are generally considered risk free, debt instruments of private companies are not risk free because private corporations can default. As a result of this risk, investors must be paid a premium over the risk-free interest rate to hold private debt. As the perceived risk of the private debt rises, so does this premium.

The emergence of strains in the domestic financial system in 1982 was reflected in an increase in the spread between the 3-month commercial paper rate and the 3-month Treasury bill rate. In response to the incidents in May and June involving government securities dealers, the spread had risen by July to 1.6 percentage points, compared with only 0.8 percentage points in January. The spread declined slightly in August, as market concerns seemed to abate briefly. Then, in late August

and September, market tension mounted as international problems prompted fears of sizable losses by U.S. banks on foreign loans and continued weakness in domestic business heightened concerns. As a result, the spread soared to 2.4 percentage points in September. The spread then declined to 1.5 percentage points in October, reflecting a marked decline in market concerns. Further declines in this spread may be expected as economic and financial conditions improve and investors perceive the resulting reduction in riskiness in the private sector.

### MONETARY TARGETS AND MONETARY GROWTH IN 1982

As required by the Full Employment and Balanced Growth Act of 1978, the Federal Reserve reported to the Congress in early 1982 on its targets for growth in money and credit. That report showed that, at the February 1982 meeting, the Federal Open Market Committee (FOMC) reaffirmed the target ranges tentatively set in July 1981. The 1982 growth rate range was set at 2.5 to 5.5 percent for M1—the narrowly defined money supply consisting of currency held by the public, travelers' checks, and transactions deposits at banks and other depository institutions. Transactions deposits include demand deposits and other checkable deposits (OCD's), such as NOW accounts. Target growth rate ranges for M2 and M3—more broadly defined aggregates including M1 and such other assets as savings deposits, time deposits, and shares in money market mutual funds (MMMMF's)—were set at 6 to 9 percent for M2 and 6.5 to 9.5 percent for M3. Bank credit growth was targeted at 6 to 9 percent. In July 1982, the FOMC reaffirmed these 1982 targets for monetary and credit growth.

Through November, all the 1982 growth rates for these monetary aggregates were running above the upper end of the target ranges

(Table 3). Growth of M1 at 8.7 percent was well above the upper end of its range of 2.5 to 5.5 percent. Growth in M2 of 9.9 percent and growth in M3 of 10.5 percent slightly exceeded the upper limits of their ranges. M1 grew considerably more rapidly in 1982 than in 1981 and somewhat more rapidly than in 1980. On the other hand, M2's growth rate in 1982 was only slightly greater than in the previous two years, while M3 grew less rapidly in 1982 than in 1981 and only slightly more rapidly than in 1980.

Much of the growth in M1 in 1982 was accounted for by very rapid growth in OCD's. From the fourth quarter of 1981 through November 1982, OCD's, the only component of M1 that pays interest, increased \$26.1 billion, compared with a total rise in M1 of \$37.9 billion. During that time OCD's increased as a share of M1 from 17.0 percent to 21.2 percent. In contrast, demand deposits, the

**Table 3**  
**GROWTH RATES OF MONEY SUPPLY**  
(Percent Change at Annual Rates)

Period	M1*	M2	M3
1980	7.3	9.2	10.0
1981	2.3	9.5	11.4
1982: First 11 Months†	8.7	9.9	10.5
1982: Target Range	2½-5½	6-9	6½-9½
1982: Q1	10.4	9.8	8.7
Q2	3.3	9.5	10.7
Q3	3.5	9.7	12.1
Sept.	14.0	5.0	3.9
Oct.	20.3	8.2	9.1
Nov.	16.1	11.2	8.9

Note: Annual rates of growth are based on quarterly average data.

\*M1 is equivalent to M1-B in 1980 and M1-B adjusted for deposit shifts into NOW accounts in 1981.

†Fourth quarter 1981 through November 1982.

**Table 4**  
**GROWTH RATES OF NOMINAL GNP,  
M1, AND VELOCITY OF M1**

Period	GNP	M1	M1 Velocity
1979	9.7	7.4	2.1
1980	9.4	7.3	2.0
1981	9.6	2.3	7.2
1982: First 3 Quarters*	3.8	5.8	-1.9

Note: Annual rates of growth are based on quarterly average data. M1 is equivalent to M1-B in 1979 and 1980 and M1-B adjusted for deposit shifts into NOW accounts in 1981.

\*Annualized percent change from fourth quarter 1981 to third quarter 1982.

largest component of the narrowly defined money supply, declined as a percent of M1, dropping from 54.0 percent in the fourth quarter of 1981 to 50.1 percent in November 1982. Of the components of M2, the fastest growing in 1982 were OCD's, MMMF's, and small denomination time deposits, although the latter declined in October due to the maturing of a large volume of all savers certificates. The decline in demand deposits in 1982 and the sharp increase in OCD's, MMMF's, and small denomination time deposits reflect the increasing tendency for depositors to keep their money balances in accounts that pay the highest return.

The rapid growth in M1 in 1982 is especially noteworthy. In light of the weakness in economic activity throughout the year and the concomitant disinflation, this rapid growth in M1 did not reflect a growing need for money to finance economic transactions. Indeed, during the first three quarters of 1982, M1 grew faster than nominal GNP. Thus, there was a decline in the velocity of money, or its rate of turnover (Table 4). This decline in velocity was in sharp contrast to the unusual increase in velocity in 1981, when, although M1 growth was quite

moderate, turnover was rapid enough to support fairly rapid growth in nominal GNP. In contrast, with declining velocity during the first three quarters of 1982, considerable growth in M1 was associated with a slowing in nominal GNP growth.

It is not surprising that M1 velocity declined in 1982. Slower turnover of money is not unusual in a recession. However, the magnitude and persistence of the 1982 decline are unusual. Indeed, Chairman Volcker described it as the first significant drop in velocity in about 30 years.<sup>3</sup>

Velocity can ordinarily be explained by historical demand relationships in which the desire to hold money depends on interest rates, prices, and real income. From time to time, however, other factors interfere with the normal relationships, making velocity unpredictable. Interest rate declines, sluggish real economic growth, and price disinflation do not by themselves explain the significant decline in velocity in 1982. It is necessary to look beyond these conventional elements of explanation of money demand. It seems quite plausible that, in a time of concern and uncertainty about business and financial conditions, individuals were seeking to hold precautionary balances in as liquid a form as possible while still earning a return. As most of 1982's M1 growth was in interest-bearing OCD's—transactions accounts with some of the characteristics of savings deposits—these accounts apparently meet the precautionary demand for liquidity.

