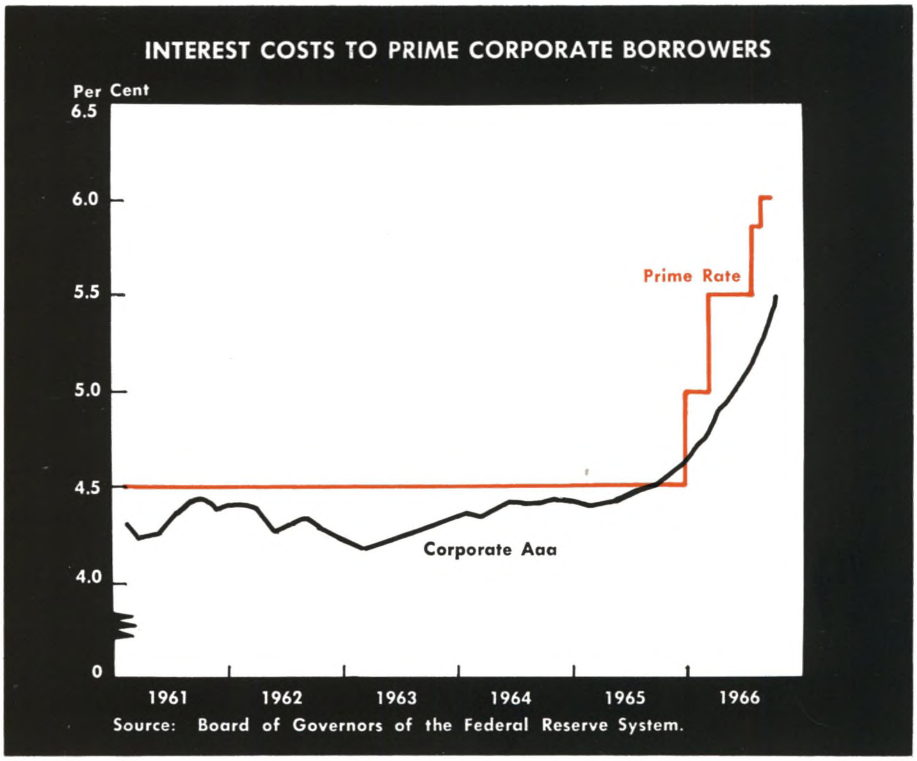
MONTHLY REVIEW



After fluctuating narrowly for almost five years, interest rates paid by business borrowers climbed steeply in 1966.

FEDERAL RESERVE BANK OF RICHMOND DECEMBER 1966

INTEREST RATES in the CURRENT EXPANSION

The rise in rates which has occurred in the current economic expansion has differed significantly from previous postwar experience. In previous expansions, interest rates began rising almost coincidentally with the upturn in economic activity and rose rapidly with only minor interruptions throughout the expansion phase of the cycle. In the latest expansion, which began in February 1961, long-term interest rates fluctuated around the same level for 4½ years before undergoing a period of sustained, rapid increase, and short-term rates during most of the expansion rose much less rapidly than is typical of a period of expanding economic activity. This article discusses year by year the major factors affecting interest rate behavior.

Year 1961 Economic activity expanded vigorously in 1961 as the nation recovered from a mild recession. While total credit demands rose fairly sharply, these demands were satisfied by a large expansion of bank credit, encouraged by monetary ease, and by increased personal saving as consumer expenditures lagged behind sharp gains in personal income.

Monetary policy during the year was designed to encourage bank credit and monetary expansion. At the same time, because of the large deficit in the international balance of payments, the Federal Reserve endeavored to avoid downward pressures on short-term interest rates, thereby reducing outflows of short-term capital which might have been attracted by higher rates abroad. To this end the System did not ease as much as it might otherwise have done, and on February 20, the System announced that open market operations would no longer be confined exclusively to short-term securities. This was the beginning of "Operation Twist," the label subsequently attached to the Federal Reserve and Treasury policy of trying to keep long rates down to promote domestic expansion and short rates up to protect the capital account of the balance of payments.

Long-term rates advanced sharply during the spring and summer, in part due to borrowing in anticipation of rising rates. Anticipatory borrowing subsided in the fall, however, as market participants realized that rates would not surge upward as in earlier expansions. Long rates closed the year at approximately their summer highs. Short rates remained about unchanged until the late fall when seasonal pressures forced a sharp, though temporary, run up. Throughout the year, Federal funds traded well below the discount rate.

Year 1962 The salient feature of 1962 was a flattening of the yield curve. Short-term rates rose moderately while long-term rates generally declined despite continued expansion of the economy and a substantial increase in the total demand for funds. The twisting of the yield curve was the result of a number of influences, but probably the single most important factor was the changing structure of bank liabilities which followed the January 1 revision of Regulation Q permitting commercial banks to raise their rates on time and savings deposits. Banks moved heavily into tax exempt securities, mortgages, and long-term Governments which the Treasury was making available through its relatively new technique of advance refunding. At the same time, banks generally became net sellers of short-term securities, thus contributing to the upward pressure on short-term rates.

Monetary policy continued to be expansionary, but the degree of stimulation was reduced slightly in June and again in December because of concern over the persistence and magnitude of the balance of payments problem. The Federal Reserve welcomed the tendency for short-term rates to rise and long-term rates to fall. To further this end, it continued the "Operation Twist" policy. By the end of the year the three-month bill rate had risen to within 10 basis points (1/10 of 1%) of the discount rate which was then 3%, and Federal funds traded at or near the discount rate most of the time.

