The Economic Recovery: Will Agriculture Follow in 1976?

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Keeping in step with the'economy, agricultural conditions have improved considerably during the second half of 1975. After bottoming out in March, prices received by farmers began to rise sharply in response to diminishing red meat supplies and to rising total demand, especially in the foreign sector. This uptrend in prices was finally interrupted in October when huge grain harvests caused average farm prices to drop one-half of 1 per cent. However, as a result of improved prices, the net farm income picture for 1975 has turned out much better than originally expected. Current estimates indicate that 1975 net farm income will be approximately $25 billion, as compared with $27.7 billion in 1974. Most of the 1975 decline is attributable to yet another rise in production costs, which will probably exceed the $73.4 billion spent in 1974 by about $3.5 billion.

The brighter agricultural picture that has developed in the last several months reflects various adjustments in farm output and improvements in the general economy. In the crop sector, for example, greatly improved growing and harvesting conditions pushed production sharply above 1974 levels when yields were plagued by spring floods, a summer drought, and early frosts. New production records were established for corn and wheat in 1975, and soybean output—while falling somewhat short of the 1.55 billion bushels produced in 1973—jumped about 23 per cent above last year's weather damaged crop. Although prices declined seasonally during the harvest period, precipitous drops were avoided because of the relatively tight world grain situation and the excellent prospects for foreign sales. Without foreign markets to absorb the bumper crops, U. S. farmers would obviously be receiving very low prices for their grain in the 1975-76 marketing year.

Livestock producers have also made significant adjustments in output. During the first 9 months of 1975, for example, total red meat production was about 3 per cent less than in the comparable year-earlier period. However, virtually all of the drop in output occurred in the hog industry as beef supplies exceeded 1974 levels by 3 per cent. These adjustments reflect the sharp deterioration in profits in 1974 which induced livestock producers to start liquidating their breeding herds. Since the hog industry adjusted rather quickly, farrowings and marketings in 1975 have fallen very sharply, running as much as 20 per cent below year-earlier levels. However, cattle producers—who also began to adjust herd size in 1974—are still in the liquidation process, which explains the small increase in beef output this year.

The strong recovery in the economy and the prospects for continued expansion, as summarized in the companion article in this ***Review,*** have also bolstered the agricultural sector in recent months. Since the end of the recession in the second quarter, personal incomes and employment have risen significantly, reflecting consumers' increased ability to spend. To the extent that consumers have directed a portion of their higher incomes toward food consumption, farm prices and incomes have no doubt benefited.

PREVIEW OF 1976

Given the turnaround in the economy and the prospects for continued growth in 1976, domestic demand for agricultural commodities should strengthen in the year ahead. Certainly, the natural growth in population and rising disposable incomes will have a positive effect, but any reduction in food stamp benefits in 1976 would be partly offsetting. Nevertheless, given the outlook for agricultural exports, the total demand picture for farm commodities is excellent. On the supply side, farm producers will likely continue to make adjustments in their production programs for both crops and livestock. Total meat supplies are expected to increase somewhat above 1975 levels, mostly on the strength of an expansion in beef and poultry output. However, if the relationship between production costs and hog prices remains favorable for the next few months, the production of pork in 1976 may also exceed the 1975 level.

The key to 1976 crop production will probably be the weather since total acreage will not change appreciably. Over the last few years, virtually all of the idled cropland that had been held in reserve under various farm programs has been brought back into production. Since the Secretary of Agriculture has announced that there will be no set aside requirements for 1976, farmers may cultivate as much land as they wish. However, the constraints on land availability coupled with uncertainties about production costs, the weather, and new export policies will likely temper, if not preclude, a significant expansion in crop acreage. Therefore, the realization of higher production levels in 1976 will require further improvements in yields, which implies nearly ideal weather, or the substitution of one crop for another. Given recent price relationships, there is a strong possibility that corn and perhaps cotton acreage will increase at the expense of soybean acreage in 1976.