In view of the continued rapid growth in M1 in October and November, along with the continued sluggish economy, M1 is likely to have grown faster than nominal GNP in the fourth quarter of 1982—although December's M1

<sup>3</sup> Statement of Chairman Volcker to Joint Economic Committee, November 24, 1982.

growth could be slowed by transfers from M1 balances into the new money market deposit instrument introduced at midmonth. Thus, the downward trend in velocity may be extended another quarter. A significant part of the rapid October-November growth in M1 was due to the maturing of all savers certificates, and some of these funds were transferred into demand deposits and OCD's. Nevertheless, apart from the effect of the all savers certificates, velocity probably would have declined in the fourth quarter or increased only slightly.

### MONETARY POLICY IN 1982

As 1982 opened, the Federal Reserve remained committed to restraining growth in money and credit so as to bring continuing downward pressure on the inflation rate. The FOMC, therefore, set targets for 1982 aimed at slowing money growth over time to a pace consistent with reasonably stable prices and the needs of an economy growing in line with its productive potential. As noted earlier, the FOMC set target growth ranges for 1982 and reaffirmed the ranges at its July meeting.

In implementing monetary policy in 1982, the FOMC was faced with a consistent tendency for the money and credit measures to exceed their target ranges, despite the recession. Except briefly in July and August, this was especially true for M1, which rose sharply in January and remained at above-target levels throughout the first half of the year despite small declines in May and June. From the fourth quarter of 1981 through June, M1's growth rate was 5.8 percent, 0.3 percentage points above the upper limit of the 1982 target range. M2's first half growth rate of 9.5 percent was 0.5 percentage points above its target range.

M1 declined again in July, briefly placing its year-to-date growth rate within the target range. In August, however, M1 began four

months of rapid growth. By November its year-to-date growth rate was 8.7 percent, 3.2 percentage points above the upper limit of its target range, considerably more than at midyear. For M2, the year-to-date growth rate that month was 9.9 percent, 0.9 percentage points above the upper limit of its target range and only slightly more than in June.

Despite the persistence of above-target growth in M1 in the first half of 1982, the Federal Reserve took no overtly restrictive policy action during the period, as the basic discount rate remained at 12 percent. However, the Federal Reserve did not supply sufficient nonborrowing reserves to fully accommodate the above-target growth, so that short-term interest rates came under upward pressure from time to time and were somewhat higher at the end of June 1982 than at yearend 1981.

Nevertheless, the discount rate was reduced in four steps in July and August, from 12 to 10 percent (Table 5). These discount rate actions, taken following the May-July decline in M1 that brought it back within the target range, were in line with declines in market interest rates that occurred during the period. Despite the return of M1 to above-target growth after August, the discount rate was

**Table 5**  
**THE DISCOUNT RATE IN 1982**  
(In Percent Per Year)

<u>Date</u>	<u>Discount Rate</u>
January 1*	12
July 20	11½
August 2	11
August 16	10½
August 27	10
October 12	9½
November 22	9
December 15	8½

\*The discount rate was set at 12 percent on December 4, 1981.

again reduced in October to 9.5 percent, in November to 9 percent, and a further drop to 8.5 percent occurred in December.

In retrospect, the moderate policy response to above-target M1 growth in the first half of 1982 and the easing in the latter part of the year in the face of continued above-target growth reflect the Federal Reserve's progressive deemphasis in 1982 of M1 targets and performance. At its March meeting, for example, the FOMC decided that M1 deviations from target during the coming period should be evaluated partly in light of M2 behavior. This decision was based in part on most of the large first-quarter increase in M1 being in OCD's—which suggested a desire by individuals to hold more precautionary liquid balances.<sup>4</sup> The approach to M1 adopted in March was reiterated in May, as outlined in the FOMC's Record of Policy Actions for the May 18 meeting:

Given the uncertainties relating to the public's demand for liquid balances, notably NOW accounts, most members continued to believe that the behavior of M1 should be evaluated partly in light of the behavior of M2 over the weeks ahead. Thus, for example, somewhat more rapid growth of M1 might be accepted if it appeared to be associated with a continuing desire by the public to build up liquid balances and with growth of M2 near its specified rate.<sup>5</sup>

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<sup>4</sup> "Record of Policy Actions of the FOMC, Meeting Held on March 29-30, 1982," Federal Reserve Press Release, May 21, 1982.

<sup>5</sup> "Record of Policy Actions of the FOMC, Meeting Held on May 18, 1982," Federal Reserve Press Release, July 2, 1982, p. 9

The midyear meeting of the FOMC included further discussion of the role of M1 in implementing monetary policy. Again, it was noted that the growth in M1 was concentrated in OCD's, which made OCD's a larger part of the total, and, in turn, made M1 more sensitive to changes in the public's desire to hold very liquid assets. For this reason, the FOMC—while deciding that the money growth targets for 1982, which had been established earlier in the year, were still appropriate—concluded that M1 growth somewhat above the top of its range would be acceptable. As Chairman Volcker said in his testimony to Congress in July,

... growth somewhat above the targeted ranges would be tolerated for a time in circumstances in which it appeared that precautionary or liquidity motivations, during a period of economic uncertainty and turbulence, were leading to stronger than anticipated demands for money.<sup>6</sup>

The FOMC's deemphasis of M1 in 1982 became more pronounced at its October meeting where the directive to the Manager of the Open Market Account specified short-run growth paths for M2 and M3 from September to December, but none for M1. Commenting on the role of M1 in a speech after the October meeting, Chairman Volcker said:

We face over the next few months, not just the possibility but the virtually certainty of distortions—distortions growing out of legislation and regulation—in the M1 number . . . . Both the 'ups' and 'downs' in M1 reflecting these

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<sup>6</sup> Volcker testimony, p. 9

regulatory changes will be artificial and virtually meaningless in gauging underlying trends in 'money' and liquidity . . . . In the circumstances, I do not believe that, in actual implementation of monetary policy, we have any alternative but to attach much less than usual weight to movements in M1, over the period immediately ahead.<sup>7</sup>

The distortions the Chairman referred to derive from two factors. One is the maturing of all savers certificates and the movement of those funds into other investments, maybe after being parked temporarily in transactions accounts. The other distortion derives from the introduction of the new money market deposit by banks and thrift institutions and the uncertainty of the public's response to it.