Year 1963 A slow but sustained rise in rates on high quality long-term issues occurred during 1963. In contrast, rates on mortgages continued to decline as did rates on lower quality bonds, as banks "reached for yield" to cover the higher costs of attracting short-term money. The decline in mortgage rates, which occurred in the face of a record increase in mortgage loans outstanding, was attributable to the continued rapid rate of savings flows into banks and other financial intermediaries, and the keen competition for mortgages by investors.

Rates on short-term instruments rose sharply at mid-year in response to a tightening move by the Federal Reserve for balance of payments reasons. In May the Federal Open Market Committee voted to reduce reserve availability and in July the discount rate was raised to 3½%. Short rates adjusted higher in anticipation of the discount rate action and continued to rise steadily until near the end of the year before stabilizing at a level some 60 basis points higher than the level which prevailed in the spring. Both the Federal Reserve and the Treasury continued to conduct security operations in such a way as to put upward pressure on short-term rates. Commercial banks also contributed to this upward pressure by concentrating sales in the short-term area. By the end of the year the rate on the three-month bill was slightly above the discount rate, and Federal funds during most of the second half traded quite consistently at the discount rate, which then acted as a ceiling on the Federal funds rate.

Year 1964 Despite a very sharp increase in the demand for funds, 1964 was a year of rate stability. These demands were accommodated without a rise in rates because of continued large flows of financial savings, an easy, though slightly firming, monetary policy, and a climate of expectations which favored rate stability.

The posture of monetary policy throughout most of 1964 remained essentially unchanged from that adopted in mid-1963, but in August a slight firming was attempted in response to rising deficits in the balance of payments in the second and third quarters. Then in November the Federal Reserve raised the discount rate and the Regulation Q ceilings in response to British moves to deal with a sterling crisis. These actions were directed almost exclusively at the international situation, since there were few if any signs of domestic overheating. The unemployment rate, for example, closed the year at 5%. As in earlier years the Federal Reserve and Treasury continued to conduct their security operations in such a way as to exert upward pressure on short-term rates.

Year 1965 Long-term rates remained roughly unchanged until about mid-1965. Rates on tax exempt securities actually declined early in the year, in part because of heavy purchases by commercial banks. Short-term yields made only a partial adjustment to the November 1964 increase in the discount rate. The rate on the three-month bill fluctuated without a discernible upward trend until early fall. This was due in part to the retirement of short-term debt from the proceeds of a Federal cash surplus which, in turn, had resulted from large tax receipts generated by the rapidly expanding economy.

Despite emergent signs of overheating, such as rising industrial prices and reports of increasing scarcities of skilled workers, and growing private demands on the capital market, most market observers continued to predict rate stability for several reasons. First, it was generally felt that the feverish pace of the economy in the first half was a temporary phenomenon associated with the buildup of steel inventories as a hedge against the possibility of a steel strike in the fall. Second, the heavy business demand for credit, especially bank credit, was considered to be largely the result of the rapid but temporary accumulation of business inventories. Third, most observers expected Government demands on the money and capital markets to remain light throughout the year because of record tax receipts accruing from rapidly rising incomes. Fourth, the President announced the initiation of a Voluntary Foreign Credit Restraint Program in February to reduce the heavy capital outflows which plagued the balance of payments in 1964. This program quickly relieved pressure on the balance of payments and removed one important reason for further monetary restraint. Finally, there was a strong feeling that the Government had both the will and the power to keep the rate structure essentially unchanged. This feeling stemmed in part from the fact that certain banks which raised their prime rate in November and December of 1964 quickly rescinded that action in response to Presidential pressure.

Rate stability persisted despite tightening moves by the Federal Reserve in February and March. As banks attempted to meet the strong demand for loans, borrowings from the Federal Reserve expanded, and net borrowed reserves appeared in February for the first time in many years. Federal funds began to trade above the discount rate as money market banks bid aggressively for funds. Despite these signs of relative scarcity of funds, most rates remained unchanged. The climate of expectations acted like a dam holding back the pressures of fundamental forces. When the dam broke, higher rates came with a rush.

The change in expectations occurred at mid-year. In July the President announced a significant step-up in our commitment of men and material in Vietnam, and the conviction grew that the economy would not slow down as had been expected earlier but would continue to expand rapidly well into 1966. Upward revisions of spending plans for plant and equipment highlighted the growing corporate demand for funds, and fears of inflation led to speculation about the possibility of tighter money. Thus, the cyclical forces which had been held in abeyance for so long finally took hold and rates moved rapidly higher. The run up of rates in the second half resembled the sharp increases which occurred during the expansion periods of the 1950's when the economy typically operated on the verge of inflation with aggregate demand pressing tightly against the ceiling of productive capacity.

Government expenditures rose sharply in the second half. Treasury financing needs increased more than seasonally, while private demands continued strong. Business borrowing, especially from commercial banks, became very heavy, particularly in the fourth quarter when rates on Aaa corporate bonds rose above the 4½% prime rate charged by banks.