The volume of farm marketings in 1976 is expected to be moderately larger than in 1975 assuming that the crops are good. Although the demand prospects are strong, large supplies of farm products will likely create some downward pressure on prices, especially during the second half of the year when livestock production starts expanding more rapidly. In view of the demand structure for most agricultural commodities, which tends to be relatively price inelastic, any gain in 1976 gross farm income over 1975's estimated level of $103 billion will likely be small. Although production costs are not expected to rise sharply during the coming year, they probably will increase enough to erode any gains in gross receipts, leaving net income a little below the 1975 figure. Barring any unforeseen shocks, therefore, the net income situation in agriculture should stack up quite well by historical standards in the coming year, resulting in either the third or fourth best year on record. Furthermore, livestock producers will probably enjoy a larger share of total farm income than they received in 1975.

An End to Rising Food Prices?

For all of 1975, it is estimated that food prices will average about 9 per cent above the 1974 average, which compares with increases of 14 per cent in each of the 2 previous years. Thus, some progress has been made in slowing the rate of increase in food prices in the last year. A continuation of this trend will require that prices at the farm level either stabilize or fall in the year ahead and that farm-to-retail price spreads do not widen unduly.

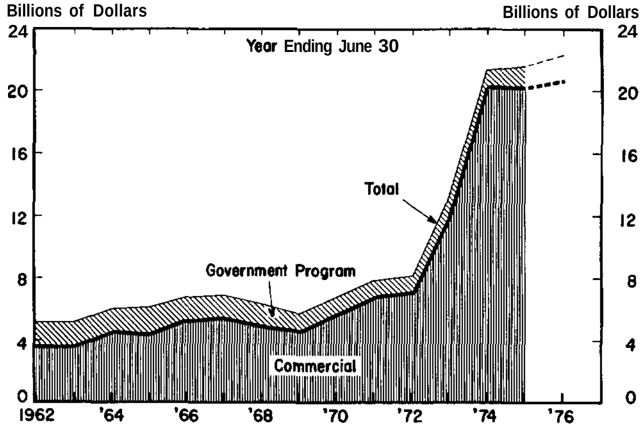
Earlier this year, great concern was expressed about the probable impact on food prices of large grain sales to Russia. Many recalled that the 1972 episode with Russia resulted in a heavy runoff of grain stocks and a sharp rise in prices at both the farm and food retail levels. Coming as it did, this runup in prices exacerbated the inflationary forces at work in the economy and produced an outcry for closer controls on exports. Quite naturally, therefore, the public remains very sensitive about Russian forays in the U. S. market, which partly explains the moratorium on grain sales that was imposed in August. In analyzing the probable impact on food prices, the Department of Agriculture has indicated that the large grain sales made to Russia this past summer will boost food prices about 1.5 per cent higher than they otherwise would be in 1976.

Considering the outlook for farm prices in the year ahead, there is a good possibility that the upward pressures on food prices resulting from the Russian grain sale will be nearly offset by price declines at the farm level if supplies materialize as expected. Therefore, the issue of food prices in 1976 will depend largely on what happens to the farm-to-retail price spread. Following a 20 per cent jump in 1974, marketing spreads for assembling, processing, transporting, and distributing are expected to average about 8 per cent higher in 1975. In 1976, the farm-to-retail margin will no doubt widen once more to cover higher marketing and processing costs. The question is—how much? Although historical evidence shows that significant year-to-year deviations may occur, marketing margins tend to reflect the general rate of inflation because the food industry is basically service oriented. The economic recovery will probably result in a higher demand for built-in food services, which will likely lead to wider spreads and higher food prices, but it is hoped that economic conditions will be stable enough in the year ahead to remove some of the impetus for ever-widening marketing margins. If so, 1976 food prices should conform more closely to the general rate of inflation, which promises to be moderate. Hence, the rate of increase in food prices in the coming year likely will be less than the 9 per cent rise posted in 1975.

Foreign Demand to Continue Strong

Although the availability of U. S. grain stocks has increased sharply this year, the prospects for world trade are more favorable than a year ago because of production shortfalls in several major producing countries, particularly in the Soviet Union. Thus, the volume of agricultural exports in the 1975-76 fiscal year promises to exceed the previous year's level by a wide margin—perhaps as much as 15 to 20 per cent. Prices, however, are expected to average somewhat lower in the current period, which will offset some of the gains in volume. Still, foreign sales should surpass the record $21.6 billion posted in fiscal 1975 and provide another large surplus in the trade balance for agricultural commodities (Chart 1). The surplus from agricultural trade has amounted to about $12 billion in each of the last 2 fiscal years, up from $5.6 billion in fiscal 1973. Moreover, the expected surplus in the current period also should equal, if not surpass, the $12 billion level. Obviously, the sharp expansion in agricultural exports has been extremely beneficial to the United States in balancing the payments associated with international trade.