In summary, in conducting monetary policy in 1982, the Federal Reserve was faced with a consistent tendency for the monetary aggregates, especially M1, to grow faster than the established target ranges. Under a rigid application of the monetary control procedures used in recent years, the Federal Reserve, in an effort to slow monetary growth in order to help reduce inflation, would have responded to above-target monetary growth with restrictive policy actions, such as increases in the discount rate. However, the discount rate remained unchanged during the first half of 1982, although the Federal Reserve did not supply sufficient nonborrowed reserves to fully accommodate the above-target M1 growth. Moreover, the discount rate declined during the last half of the year.

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<sup>7</sup> *Informal Talk to Business Council* at Hot Springs, Virginia, October 9, 1982, pp. 3-4.

The apparent departure from previously employed procedures reflects the progressive deemphasis of M1 as a guide to monetary policy actions in 1982. The deemphasis during the first half of the year reflected the FOMC's assessment that, as the above-target growth in M1 was due to an increase in demand for liquidity, it did not represent excessive monetary growth that would add to inflationary pressures. Later in the year, the deemphasis on M1 also reflected the FOMC's recognition that special factors—maturing all savers certificates and the new deposit instrument—had distorted the behavior of M1, making it an unreliable guide to monetary policymaking.

In deemphasizing M1 in 1982, the Federal Reserve placed relatively greater weight on the behavior of M2. This aggregate was affected less than M1 by greater liquidity demands and special factors and grew more in line with its target range in 1982 than did M1. Also, in taking specific policy actions in 1982, the Federal Reserve considered a number of factors, such as the progress being made in reducing inflation, the continued weak economy, and developments in domestic financial and foreign exchange markets. As Chairman Volcker said in connection with the October decline in the discount rate:

. . . as is usually the case, the change was, in an immediate sense, designed to maintain an appropriate alignment with short-term market rates. It was, of course, also taken against a background of continued sluggishness in business activity, the exceptional recent strength of the dollar on the exchange markets, and indications of strong demands for liquidity in some markets . . . .<sup>8</sup>

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<sup>8</sup> *Talk to Business Council*, p. 1.

The Chairman added that neither the 1982 declines in the discount rate nor the reduced emphasis on M1 represented a change in the basic anti-inflationary thrust of the Federal Reserve's monetary policy.

### **THE ECONOMY AND MONETARY POLICY IN 1983**

While 1982 has been a year of recession and strain for the U.S. economy, it has also been a year in which the stage has been set for sustainable—albeit modest—expansion in the future. The elements primarily responsible for providing the environment in which expansion can be sustained are continuing disinflation and recently lower interest rates.

This view remains well founded in spite of mixed signals regarding business activity as 1982 ends. The long-awaited, mainly consumer-led recovery is still not in evidence, although enough strength is expected to pull the economy onto a path of moderate growth. Increasing consumer purchases will be supported by modest growth in housing and some further strength in federal purchases. Countervailing these sources of modest economic strength will be continued weakness in business capital spending, net exports, and purchases by state and local governments. All in all, growth in real GNP in 1983 may not be too different from the long-run trend of 3 to 4 percent.

Two corollaries follow from such an out-

look, with its implications for a great deal of continued slack in the economy. With real growth near the economy's long-run trend rate, few inroads can be expected soon into the high rate of unemployment or the low rate of industrial utilization. At the same time, continued slack in the economy during a modest expansion promises to keep downward pressure on inflation.

The task of monetary policy in 1983 will be to provide money and credit to the economy sufficient to support the expected moderate expansion in business activity, while consistent with the expected further decline in inflation. In July 1982, the FOMC tentatively extended the 1982 growth rate ranges for monetary aggregates into 1983. These tentative ranges will be reconsidered at the meeting in February.

One of the major issues facing the Federal Reserve in 1983 will be the role of M1 in monetary policymaking. Whether M1 remains a reliable guide for the conduct of policy—and to what extent—will need to be given serious consideration. Also to be considered are the role and relative importance of M2 and other policy guides, such as broader measures of money and credit and interest rates. In resolving these issues, the Federal Reserve will seek to employ policy guides that are best suited under the conditions existing in 1983 to achieving the goals of sustainable economic growth and continued disinflation.

# The Outlook for Agriculture: Is Recovery on the Way?

*By Marvin Duncan and Mark Drabenstott*

The past year proved another disappointment to U.S. farmers. As in 1981, farm product prices generally declined because of abundant supplies and weaker than expected domestic and foreign demand. As a result, farmers experienced their third year in a row of sharply depressed farm income and, more recently, declining asset values.

Total cash receipts from farm marketings in 1982 are expected to decline slightly from the record level of 1981. Cash receipts from livestock marketings—a bright spot in an otherwise gloomy picture—reached a record high in 1982. That gain was more than offset, however, by lower cash receipts from crops. Although production costs did not increase as much as in 1981, net farm income, at about \$19 billion, was off some 24 percent from the previous year.

## 1982 IN REVIEW

Prospects for improved farm income in 1982 had been based on an early recovery from the recession and improvements in the economic performance of trading partner countries that

would increase export demand for U.S. farm products. Efforts by farmers to reduce meat and grain production were expected to raise farm product prices. Lower inflation was also expected to bring relief on farm production costs.

Developments that could have led to stronger farm income, however, failed to materialize. The expected economic recovery did not come in early 1982. As the year draws to a close, the economy has apparently still not begun to recover. Moreover, the economies of many trading partner countries remained weak throughout the year. Organization for Economic Cooperation and Development (OECD) countries expect the real value of the output of their goods and services to have shrunk 0.5 percent in 1982. Thus, stronger domestic and foreign demand did not materialize.