To meet this strong loan demand, banks bid aggressively for time deposit money and by early December rates on prime certificates of deposit were up against the Regulation Q ceilings which had been set in November 1964. As short-term market rates continued to rise, banks were faced with the possibility of a sharp runoff of CD's over the mid-December tax and dividend dates. The sudden shifting of a large volume of deposits from a time to demand category could have resulted in a sharp and discontinuous tightening of money and credit. On the other hand, if all the demands for borrowed money were to be satisfied at existing rate levels, the Federal Reserve would have had to increase bank reserves at an accelerated pace. To achieve an orderly tightening and to encourage banks to restore a more normal relationship between their lending rates and market rates, the Federal Reserve raised the discount rate on December 6 from 4 to 4½%, and raised Regulation Q ceilings on time deposits payable in 30 days or more to 5½%. On December 7 banks raised their prime rate from 4½ to 5%, and short-term market rates adjusted sharply higher. The three-month bill rate closed the year at 4.47%, almost 70 basis points higher than the level which had prevailed in June.

Year 1966 Until September of 1966, interest rate developments were very much a continuation of trends set in motion in the second half of the previous year. The economy continued to experience inflationary pressures, demands for credit pressed against available supply, and market participants generally expected a continuation of rising rates. This expectational pattern probably led to anticipatory borrowing as borrowers rushed to the market to beat the rise in rates. In this environment, the only significant decline in long-term rates occurred in March when the possibility of a tax increase was actively discussed. But as the likelihood of a tax increase faded, long-term rates resumed their upward march. By September, all long-term rates, including mortgage rates, had moved to new highs for the postwar period, and some to the highest levels since the 1920's.

Short-term rates also advanced in the first half, except for bill rates which were held down by strong investment demand and System purchases. Money market banks raised rates on CD's, and by June some large New York banks were paying the ceiling rate of 5½% on maturities of less than 90 days. By August this was common practice. This run up produced an unprecedented spread between short-term market rates and the 4½% discount rate.

As short-term rates advanced beyond 5½%, large commercial banks found it increasingly difficult to attract funds. The volume of CD's outstanding remained about unchanged from the end of May through mid-August when a precipitous decline began. New York banks actually began to lose time deposits at mid-year, but banks elsewhere were able to attract funds for another two months. By the end of October, large commercial banks had lost about $2.6 billion of deposits evidenced by CD's.

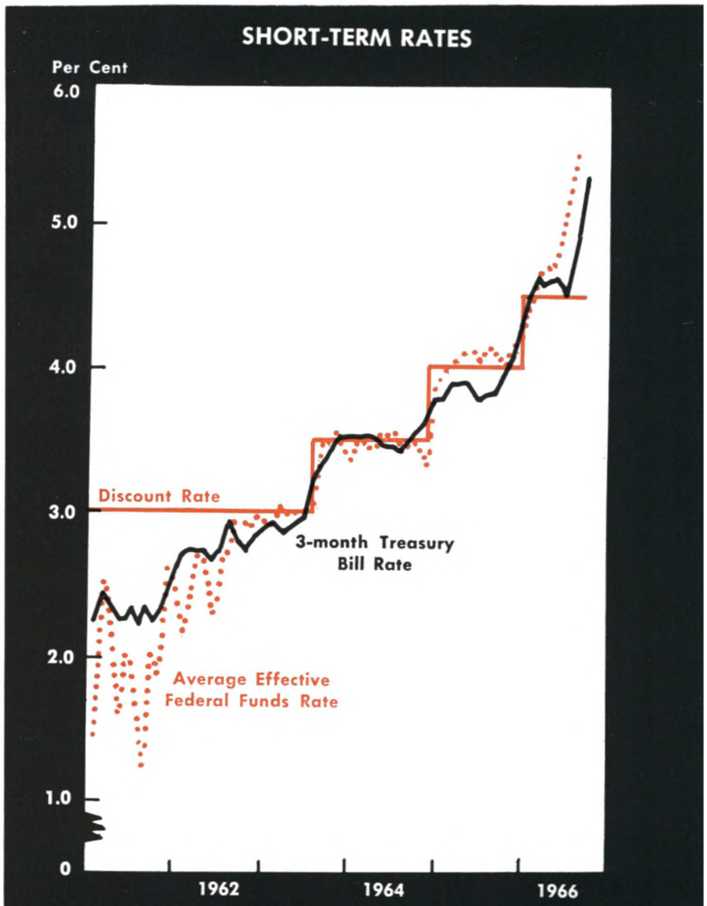
Concomitantly with the slowdown of time deposits, banks came under additional pressures from a reversal of the upward trend of Federal Reserve credit. Beginning in early May, total reserves ceased to rise and began to fluctuate around a horizontal trend line. With the demand for business loans extremely strong, banks began to bid even more aggressively for Federal funds to obtain needed reserves. The

Source: Board of Governors of the Federal Reserve System.

effective Federal funds rate climbed about 70 basis points from the end of June to early September and trading at 6 to 6⅛% became commonplace.