Chart 1
U.S. AGRICULTURAL EXPORTS



SOURCE: U.S. Department of Agriculture

In the last fiscal year, the volume of agricultural exports declined about 15 per cent due largely to the small harvests in 1974. Nevertheless, wheat and feed grain sales posted new highs, reaching $5 billion and $4.7 billion, respectively. Rice exports, rising 33 per cent, broke the $1 billion mark for the first time. However, cotton and soybean exports fell 21 per cent and 9 per cent, respectively, because of reductions in demand. Reflecting the worldwide recession in 1974-75, sales to Japan—the largest single market for U. S. agricultural exports—fell about 5 per cent in the last fiscal year to a level of $3.2 billion. Interestingly, total sales to both Russia and China amounted to less than $800 million, down sharply from the $1.35 billion shipped in fiscal 1974.

A Word About Grain Agreements

While creating a storm of controversy, the 5-year grain agreement recently consummated with the Soviet Union merely represents another chapter in the long history of agricultural trade policy. Almost from the beginning, the Government has influenced, if not controlled, the conditions under which American farm commodities could enter international markets. However, the stance on trade policy has changed from time to time, varying from strong protectionist policies, as championed by the Smoot-Hawley tariffs in the 1930's, to programs that have sought to liberalize trade barriers and expand foreign markets. In addition, considerable effort has gone into developing programs that provide needy countries with food. and other farm products on a concessional basis. Hence, many people are apprehensive about the Russian grain agreement because it seems to conflict with a general policy of market expansion for agricultural commodities.

Before such a conclusion is reached, however, the terms of the agreement should be analyzed carefully. Beginning October 1, 1976, Russia will be committed to purchase annually, for the next 5 years, at least 6 million metric tons of wheat and corn in approximately equal proportions. If American grain stocks exceed 225 million tons, Russia may purchase an additional 2 million tons without prior consultation with the U.S. Government. Furthermore, it is expected that purchases and shipments will be spaced as evenly as possible over each 12-month period. If U.S. grain stocks should fall below 225 million tons, a highly unlikely development based on historical evidence, an "escape clause" will permit the United States to reduce the quantity of grain sold to the Soviet Union below the 6 million ton minimum. Similarly, any desire by either party to go beyond the 8 million ton maximum will require additional consultations before the sales are made. The agreement only applies to corn and wheat, which means that trade may occur in other commodities without restrictions. Finally, no concessional credit will be provided by the U.S. Government to finance Russia's purchases.

As with any agreement, there are advantages and disadvantages. On the positive side, the Russian grain agreement may remove much of the emotionalism that has characterized earlier transactions. At a minimum, the agreement promises to smooth out Russia's buying patterns for the next few years, to help her build up grain reserves during good crop years, and to partly reduce the wide price fluctuations in U.S. grain markets, assuming that sales to other countries do not vary unduly. Greater price stability not only will allow grain producers to make better decisions but will also offer some protection to the livestock industry against sharp runups in feed costs. Moreover, the steady flow of grain to the Soviet Union over the next 5 years will result in a substantial amount of foreign exchange to help relieve some of the pressure on the balance of payments problem.

On the negative side, the quantity limits specified in the agreement have a relatively narrow range and, as such, are tantamount to export controls. While it can be argued that Russia's access to U.S. markets should not go unchecked due to her proclivities for making massive purchases within short time periods, a maximum limit higher than the 8 million tons would still act as a constraint and, at the same time, provide a wider range within which the pricing system could operate. As it now stands, the Soviet Union has a strong incentive to glean the world market before coming to the United States to negotiate for additional quantities above the maximum limit. Although most of these lost sales would probably be offset by larger grain shipments to third countries, the net effect of this policy is to make the United States a residual supplier of grain.