Farmers were only partially successful in reducing production as a means of obtaining higher prices. Production of beef and especially pork fell short of year-earlier levels, resulting in a welcome improvement in livestock prices. Farmers were reluctant to cooperate in government efforts to reduce acreage of major crops, however, and with favorable weather major grain crops reached record levels. World grain production was also expected to register an increase over 1981.

Moderating increases in production costs were a source of optimism for farmers. Pro-

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Marvin Duncan is an assistant vice president and economist and Mark Drabenstott is an economist, both with the Economic Research Department at the Federal Reserve Bank of Kansas City. Anne O'Mara McDonley, a research associate with the Bank, assisted with the preparation of this article.

**Table 1**  
**BALANCE SHEET FOR MAJOR CROPS**  
(Millions of Bushels, Bales, or Tons)

	Corn (bu)		All Feed Grains (metric tons)		Soybeans (bu)		Wheat (bu)		Cotton (bales)	
	Marketing Year Oct. 1-Sept. 30		Marketing Year*		Marketing Year Sept. 1-Aug. 31		Marketing Year June 1-May 31		Marketing Year Aug. 1-July 31	
	1981-82	1982-83†	1981-82	1982-83†	1981-82	1982-83†	1981-82	1982-83†	1981-82	1982-83†
<b>Supply</b>										
Beginning Carryover	1,034	2,366	34.6	73.0	318	268	989	1,163	2.7	6.6
Production and Imports	8,202	8,331	248.7	252.8	2,000	2,300	2,796	2,813	15.6	12.1
<b>Total</b>	<b>9,236</b>	<b>10,697</b>	<b>283.3</b>	<b>325.8</b>	<b>2,318</b>	<b>2,568</b>	<b>3,785</b>	<b>3,976</b>	<b>18.3</b>	<b>18.8</b>
<b>Demand</b>										
Domestic	4,903	5,100	151.7	156.3	1,121	1,188	849	865	5.3	5.4
Exports	1,967	2,100	58.6	61.3	929	950	1,773	1,600	6.6	5.4
<b>Total</b>	<b>6,870</b>	<b>7,200</b>	<b>210.3</b>	<b>217.6</b>	<b>2,050</b>	<b>2,138</b>	<b>2,622</b>	<b>2,465</b>	<b>11.9</b>	<b>10.8</b>
<b>Ending Carryover</b>	<b>2,366</b>	<b>3,497</b>	<b>73.0</b>	<b>108.2</b>	<b>268</b>	<b>430</b>	<b>1,163</b>	<b>1,511</b>	<b>6.6</b>	<b>8.0</b>

Source: U.S. Department of Agriculture.

\*Marketing Year begins October 1 for corn and grain sorghum, July 1 for barley and oats.

†Preliminary USDA estimates as of November 1982.

gress against inflation was even faster than forecast. Increases in production costs of farmers are usually correlated with increases in the general price level. As inflation slowed this past year, increases in farmers' production costs have also slowed. Cost increases in 1982 were the lowest in several years.

### Crops

Farmers harvested bumper crops for the second year in a row, setting new records for wheat, corn, and soybean production. While favorable weather played an important part in the large crops, only about half the nation's wheat base acreage and 29 percent of its corn base acreage were included in the government's

acreage reduction program in 1982. About three-fourths of the cotton base acreage was included.

Farmers are rarely enthusiastic about reducing planted acreage to cut back crop production. Fixed costs of ownership for land and equipment not fully used must then be spread over the smaller number of planted acres, raising average per-acre production costs. Because much of the wheat crop was planted before the U.S. Department of Agriculture (USDA) announced the acreage reduction program, wheat producers were particularly reluctant to destroy crop acres and comply with the program. Cotton producers, however, typically have higher compliance rates with farm pro-

**Table 2**  
**U.S. AVERAGE FARM LEVEL PRICES**

Commodity	1981-82	1982-83 (Forecast)	Percent Change From One Year Ago*
<b>Crops</b>			
Wheat	\$3.65/bu.	\$3.40-3.50/bu.	-5.5
Corn	\$2.45/bu.	\$2.15-2.35/bu.	-8.2
Soybeans	\$6.08/bu.	\$5.25-5.75/bu.	-9.5
Cotton	54.7 cents/lb.	N/A	N/A
<b>Livestock</b>			
Choice Steers (Omaha)	\$64-66/cwt.	\$64-70/cwt.	3.1
Barrows and Gilts (7 major markets)	\$55-57/cwt.	\$56-62/cwt.	5.4
Broilers (9 city average)	43.45 cents/lb.	43-49 cents/lb.	4.6
Turkeys (NY young hens)	61-63 cents/lb.	62-68 cents/lb.	4.8
Milk	\$13.45-13.55/cwt.	\$13.30-13.70/cwt.	0.0

\*Percent change is calculated from the midpoint of the 1982-83 range.

Source: USDA World Agricultural Supply and Demand Estimates, November 12, 1982.

grams than do food and feed grain producers.

Many feed grain and wheat producers stayed out of compliance, hoping market prices would exceed the price and income benefits provided in the program. These producers were counting on production shortfalls elsewhere in the world, production cutbacks by neighbors participating in the program, or increases in export demand to raise wheat and feed grain prices above Commodity Credit Corporation (CCC) loan levels.<sup>1</sup> Record U.S. production, however, drove crop prices below CCC loan levels. Financially,

<sup>1</sup> CCC loan rates for 1982 crops were wheat, \$3.55 per bushel; corn, \$2.55 per bushel; grain sorghum, \$2.42 per bushel.

farmers that participated in the acreage reduction program now appear to have fared better than those that did not.

The nation's wheat production reached a record 2.8 billion bushels in 1982 from harvested acres only slightly less than last year (Table 1). With the carryover stock, total supplies for the 1982-83 marketing year are up about 5 percent from a year earlier. These large supplies together with somewhat weaker export demand have held the average farm price for wheat below the year-ago level (Table 2).