In August an air of deepening pessimism descended over the money and capital markets as market participants saw nothing on the horizon to lead them to expect other than rising rates. The prime rate was raised to a record high of 6% on August 16, the third increase since the start of the year, and disappointed business borrowers continued to press a record volume of securities on the corporate bond market. The market for municipals came under great strain as banks generally scaled back their purchases of new tax exempt issues and some large banks became net sellers of seasoned issues. Market jitters were aggravated by the possibility that the high and rising money market rates would prevent banks from replacing the large bloc of CD's maturing in mid-September, forcing them to meet the runoff by a wholesale dumping of municipal securities. The Treasury's August refunding, sales of $3 billion of agency issues in July and August, and prospects of further large sales of agency issues triggered a sharp rise in short- and intermediate-term Governments. Bill rates soared as investment and System demand moderated and dealer financing became more costly. On August 17 the Board of Governors announced an increase in reserve requirements from 5 to 6% on time deposits in excess of $5 million. The move was widely interpreted as another turn of the monetary screw. Finally, the obvious penetration of the wage-price guidelines with the wage settlements in the automobile and airline industries led to fears that the pace of inflation would accelerate and that monetary policy would become even tighter. There was talk in the financial press about the possibility of a financial crisis.

In early September, the situation changed abruptly. The President announced a program of anti-inflationary measures which altered the market's psychological complexion and prices rallied. The program included suspension of accelerated depreciation and the 7% investment tax credit, and a sharp cutback in agency offerings. During September and October market participants became increasingly confident that yields would not return to their highs. This was due not only to the improved outlook for a more restrictive fiscal policy, but to the emergence of some evidence of a slowing trend in the private sector of the economy. In addition, the volume of new corporate and municipal offerings receded somewhat. The effects of the change in expectations permeated all sectors of the money and capital markets. Rates of most high grade bonds retreated to levels which prevailed in the early summer, and rates on Treasury bills and other short-term Governments backed away from their August highs.



Source: Board of Governors of the Federal Reserve System.

Conclusion After prolonged stability, unusual for a period of business expansion, interest rates rose sharply from June 1965 to September 1966. While the upward march of rates resulted from fundamental conditions of supply and demand in the market for loanable funds, the rapidity of the advance was in no small part attributable to the pattern of expectations which emerged from a near uniform assessment by market participants of the interest rate implications of economic developments. Since September a number of crosscurrents have entered the interest rate picture and uniformity of expectations has given way to a wide range of views as to the future course of rates. In this environment interest rates have generally declined, but the period of decline has been marked by a few instances of rising rates. It seems that, for the moment at least, expectations have become more or less neutral and that rates are being determined to a great extent by other factors affecting supply and demand.

WASHINGTON
DISTRICT OF COLUMBIA

The District of Columbia was chartered as a city by an act of Congress in 1802 and designated as the seat of the Federal Government. This was the first instance, in the modern western world, of a city planned specifically as a national capital. After selecting a site on the Potomac River, Congress chose a French engineer, Pierre Charles L'Enfant, to plan the city. To emphasize the Federal Government as the hub of the city, he designed the city with broad avenues which radiate from the Capitol and executive mansion, a distinctive characteristic of Washington today.

Thomas Jefferson, who was influential in determining the location of the city and was the first President to be inaugurated there, had originally envisioned the city as ultimately attaining a population of 200,000. Today the city has grown to 800,000, and the entire metropolitan area has a population of over 2 million. In addition to the city itself, the Standard Metropolitan Statistical Area encompasses Montgomery and Prince Georges Counties in Maryland and Arlington and Fairfax Counties, along with the independent cities of Alexandria and Falls Church, in Virginia. The area is serviced by two major airports, seven railroads and numerous highways, making it one of the most easily accessible cities in the nation.

Characteristic of the economy is a low rate of unemployment and a high per capita income. In 1965 per capita income exceeded $3,200, among the highest of any area [illegible] nation. Unemployment rates for that year ranged around 2.4% well below the 4.5% rate for the nation as a whole. The Fede Government remains the largest single employer of the civilian la force, but industry, trade and services are becoming increasingly portant as sources of employment to the District's economy.

The communications and public ties sector is one of the fastest growing, due to population incres and a rising standard of living. The number of research andevelopment organizations has tripled in the last decade and in 63 employed 35,000 persons. Printing and publishing firms an ood products plants comprise the major manufacturing activity.

Institutions of higher learning are undant, and students may earn degrees in undergraduate, graduaand technical fields at the 21 colleges, universities and technical ools located in the area. With an increasing number of studentsontinuing their education, these institutions are planning continue expansion over the next decade to accommodate ever growing dent bodies.

As shown in the accompanying le, the Washington Area has experienced significant growth in most al sectors in the past six to eight years, in many cases sursing that for the nation as a whole.

SELECTED STATISTICS WITH RECENT AVERAGE ANNUAL GROWTH RATES

	Annual Growth Rate in the Period Indicated		Washington SMSA
	Washington	U. S.	(Most Recent Year)
Population (1960-65)	3.3	1.6	2,323,000
Civilian labor force (1960-65)	4.6	2.1	1,087,700
Wage and salary employment (1960-65)	4.8	2.0	1,067,500
Manufacturing	3.8	0.5	41,500
Nonmanufacturing	4.9	2.7	921,400
Self-employed and other workers (1960-65)	4.0	3.3	104,600
Value added by manufacture (1958-63)	11.0	6.1	$ 524,768,000
Value of retail sales (1958-63)	1.7	4.0	$1,417,703,000
Value of wholesale sales (1958-63)	4.2	4.6	$2,058,972,000
Receipts of service establishments (1958-63)	7.4	6.5	$ 432,462,000
Total taxable payrolls (1959-64)*	9.3	5.5	643,741
Total bank deposits (1960-64)	8.1	7.4	$3,180,777,400
Private bank deposits (1960-64)			
Demand	5.4	2.5	$1,745,559,500
Time	13.3	12.4	$1,080,162,600

*First quarter only.