A more disturbing ramification, however, is that an element of competition has been removed from the marketplace. Now that an agreement has been reached with Russia, in addition to the Japa-

Table 1
BALANCE SHEET FOR MAJOR CROPS
United States
(Millions of Bushels or Tons)

	Corn (bu) Marketing Year Oct. 1-Sept. 30		All Feed Grains (ton) Marketing Year*		Soybeans (bu) Marketing Year Sept. 1-Aug. 31		Wheat (bu) Marketing Year July 1-June 30	
Supply	1974-75	1975-76†	1974-75	1975-76†	1974-75	1975-76†	1974-75	1975-76†
Beginning Carryover	483	359	22.2	15.8	171	186	247	320
Production and Imports	4653	5805	165.6	204.6	1233	1520	1795	2139
Total	5136	6164	187.8	220.4	1404	1706	2042	2459
Disappearance								
Domestic	3628	4040‡	132.9	146.8‡	808	856‡	683	706‡
Exports	1149	1450‡	39.1	49.9‡	410	475‡	1039	1350‡
Total	4777	5490‡	172.0	196.7‡	1218	1331‡	1722	2056‡
Ending Carryover	359	674‡	15.8	23.7‡	186	375‡	320	403‡

*Marketing year begins October 1 for corn and grain sorghum, July 1 for barley and oats.
†Preliminary projections available November 1, 1975.
‡Average of a range of estimates.

SOURCE: U.S. Department of Agriculture.

nese grain agreement that was reached earlier this year calling for minimum shipments of 14 million metric tons a year for **3** years, other countries wishing to line up supplies from the United States will likely seek similar commitments. Hence, this carving up of the export market among various countries would tend to reduce the aggressiveness of buyers in the marketplace, which might result in lower bids on the grain that is for sale. Such an arrangement would obviously be the ultimate form of export controls.

COMMODITY OUTLOOK FOR *1976*

The important ingredients in the 1976 outlook for agricultural products are the uncertainties associated with the strength and duration of the economic recovery, future developments in export demand, and probable production levels in both the livestock and crop sectors. It is generally assumed that output will expand in the year ahead, and that total demand will rise enough to lend some support to farm prices. However, favorable crop weather and expectations of good profit margins in livestock feeding will be a prerequisite to higher production levels in ,1976. Although the demand picture presently looks good, conditions can suddenly change. A rekindling of inflation, for example, could seriously jeopardize the economic recovery, which would likely have a harmful effect on agriculture.

Crop Situation

Due to large harvests in 1975, crop supplies for the current marketing year are sharply higher than a year ago (Table 1). The production of feed grains and wheat both hit record highs, pushing total supplies of these commodities up 20 per cent. Although soybean production did not match 1973's record, the combination of a 23 per cent increase in production and a larger carryover boosted the total supply to an all-time high of 1.71 billion bushels. In contrast to 1974-75, when supplies were very tight, grain stocks for the coming year appear ample for expanded domestic and foreign demand while still allowing for some buildup in the carryover next summer and fall. This larger carryover will likely dampen any sharp upward movement in grain prices.

The grain markets are still being buffeted by the weight of large domestic harvests and uncertainties about future sales to the Soviet Union. Following the lifting of the embargo in October, Russia did purchase additional grain—bringing the total for 1975 to more than 13 million metric tons. However, instead of rising, prices fell. Apparently, the grain trade ascertained that even if Russia decided to push total purchases to 17 million tons, an amount about equal to her acquisitions in 1972-73, the supply of wheat and feed grains would easily stretch to the 1976 harvests.

In the last marketing year, farmers received prices which averaged about $4.00, $3.00, and $6.50 per bushel for wheat, corn, and soybeans, respectively. With the exception of wheat, which may average near last year's level, prices will likely average lower in the current marketing year, especially for soybeans. Furthermore, the post-harvest seasonal rise that normally occurs in the winter and spring months may be somewhat restricted this year unless foreign demand should strengthen further or the 1976 crop prospects run into difficulty.

A sharp decline in production and a likely increase in U.S. mill consumption highlight the cotton outlook. With relatively stable exports, ending carryover stocks for the 1975-76 marketing year should fall moderately below this year's level of 5.75 million bales, which suggests that prices will be reasonably good. Supplies of most fruits and vegetables are somewhat larger this year, but total demand promises to keep prices near, if not above, 1974-75 levels.