Feed grain production totaled 253 million metric tons from an acreage only slightly smaller than a year earlier. Including carryover, total supplies in the 1982-83 marketing year are

up nearly 15 percent. The rapid increase in U.S. feed grain supplies poses a potentially serious price-depressing threat to markets that could extend well beyond the current marketing year.

Corn production topped the year-earlier output to set a new record of 8.3 billion bushels in 1982. With carryover stocks added in, total corn supplies available in the current marketing year are up 16 percent from a year ago. Burdensome supplies and weaker export demand in the 1981-82 marketing year held the average U.S. farm level corn price sharply below the year-ago level.

The soybean crop reached a record 2.3 billion bushels from a harvested acreage slightly larger than in 1981. Including carryover, total supplies available for the 1982-83 marketing year are about 11 percent higher than a year ago. Consequently, the average U.S. farm level price for soybeans in the 1981-82 marketing year was off sharply from the previous year.

Cotton production in the United States declined sharply in 1982 to 12.1 million bales. The decline resulted from both a one-third reduction in harvested acreage from a year before and adverse weather in Texas, a major producing state. Due to large carryover stocks, however, total supplies in the 1982-83 marketing year are slightly larger than a year ago. With larger supplies and somewhat weaker demand, the average U.S. farm level price of cotton was off more than one-fourth in the 1981-82 marketing year.

It seems clear that stock levels for major crops are now well in excess of prudent reserve levels and as a result are a marked depressant on prices.

### **Livestock**

Meat production in 1982 declined nearly 3 percent from the year-earlier level. For this reason most livestock producers were able to earn higher prices for livestock sold in 1982 despite weakness in demand.

The key element in reduced meat output was an almost 12 percent reduction in pork production, which reflected fewer hogs on farms than in 1981. Compared with a year earlier, producers farrowed between 10 and 13 percent fewer sows each quarter of the year. Producers have also given little indication of future production increases despite profitable cost-price relationships. The December inventory of breeding hogs was well below year-earlier levels. As a result, hog prices averaged over 5 percent more than in 1981 (Table 2).

Cattle producers benefited from reduced pork production. Although beef production was up slightly in 1982, prices for choice steers at Omaha averaged about 3 percent higher than a year earlier (Table 2). The combination of somewhat improved fed cattle prices and lower feed costs resulted in positive margins for cattle feeding during most of the year. There was also some improvement in feeder cattle prices, although prices probably remained below full costs of production for most ranchers.

Lamb and mutton production rose 8 percent in 1982 to the highest level since 1976. However, with overall meat production down, choice lamb prices averaged about the same as in 1981.

Poultry production rose about 1 percent in 1982. All the increase was in broilers. Turkey production was down slightly. Increased poultry production caused broiler prices to average about 5 percent less than in 1981. As a result of reduced output, turkey prices averaged about 5 percent higher than in 1981.

Dairy producers, in response to favorable dairy support prices, increased milk production almost 2.5 percent in 1982. The number of cows in the dairy herd was up slightly at midyear. Milk production again exceeded market demand at support price levels in 1982. As a result, CCC uncommitted inventories of butter and cheese at yearend were 35 and 32 percent, respectively, above year-earlier levels.

## Prices and Income

Sluggish domestic and export demand coupled with large grain stocks served to temper upward movement in farm commodity prices in 1982. As a result, the November index of prices received by farmers was 0.8 percent lower than a year earlier. Prices paid by farmers, responsive to increases in the general price level, rose 4.0 percent over the same period.

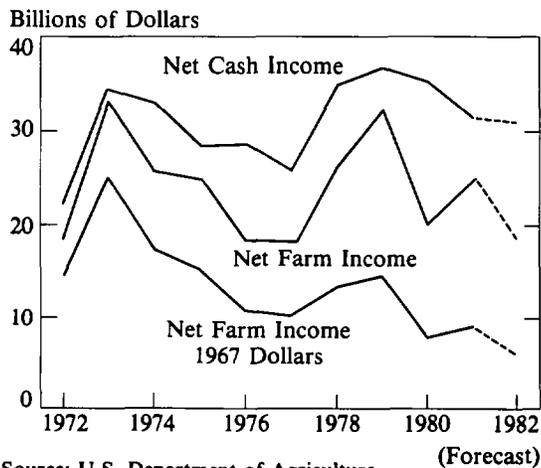
Total cash receipts from farm marketings slipped below last year's record level to about \$142 billion. Record livestock receipts were more than offset by lower crop receipts. Direct government payments to farmers totaled \$4 billion in 1982, more than twice the amount of payments in 1981. Other farm income from such sources as recreation, custom work, and the imputed rental value of farm operator dwellings exceeded year-earlier levels, boosting total gross income to a record \$163 billion. Record high production expenses, however, reduced net farm income to only \$19 billion (Chart 1). The value of inventory adjustment

was not expected to change that figure. Net cash income for the year, the difference between cash receipts and cash expenditures, was \$31 billion, only 1.6 percent less than in 1981.

Off-farm income continues to be an important source of family income to the farm sector, exceeding that earned from farming in recent years. Farm families are estimated to have earned an average of \$17,000 in off-farm income in 1982, up about \$850 from 1981. Total income per farm in 1982—including both farm and nonfarm income sources—is estimated at \$24,900, compared with \$26,456 in 1981. Off-farm income accruing to farm families is considerably more important to smaller and middle-size farmers than to large farmers.

Farm real estate values declined in 1982 for the second year in a row. The decline was in response to depressed net farm income, the high real cost of carrying debt, and reduced inflationary expectations. Agricultural bankers, responding to a quarterly agricultural credit survey conducted by the Federal Reserve Bank of Kansas City at the end of the third quarter of 1982, indicated that values for nonirrigated cropland in the Tenth District were off about 15 percent from the market highs reached in the first half of 1981. Values of irrigated cropland were off 17 percent, and values of ranchland were down 13 percent. Consequently, real farm equity declined in 1982 for the third year in a row—the first time this has happened since before 1940. Government income transfers, commodity price supports, and credit programs for farmers all serve to put a safety net under farmland values. Moreover, recovery in the farm economy can be expected to lead to firming and eventually increasing farmland prices.