Sources: Board of Governors of the Federal Reserve System; U. S. Department of Commerce, Bureau of the Census; U. S. Department of Commerce, Bureau of Labor Statistics; Washington Convention and Visitors Bureau.

What's Happening to our Trade Surplus?

Large and persistent deficits in the United States' balance of international payments have been a major cause for concern for a number of years. Since the end of 1957 these deficits have brought about a reduction of more than $9.5 billion in the U. S. gold stock while liquid dollar liabilities to foreigners have increased almost $13 billion.

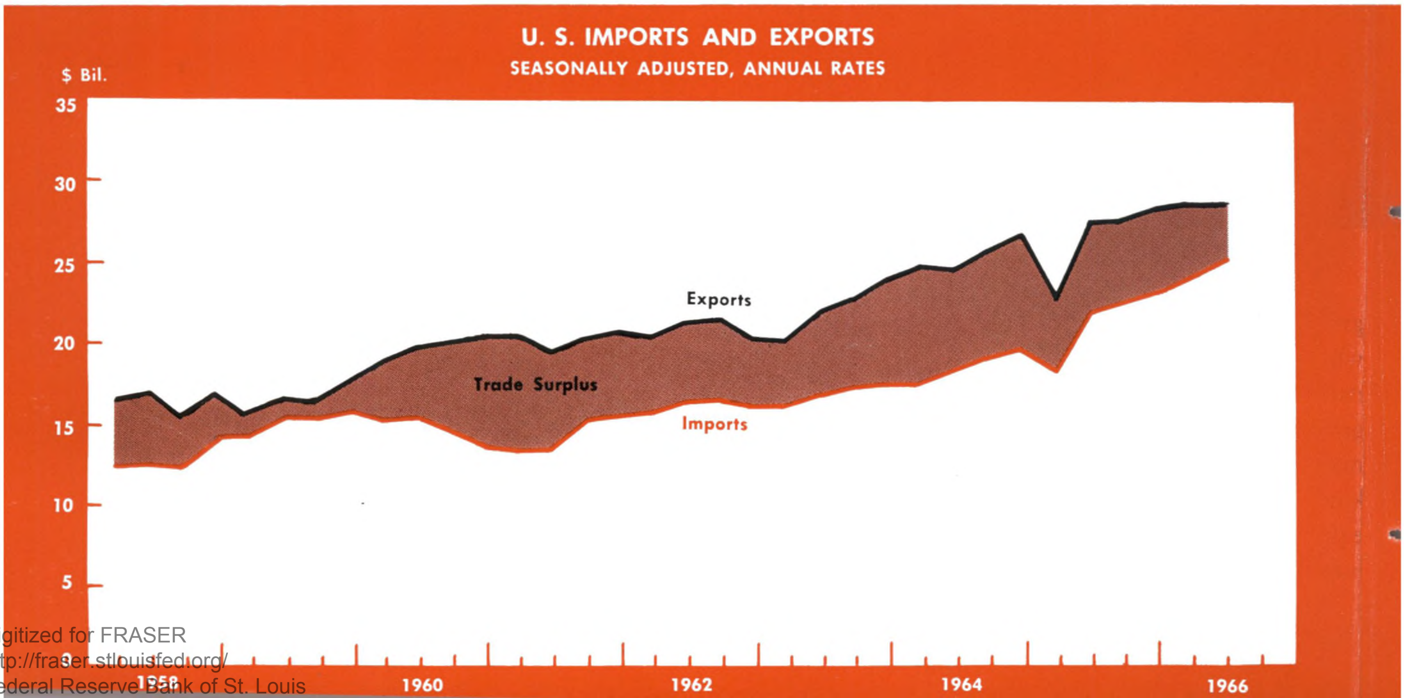
Throughout most of this period, however, the one bright spot in the balance of payments picture has been the large surplus in this country's merchandise trade with the rest of the world. After an unusually strong showing in 1957, which was influenced by the Suez Crisis, the trade surplus declined to $3.3 billion in 1958 and to less than $1.0 billion in 1959. But in 1960 it rebounded sharply to $4.8 billion and it has remained above $4.0 billion in each year since then. In 1964 it reached $6.7 billion, the largest since the early postwar years. From that point, however, it has declined steadily, falling almost $2.0 billion in 1965 and the annual rate through the first three quarters of this year was about $3.5 billion.