Livestock Situation

Despite the improved profitability picture of recent months, cattle feeders and hog producers apparently are taking a guarded approach to expanding output, due to uncertainties about future cost-price relationships. Only recently has there been any evidence of a turnaround in hog farrowing and feedlot placements. In September, for example, hog producers reported that they planned to increase farrowings for the December 1975-February 1976 period 6 per cent above the same period a year earlier, but this will still be well below the levels posted in 1973 and 1974. The number of cattle placed in feedlots during the third quarter of 1975 was 22 per cent higher than the very low levels of a year ago. Nevertheless, this increase in placements was sufficient to boost the total number of cattle on feed as of October 1, 1975, slightly above the previous year, the first such year-to-year gain since October 1973.

Although livestock output now appears to be on the expansion path, actual production in the year ahead will depend largely on how producers assess their potential profits. In the hog industry, the outlook is quite favorable, especially for the first half of 1976. Even though farrowings will be increasing rather sharply, pork production is not expected to exceed year-earlier levels until mid-year. Slaughter during the second half of the year will likely be large enough to offset an anticipated decline of about 10 per cent in the kill rate during the first 6 months. Thus, pork supplies in 1976 should be slightly larger than in 1975, which, on a per capita basis, were the lowest in 40 years. Although prices are not likely to surpass the $65 per hundredweight peak established last fall, some seasonal strength may occur in the spring. But once supplies of pork and other red meats begin to expand more rapidly next summer, some retrenchment in pork prices is expected. For the year as a whole, prices on barrows and gilts will probably average a little below the $50 per hundredweight estimated for 1975.

The sharp rise in cattle and calf slaughter in 1975 apparently will stem the buildup in inventory numbers. It was estimated a year ago that the cattle inventory was 131.8 million head, and all of the evidence suggested that another increase would occur in 1975. However, a larger-than-anticipated death loss coupled with sharply higher slaughter rates for cows, calves, and non-fed steers and heifers have placed cattle numbers in better balance with market demand. Stopping the inventory buildup will not necessarily result in higher cattle prices in the coming year, but it at least sets the stage for a stronger and more profitable market at some point in the future.

Looking at potential beef supplies, fed cattle marketings in the first quarter of 1976 will likely increase about 10 per cent above year-ago levels and 15 per cent or so above the fourth quarter, 1975.

Furthermore, fed marketings in the second quarter should also be up sharply from the year-earlier period. Although increases of these magnitudes would normally presage a drop in price, marketings from the non-fed sector are expected to decline rather significantly during the winter months. Therefore, total slaughter during the January-March period may be only **3** to 4 per cent larger than a year earlier, which suggests that prices on choice steers and heifers will remain fairly strong. Reflecting a probable shift back to more grain-fed cattle and fewer non-fed steers, heifers, and calves, **1976** production levels are expected to show a moderate increase over this year. Although the price outlook is mixed, most of the evidence suggests that choice steer prices should average near the **$45** per hundredweight received this year.

While improving, the outlook for the cow-calf producer is not particularly bright for **1976.** Until the cattle inventory is liquidated further or profits in cattle feeding show greater promise, feeder cattle prices are likely to hover around current levels, showing at most some seasonal strength this spring. Conditions in **1977** and **1978,** however, should be much better for the rancher.

In response to more favorable prices, poultry and egg production has recently been expanding. This expansion will likely put some downward pressure on prices in the months ahead, but if the relationship between feed costs and prices does not deteriorate significantly, **1976** profits should compare favorably with **1975** earnings. The dairy industry has benefited from higher prices and lower feed costs in **1975.** Milk production for the year is estimated to be about equal to the **115.4** billion pounds produced in **1974.** Some increase in output is likely for **1976,** but the gain should not depress prices and incomes to any great extent. Continuing a trend of several years, lamb slaughter will probably be down again in **1976.** However, larger supplies of beef and pork will temper any price movements for lambs much above **1975** levels.

A FINAL NOTE

On balance, the agricultural picture for **1976** appears good even though prices and net incomes may slip somewhat below **1975** levels. This evaluation presupposes, however, that weather conditions in the year ahead will be conducive for big crops and that profit margins in livestock feeding will remain generally favorable. There is also an implicit assumption that the economy will continue to grow in **1976,** which will afford higher levels of employment and larger disposable incomes. However, because the wheel of fortune in agriculture is capable of producing surprising outcomes, farmers should exercise more than the usual amount of caution in their production and marketing decisions in **1976.**