Chart 1  
NET FARM INCOME



Source: U.S. Department of Agriculture.

## Farm Policy

Some changes in farm commodity programs have been made for 1983. Highlights of the programs are outlined in Table 3.

**Table 3**  
**1983 COMMODITY PROGRAM HIGHLIGHTS**

1983 crop	Wheat	Corn	Grain Sorghum	Barley	Oats	Rye	Upland Cotton
	\$/bu.						¢/pound
Target price	4.30	2.86	2.72	2.60	1.60	None	76.00
Regular loan rate	3.65	2.65	2.52	2.16	1.36	2.25	55.00
	Percent						
Acreage reduction <sup>1</sup>	15	10	10	10	10	None	20
Paid land diversion <sup>1</sup>	5	10	10	10	10	None	5 <sup>2</sup>

<sup>1</sup> There are two feed grain bases—one for corn and sorghum, one for barley and oats.

<sup>2</sup> Optional.

Source: Agricultural Outlook, October 1982, p. 20.

Acreage reduction provisions will be in effect for several major crops in 1983. To be eligible for program benefits, including CCC loans and target price protection, producers will be required to participate in acreage reduction and diversion programs where applicable. Wheat and feed grain producers will have to participate in both acreage reduction and paid land diversion to qualify for program benefits. Cotton producers need participate only in the acreage reduction. Land diverted from production must be put to approved conservation uses.

The 1982 Budget Act, reflecting Congressional concern over lagging farm export sales and subsidization of sales by foreign competitors, requires the Secretary of Agriculture to use between \$175 million and \$190 million a year in CCC funds for fiscal 1983, 1984, and 1985 to increase exports. The Secretary has decided to use much of the funds to "buy down" interest rates charged foreign buyers on credit sales of U.S. farm products. Under this

program, \$100 million a year in interest free loans will be provided to countries buying U.S. farm products. This will be in addition to \$400 million a year in U.S. government commercial credit guarantees reassigned to the program. As a result, the effective interest rate on the \$500 million in credit will be reduced by one-fifth.

Congress, after lengthy consideration, reached agreement on a major reform of the water reclamation law in effect since 1902. Revisions to the law raise the ownership limit for receiving federally subsidized water for irrigating up to 960 acres for single owners and small corporations (up to 25 stockholders). The limit had been 160 acres. That limit had not been enforced, however, until recent years. Single owners and small corporations have also been given federal water for unlimited amounts of land, whether owned or leased. But for more than 960 acres of owned land, they have to pay the full-cost price. Large corporations (more than 25 stockholders) that received subsidized

water before October 1, 1981, are still eligible for subsidized water up to 320 acres. They can receive unlimited amounts of water from federal reclamation projects at the full-cost price of water. Corporations that did not receive federal water before October 1, 1981, can receive irrigation water for on up to 640 acres, but only at full cost.

The dairy price support program has been changed to freeze the minimum price support for milk (3.67 percent milk fat) at \$13.10 per hundredweight through September 30, 1984. Plans call for the minimum support for fiscal 1985 to be set at the same parity level that \$13.10 represented on October 1, 1983. If net price support purchases meet or exceed a trigger level of 5 billion pounds of milk during a fiscal year, the Secretary of Agriculture can assess 50 cents per hundredweight on any milk that producers market commercially. That assessment became effective December 1, 1982. An additional 50 cent assessment is expected to be made, starting April 1, 1983, if estimated federal purchases of at least 7.5 billion pounds

are expected during a fiscal year. The second assessment can be refunded if dairy producers reduce production. Moreover, legislation gives the Secretary of Agriculture increased authority to donate dairy products to the needy in the United States and elsewhere through government or humanitarian organizations.

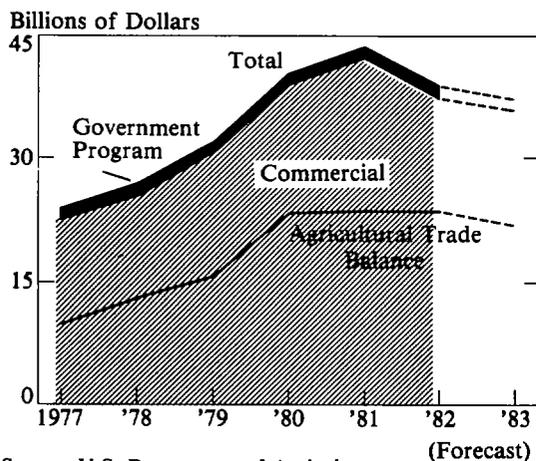
Despite more severe farm financial stress in 1982 than at any time in the 1970s, the Administration did not use its authority to extend to farmers another large infusion of government subsidized credit, as was done with the livestock and economic emergency loan programs of the 1970s. Moreover, Congress did not increase the CCC loan rate and target price levels for major crops.

### THE YEAR AHEAD

With large supplies of grain being carried over into 1983, a farm recovery next year will depend both on improved markets for agricultural products and a reduced harvest. Performance of the general economy will influence meat demand and grain use in 1983. Current grain supplies are so large, however, that an economic recovery by itself is not likely to raise grain prices substantially. Expanded exports will also be needed to raise grain prices. Since forecasts indicate that total grain demand, foreign and domestic, may increase only slightly in 1983, a sharply reduced 1983 U.S. grain crop will be essential in restoring crop prices to more profitable levels.

Livestock production is again likely to be more profitable than crop production, making 1983 a repeat of 1982. Expected reductions in meat supplies, availability of inexpensive feedstuffs, and possible improvements in demand point to profits for most livestock producers at least through the first half of the year. Crop producers, on the other hand, may encounter unsatisfactorily low grain prices throughout 1983.

**Chart 2**  
**U.S. AGRICULTURAL EXPORTS**



Source: U.S. Department of Agriculture.

## Export Sales

The value of U.S. agricultural exports is estimated to have declined to \$39.1 billion in fiscal 1982 from \$43.8 billion a year earlier (Chart 2). This decline, the first since 1969, interrupted a pattern of rapidly expanding exports that dominated U.S. agriculture in the 1970s. The value of agricultural exports more than quadrupled during that decade. The agricultural trade balance decreased slightly in fiscal 1982 to \$26 billion. The volume of U.S. agricultural exports also declined in fiscal 1982, to 158 million metric tons.