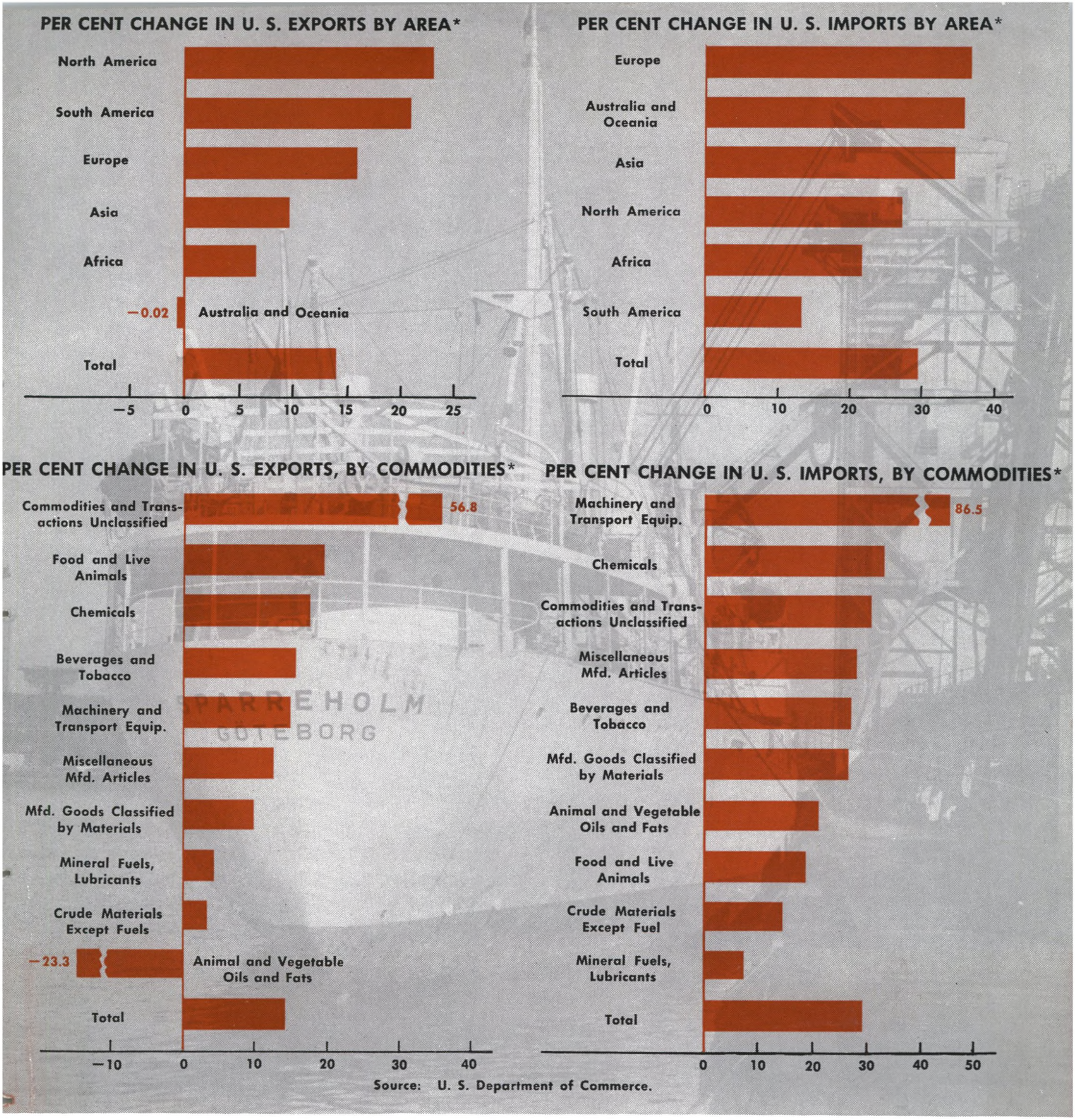
Growth in Exports and Imports As the chart on page 8 shows, the smaller trade surplus did not result from a decline in exports but rather from a sharp expansion of imports. The interpretation of data on exports and imports over the past few years is complicated by such developments as the maritime strike in January-February 1965 which sharply distorted the figures for the first half of that year. Nevertheless, the chart clearly shows that between mid-1963 and the end of 1964, exports expanded at a much greater rate than imports, but between the second quarter of 1965 and the second quarter of 1966 export growth slowed considerably while imports increased at a much faster pace.

The charts on page 9 show recent changes in imports and exports by area and by major commodity groups. The percentage changes shown on these charts compare the performance in the first eight months of 1965 with that in a base period. The base figure is the average of the totals for the first eight months of 1964 and the first eight months of 1965. Ordinarily, these changes would be computed on the basis of a comparison of performance in the first eight months of 1966 with that in the first eight months of 1965. This was not done here, however, because of the distortions in the 1965 data resulting from the maritime strike.

Total exports were about $2.4 billion greater in the first eight months of this year than in the base period, for an increase of about 14%. However, imports rose $3.75 billion, or more than 29%, so that the trade surplus was reduced in spite of a substantial increase in exports.

Changes by Major Commodity Groups The charts showing exports and imports by commodity





***Compares performance in the first 8 months of 1966 with the average for the first 8 months of 1964 and the first 8 months of 1965.**

groups and by area are based on Census Bureau data which differ somewhat from the balance of payments data shown in the chart on page 8. The export group showing the largest percentage increase is made up of transactions that are unclassified as to kind. Consisting for the most part of military equipment, this category has become an increasingly important element in our export accounts.

Other commodity groups recording better than average export gains included machinery and transport equipment, foodstuffs, tobacco, and chemicals. Machinery and transport equipment exports, totaling more than $7 billion in the first eight months of this year, accounted for more than a third of the total increase over the base period. Foreign sales of capital equipment designed to reduce production costs recorded especially large gains. Exports of computers to major industrial countries rose sharply, as did sales of air conditioning and refrigerating equipment and textile machinery. Foreign sales of construction equipment showed moderate gains, but exports of agricultural machinery increased very little.

Exports of foodstuffs showed good gains, almost entirely within the last year. About half of the recent expansion was in wheat exports, with PL-480 shipments, notably to India, and dollar sales, especially to Western Europe and Japan, rising sharply. Exports of corn and grain sorghums also increased strongly, and after a poor performance in the first eight months of 1965, tobacco exports rose substantially this year.

On the import side, no small part of the very large expansion is accounted for by a phenomenal growth in imports of machinery and transport equipment. These imports totaled almost $3.0 billion in the first eight months of this year, up $1.4 billion from the base period, with the increase fairly evenly divided between machinery and transport equipment. Imports of new automobiles in the first eight months of 1966 were almost double the figure for the comparable period in 1965, reflecting in part the effects of the agreement entered into with Canada last year. Shortages of machine tools in the United States contributed to a doubling of imports of metalworking machinery over the year earlier pace. Substantial gains were also recorded in imports of various manufactured goods, chemicals, and foodstuffs.

Changes in Major Areas The geographical pattern of trade has changed in the last year or two. In U. S. trade with three areas, Europe, Asia, and Africa, imports have grown several times faster than exports. Equally interesting, but of less importance to the balance of payments, was the decline in exports to Australia and Oceania while imports from these countries rose very sharply. Growth in trade with other North American countries was fairly well balanced, while our trade balance with South America improved.

As the charts on page 9 show, imports from Europe have grown more than twice as fast as exports. Imports from West Germany and the United Kingdom each accounted for about 25% of the total increase, with machinery (largely in the textile, metalworking, and office categories), automobiles, and aircraft constituting the most important commodity groups. Shipments of wheat, corn, machinery, and aircraft to Europe expanded significantly.

In terms of value of exports and imports, Asia is this country's third most important market, with Japan by far the most important single Asian trading partner. In fact, imports from Japan accounted for about two-thirds of the year-to-year gain for the Asian area. These included motorcycles, which doubled in value; radio and television sets; and office machinery. Exports to India, Pakistan, and several smaller Asian countries declined in the last year.

Canada accounts for about 75% of this country's exports to and imports from other North American countries, and has accounted for an even larger share of the recent expansion of inter-American trade. Sales of machinery and transport equipment made up almost 75% of the increase in exports to Canada, while purchases of automobiles and parts contributed significantly to the expansion of imports.

Cause of Declining Trade Surplus The most important single factor contributing to the declining trade surplus was the strong upsurge in domestic demand beginning in the second half of 1965. This came after four years of sustained business expansion and at a time when the economy was approaching optimum output levels. The effects are evident on both imports and exports. In the January-August 1966 period, for example, imports of consumer goods were up 46% over the comparable period of 1965, and the sharp increase in capital equipment (especially metalworking machinery) has been noted. Although exports have grown substantially, there is evidence that the strong internal demand has cut into the supply available for export, as indicated by the increase in unfilled export orders.

Significance The declining trade surplus is a discouraging turn of events in the struggle to improve the balance of payments position of the United States. For several years balance of payments programs have been aimed at improving the capital accounts, perhaps on the assumption that the large trade surplus could be counted upon to continue. The combination of the voluntary credit restraint program and tight money in the United States has achieved considerable improvement in the capital accounts. Somewhat ironically, however, the excess demand conditions which caused the tight money also appear to have been the major cause of the deterioration in the trade balance.

THE FIFTH DISTRICT

WHAT'S AHEAD FOR AGRICULTURE IN 1967?

The nation's farmers can look forward to a good year in 1967, though not quite as good as in 1966. Prospects are that both domestic and foreign demand for farm products will expand further. Gross farm income is expected to be maintained at about the record level of 1966. Rising production costs will take a bigger share of the gross, and realized net farm income may decline slightly. This, in brief, is the outlook for agriculture in 1967 as seen by leading economists of the U. S. Department of Agriculture.

In making their appraisal of farm prospects for the year ahead, these analysts assumed that general economic activity in 1967 would continue upward, though at a slower pace than in 1966. They also assumed average growing conditions and took into account the possible return to production of 25 to 30 million acres under the changed feed grain and wheat programs.

Below, in more detail, are forecasts of the Department of Agriculture.

Farm Prices, Costs, and Income Farm prices in 1967 will likely average somewhat below the improved 1966 level, primarily because of lower prices for some major crops. Livestock prices are expected to average about the same as last year. Total marketings of livestock and livestock products may show little change, but crop marketings may increase if farmers respond to the chance to produce more food grains, feed crops, and soybeans on released reserve acreage. These indications point to a possible moderate increase in total cash receipts from farm marketings in 1967. A downturn in direct Government payments to farmers is anticipated, however.

Farm production expenses are likely to rise further to another new high. Not only are prices paid likely to be higher, but farmers are also expected to increase the volume of purchased inputs. Higher interest and tax payments are also in prospect.

Nationally, realized gross farm income in 1967 is expected to be about the same as the record $49¼ billion estimated for 1966. With a continued rise in production expenses, however, realized net farm income may be down as much as 5% from the near record $16.1 billion in 1966.

Supply and Demand Conditions The 1966-67 *supply* situation for the many farm commodities varies widely, but there is generally a better supply-demand balance for most crops than a year ago. Supplies of wheat, feed grains, cotton, peanuts, and most types of tobacco are down from a year earlier. Soybean supplies are up, but prospective domestic use and exports point to close supply-demand conditions. Canned and frozen vegetable supplies are about the same as last season; those of fresh and processed fruits are moderately larger. There will be less beef, but more pork, poultry, and eggs, and a little more milk.