The export outlook for 1983 is clouded by the same negative factors that influenced foreign sales this year—a strong U.S. dollar, limited credit to finance farm export sales, Soviet reluctance to buy U.S. grain, and weak economies abroad. The dollar remains strong relative to other currencies despite some recent decline in value, especially against the Japanese yen. This continued strength is due in part to interest rates in other countries having declined along with U.S. rates. In addition, the dollar has been a preferred currency during the recent period of world political and financial stress.

After more than a decade of rapidly growing credit sales of farm products financed by loans from the U.S. government and commercial lenders, the upward trend of such credit expansion has slowed markedly. Disappointing economic growth and political instability in many debtor countries have resulted in delinquent loans and the need to reschedule debt. Thus, new credit extensions for export sales will probably be limited until economic growth in debtor countries recovers enough to accommodate debt service requirements.

U.S. grain sales to the Soviet Union have been disappointing in recent years as political relations between the two nations chilled. The embargo on grain sales to the Soviet Union in retaliation for their invasion of Afghani-

stan—although later lifted—and continued U.S. economic pressure, such as efforts to limit Russian access to Western technology for construction of the European gas pipeline, have adversely affected agricultural trade relations between the two countries. Until relations improve, U.S. agricultural sales to the Soviet Union can be expected to remain weak.

The world economy continues weak, both in developed and developing nations. After negative growth in 1982, only modest real economic growth is expected for OECD countries in 1983. Until the economies of the United States and other developed countries recover, the economies of developing countries that do not produce oil are not likely to improve. Consequently, world demand for U.S. agricultural products is not likely to increase much in 1983.

Another factor compounding the problems of U.S. agricultural exporters in the year ahead is the growing number of nontariff barriers to world trade. Nontariff barriers between developed countries, such as the United States and the European Common Market or Japan, will be difficult to remove even under favorable economic conditions. During the worldwide recession, keeping major trading partners from sliding further into protectionism may be the best outcome that can be expected.

Prospects for a decade of U.S. farm prosperity in the 1980's supported by rapid growth in export sales appear to have been overly optimistic. Relatively restrained current projections for economic growth in the industrialized and developing countries of the world during the first half of the decade have resulted in significant downward adjustments in farm export sales forecasts.

On balance, the value of U.S. agricultural exports could decline further next year. The current forecast is for export sales of \$37.5 billion in fiscal 1983. Despite the discouraging outlook, the United States remains the single most important grain exporter in the world.

Should world supplies fall short of world demand in 1983, the United States will be well positioned to increase exports.

### **The Crops Outlook**

The U.S. crop outlook for the year ahead is burdened by very large stocks of many commodities, including unprecedented stocks of wheat and corn. Wheat producers may not see much price improvement in 1983. The total U.S. wheat supply for the 1982-83 marketing year could reach a record of nearly 4 billion bushels. Even with heavy feed use and exports at a near record volume next year, carryover stocks are expected to increase about one-fourth on June 1, 1983, rising to their highest level since the early 1960s. Free stocks—stocks outside of CCC ownership and the Farmer Owned Reserve (FOR)—will account for only about 23 percent of the total stocks. Thus, even a moderate increase in demand could raise farm prices above CCC support levels to bid additional stocks out of CCC loans and FOR programs.

Although U.S. wheat exports were expected to benefit in the 1982-83 marketing year from a 50 percent reduction in Australian wheat production, surpluses in Argentina, Canada, and the Common Market may be more than enough to offset reduced Australian exports. So, while U.S. wheat exports next year may nearly match the record shipments in the 1981-82 marketing year, no significant increase is expected.

With too little demand expected in 1983 to forestall further buildup in wheat stocks, price improvement may depend on the effectiveness of the 1983 government acreage reduction program. If participation in the program is high—as now expected because of unfavorable wheat price forecasts—and if growing conditions are less favorable in 1983 than in 1982, a smaller crop might raise wheat prices above the currently expected range of \$3.40 to \$3.50 a bushel.

Feed grain producers face similar prospects for 1983—fairly weak demand and growing stocks. Feed use next year may increase only marginally because of prospective reductions in livestock numbers. Feed grain exports are expected to equal the 1981-82 level and remain below the record level of 1980. Moderate increases in demand will not be enough to prevent a nearly 48 percent increase in feed grain stocks. With the additional buildup in 1983, feed grain stocks will have tripled since 1981 with corn accounting for over 80 percent of the total feed grain stocks.

Feed grain prices are expected to fall below the 1982 average. U.S. farm level corn prices will likely average \$2.15 to \$2.35 a bushel in 1983. Sorghum prices are expected to be in the range of \$2.15 to \$2.30 a bushel. Barley prices are expected to be between \$2.10 and \$2.25. With free stocks accounting for less than a fourth of total feed grain carryover stocks—the remainder being held in FOR and CCC stocks—prices will be stronger than now expected if demand exceeds current expectations.

Large supplies and weak demand also dominate the outlook for soybean producers in 1983. Domestic utilization and exports are expected to increase only modestly next year, despite low soybean prices. As a result, total soybean carryover stocks at the close of the 1982-83 marketing year are estimated to be more than 60 percent greater than when the year began. This record supply will likely depress prices in 1983 to a range of \$5.25 to \$5.75 a bushel.

One positive factor in the soybean outlook is that these large stocks may be comparatively less burdensome than stocks of other grains. The expected soybean carryover stocks in 1983 will represent only 20 percent of total annual use compared with 61 percent for wheat and 49 percent for feed grains. As a result, soybean prices may respond more than wheat and feed grain prices to any increases in demand.

Cotton supplies are expected to remain high in 1983. Domestic mill use will probably increase only marginally, while exports may decline slightly. Carryover stocks at the end of the 1982-83 marketing year are expected to total 8.0 million bales, slightly more than the previous year. Cotton prices, therefore, may show only small improvement in 1983. Consequently, a high proportion of producers are expected to participate in the government program. Another small crop next year could, however, help raise prices during the latter part of the year.