Demand for farm products, both at home and abroad, is expected to remain strong in 1967. Here at home a growing population, rising consumer incomes, and further advances in the business upswing are expected to increase consumer buying power and the demand for food and fiber. Little overall change in per capita food consumption is anticipated. Retail food prices are expected to continue to rise, though probably not as much as in 1966. Similarly, food expenditures are also likely to continue upward, but the rise will probably not be as great as in 1966 nor as large as the increase in disposable personal income. A slight decline in the proportion of income spent for food thus seems likely.

United States exports of farm products in fiscal 1966-67 are expected to reach a new high of $7.1 billion, an increase of $400 million over 1966. Dollar sales may total $5.4 billion—also a new record. Larger shipments are in prospect for soybeans, cotton, tobacco, protein meal, and rice. Expanded foreign trade in variety meats, vegetables, and some fruits also seems likely. And a continued high level of export trade in feed grains and poultry meat is expected.

Outlook for Commodities Highlights of the outlook for major District commodities follow:

Tobacco: The supply-demand situation for most tobaccos improved during the past year, and further progress in this direction is in prospect for 1966-67. The 1966 crops of flue-cured and burley were smaller than combined domestic use and exports anticipated for 1966-67. Carry-overs at the beginning of the 1967-68 marketing year are thus expected to decline further from their record 1965-66 levels.

United States cigarette consumption, including that of armed forces overseas, reached a new high in 1966, and some further increase seems probable in 1967. The rise in the smoking-age population, high levels of consumer income, and sizable shipments to overseas forces will likely be important factors in the outlook. Exports of unmanufactured tobacco in 1966-67 may exceed last year's low level by 15% to 20%. Contributing factors are the good quality of the 1966 flue-cured crop, the Government export payment program, and the widespread ban on Rhodesian tobacco imports.

Current indications are that price support levels for the 1967 tobacco crops will be 2% higher than those in 1966. The 1967 flue-cured crop will be grown under the acreage-poundage program for the third year. Marketing quotas for burley, Maryland, fire-cured, and sun-cured tobaccos will be announced February 1.

Cotton: The nation's 1966-67 outlook for cotton is highlighted by prospects for a sharp reduction in carry-over stocks. By August 1, 1967, the carry-over is expected to total around 12.6 million bales—down 4.3 million from the record 16.9 million bales on August 1, 1966. This is in sharp contrast to the situation of the past five years when the carry-over rose an average of about 2 million bales per year.

Factors behind this outlook are the small 1966 crop and an expected increase in total disappearance. Production in 1966 is estimated at 10.3 million bales, down 30% from 1965 and more than 4 million bales below prospective disappearance. Domestic mill consumption is expected to rise slightly, reaching the highest level since 1950-51. Exports may total around 5 million bales—up sharply from the 2.9 million exported in 1965-66. Accordingly, combined mill use and exports may rise to about 14.7 million bales, over 2 million above a year earlier.

Soybeans and Peanuts: Supplies of soybeans during the 1966-67 marketing year are estimated at a record 965 million bushels, roughly 10% above a year ago. A new high in soybean usage is expected, however, and at prices well above support. Both crushings and exports of soybeans are expected to hit new record levels in 1966-67, and another small carry-over next September 1 is anticipated.

Peanut supplies in 1966-67 are expected to be down slightly from last year's all-time high. With a higher per capita consumption rate anticipated and an increased population, total edible consumption is expected to rise. Peanut crushings for oil and meal will probably come close to last year's level, but exports may decline. Peanut prices will likely average about the same as a year ago.

Poultry and Eggs: Greater production of broilers, turkeys, and eggs is in the offing for 1967. Broiler production will likely rise about as fast as in each of the last two years, or about 5% to 10%. Expansion in turkey output will probably not be as large as in 1966 but should be around 5%. Egg production, which held steady in 1966, may rise 3%—the largest gain in over a decade.

Poultrymen are expanding output in response to a step-up in demand that raised farm prices for poultry and eggs during much of 1965 and 1966. Prospects are, however, that poultry and egg prices will probably average lower than a year earlier—at least during the first six months of 1967—as total production of high protein foods, which now seems to be increasing faster than demand, expands.

Meat Animals: Expectations are that the livestock situation for producers in 1967 will continue favorable. Cattle prices are expected to remain strong and average above 1966 as the result of reduced beef supplies and continued brisk demand. The improved outlook appears to be encouraging cattlemen to build up breeding herds again. As a result, slaughter of all classes of cattle in 1967 will probably be below that in 1966.

Hog production increased moderately in 1966 and is expected to continue to expand in 1967. As hog slaughter increases, hog prices are expected to fall below year-earlier levels. Prices should continue above those of other recent years, however. The hog enterprise thus seems likely to continue profitable.

Dairy Products: Dairy farmers can look forward to another good year in 1967. Total milk production is expected to increase moderately. With the rise in output and the trend toward marketing a greater percentage of output, larger farm marketings of milk and cream are also anticipated. The current price support level of $4.00 per 100 pounds for manufacturing grade milk has been extended through March 31, 1968. Farm milk prices rose sharply in 1966, and some further rise is expected in 1967. As the result of larger marketings and higher average prices, cash receipts in 1967 will likely rise above the record 1966 level.

PHOTO CREDITS

6. & 7. Washington Convention and Visitors Bureau
9. Chesapeake and Ohio Railway Company.

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