### **The Livestock Outlook**

Livestock producers are expected to fare somewhat better than crop producers in the upcoming year. Red meat supplies in 1983 are now expected to fall somewhat below 1982 levels. Increases in production costs in 1983 will be modest. For example, feed costs are not expected to increase substantially and interest costs could decline somewhat further. Finally, as recovery occurs in the general economy, some increase in demand for meat products is likely.

Beef production may increase only 1 percent in the first half of the year when compared with the same period in 1982. Increased fed cattle marketings in the first six months of 1983 may be offset by a significant reduction in nonfed slaughter. Cattle prices will be helped by continued reductions in pork supplies during the first two quarters of 1983. On balance, cattle feeders can probably expect relatively strong cattle prices throughout much of 1983. As a result, ranchers should also see improvements in feeder cattle prices as cattle feeders bid for somewhat smaller numbers of feeder cattle than were available last year.

However, a note of caution is in order. High feedlot placements in the fourth quarter of 1982 could pose the threat of large fed cattle supplies in the first quarter of 1983, especially if cattle

are fed to heavy weights. This could weaken cattle prices in the first quarter below those now expected, especially if consumer demand remains soft.

Choice steers in Omaha may average in the mid-60 dollars per hundredweight range during the first quarter of 1983 and in the high 60 dollars per hundredweight range during the second and third quarters. The average could drop to the mid-60 dollars per hundredweight range in the fourth quarter if beef supplies increase as expected.

Pork producers can expect another profitable year in 1983. Despite sizable profit margins during all of 1982, producers have not expanded farrowings. Hog slaughter in the first quarter of 1983 is expected to be down by 10 to 12 percent from a year earlier. Slaughter will be off 6 to 8 percent in the second quarter. While there is much conjecture as to why pork producers have not yet increased farrowings, since production is quite profitable, currently there is little evidence of a production increase prior to the fourth quarter. The delayed upturn in production expected next year may reflect more concentration of hog production among large producers, who apparently prefer profitability to a quick increase in production.

Prices for barrows and gilts at the seven major markets are expected to average in the high 50 dollars to low 60 dollars per hundredweight in the first three quarters of 1983. Later, if pork supplies increase significantly, prices could decline to the mid 50 dollars per hundredweight range in the fourth quarter. As with cattle prices, however, increases in consumer incomes in the second half of 1983 could bolster hog prices.

Broiler producers may see modest improvement in prices in 1983 as a benefit from lower total meat output. Broiler production is likely to increase 1 to 3 percent as producers respond to low feed costs. Demand for poultry products will increase from prospective gains in con-

sumer income. Turkey production is expected to increase 4 percent in 1983. Nonetheless, prices may range slightly higher than a year earlier.

### **Farm Income**

Current signals suggest any increase in 1983 farm income will be modest. Crop prices may not improve significantly next year because of the huge carryover grain stocks, but grain prices are not likely to move lower than current levels and there should be some seasonal strengthening in prices as summer approaches. Livestock prices will probably remain at profitable levels throughout much of the year, suggesting that livestock cash receipts will be the brightest feature of the farm income situation. Farmers and ranchers will continue to benefit from a slowing rate of increase in prices of agricultural inputs. On balance, net farm income may be a little higher than the \$19 billion estimated to be earned in 1982.

Despite financial stress in the farm sector, most farmers will survive the recession with their businesses intact. However, a small proportion of farmers will probably be forced from business or will liquidate part of their businesses to relieve financial stress. A Tenth Federal Reserve District survey of agricultural bankers indicated the proportion of farmers going out of business or filing for bankruptcy in the second and third quarters of 1982 was 40 percent more than normal. The bankers indicated the proportion of farmers selling part of their businesses during that period to relieve financial stress was about three times normal. Low commodity prices and declining farmland values will force additional farmers and ranchers into at least partial liquidation in coming months, but with lower interest rates, reduced production cost increases, and the possibility of somewhat improved farm income in 1983, the time of greatest stress for the farm

sector may be about over.

Credit availability at commercial banks and Farm Credit System outlets will be adequate to meet the expected demand of farm borrowers in 1983. Since the volume of government subsidized loans from the FMHA is not likely to increase in 1983, farmers that do not qualify for normal commercial credit will have difficulty obtaining financing. As in 1982, CCC commodity loans to farmers complying with government commodity programs will be an important source of farm operating credit. On September 30, 1982, farmers had \$10.4 billion in CCC credit secured by farm commodities outstanding, an increase of 175 percent over CCC credit outstanding a year earlier. That represented 12 percent of all nonreal estate farm credit outstanding. Farm loan interest rates are expected to average well below the near-record levels of 1982. Average interest rates on farm operating loans in the Tenth Federal Reserve District declined 2.5 percentage points between midyear and November 1, 1982, reaching a 14 to 15 percent range. Further declines could occur if inflation continues to moderate.

Farm real estate values are expected to remain soft in 1983. The amount of land offered for sale may increase in the spring due to some continued liquidations. As a result, farmland values may decline further in 1983. Lower costs of carrying debt and government farm programs, however, will probably prevent dramatic declines. Land values may begin to stabilize and strengthen later in the year if prospects continue for a farm recovery in 1984.

### **Food Prices**

Consumers will benefit from low farm commodity prices in 1983. Retail food prices in 1982, as measured by the CPI, are expected to rise 5 percent, the lowest rate of increase since 1976. The outlook for 1983 is for retail food

prices to increase only 4 to 5 percent, with most of the increase due to higher food marketing costs.

### **SUMMARY**

The past year was a disappointment to most farmers. The expected recovery from recession did not occur. Farm income declined further from the depressed levels of the previous two years. Farm real estate values declined. Grain stocks increased again, building to very burdensome levels. On the positive side, however,

livestock producers—particularly hog farmers—received higher prices and production cost increases continued to slow.

The prospect of modest improvement in farm income in 1983 is based on stronger livestock prices, somewhat higher crop prices, and further easing in inflation. Better price performance for farm products will depend on increases in both domestic and export demand, which should come as economies of the United States and other industrial countries move into a period of recovery in 1983.

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