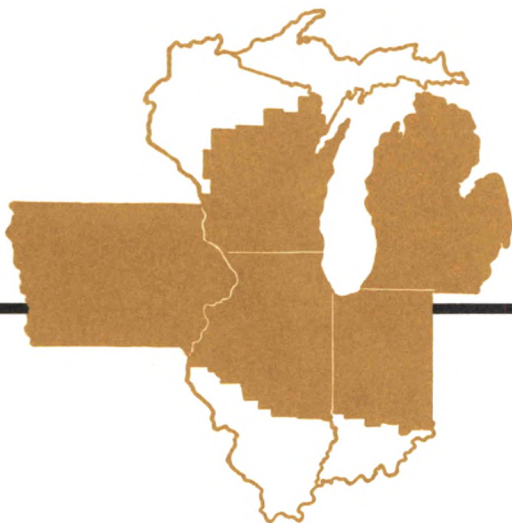


A review by the **Federal Reserve Bank of Chicago**

Business Conditions

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THE Trend OF BUSINESS

At the close of 1964, the current period of business expansion had been sustained for nearly four years without interruption. By almost any standard, the duration and performance of the climb from the low point in early 1961 was without parallel in the post World War II period. Some imbalances were apparent as the year drew to a close. In particular, some inventory buildup in steel and upward pressure on prices of a lengthening list of goods were evident.

Against this background of prolonged economic growth, a large proportion of economic projections for the year ahead, published near the end of 1964, tended to fall into two groups: those that project a continuance of the uptrend throughout 1965 and those that foresee a leveling tendency in the second half of the year.

The more optimistic forecasts reflect the view that activity in most major sectors of the economy would grow throughout 1965 at about the same rate as in 1964. The result would be a gross national product on the order of 660 billion dollars or somewhat higher—an increase of about 6 per cent, ap-

proximately the same as the increase of 1964 over 1963.

A considerable number of analysts, however, project a continuation of the current rate of expansion only through the first half of 1965, this to be followed by a leveling off or mild decline in the second half of the year. The shift in the pace of activity, according to this view, would be associated with a variety of factors, such as accelerated increase in prices, slower rise of business expenditures for plant and equipment, sharply curtailed demand for inventory and less stimulative monetary and fiscal policies. Predictions based on this line of reasoning, nevertheless, indicate a year-to-year rise in gross national product of more than 4 per cent.

Guides to policy

There are three principal methods of judging the health of the United States economy—changes in average prices, in the margins of unused productive facilities and in the extent of unemployed manpower.

Analysts are well aware that existing price indexes leave much to be desired as precise

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measures of the purchasing power of the dollar. It is difficult, if not impossible, to take into account changes in quality and the introduction of new products. In the case of wholesale prices, list prices often do not reflect promptly or fully the adjustments in the market place. Nevertheless, price indexes give a useful indication of changes in the trend of average prices. In recent months, upward pressures probably have been stronger than at any time since 1958. The major increases, however, have been confined largely to the nonferrous metals and there is, as yet, no general upward movement.

Measures of capacity in industry, like price indexes, are deficient in many respects. For example, what consideration should be given to relatively obsolete or inefficient facilities or to the possibility of adding additional shifts of workers? Nevertheless, usable estimates of capacity can be derived from available data. Except for various steel products and autos, where the pressures are temporary, and certain types of machinery and machine tools, it appears that margins of unused capacity still exist. Certainly, the situation differs markedly from the early postwar years, the Korean War or the mid-Fifties.

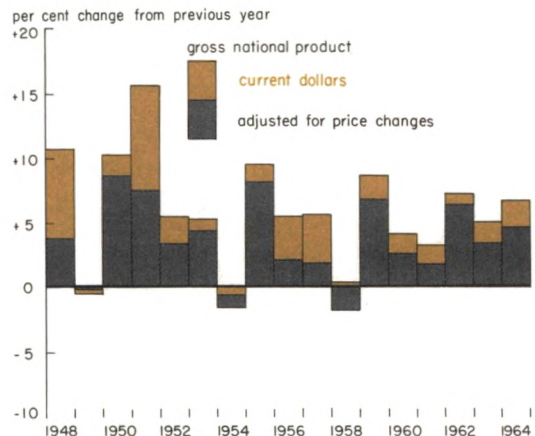
Unemployment remains at about 5 per cent of the labor force. For the Midwest, however, rates are substantially less, and there are shortages of skilled workers in the metals trades. But the cases in which production is being held back by an inadequate number of workers do not appear to be numerous. Moreover, high school and college classes in 1965 will tend to increase substantially the supply of young and presumably well educated, though inexperienced, workers.

Overall, the evidence indicates that aggregate output is not pressing tight against the potential ceiling. Moreover, there are rea-

sons for the often expressed concern that the business uptrend will not be sustained throughout 1965. The 1964 income tax cut probably has had its major impact on personal expenditures; spending by the Federal Government has leveled off and military outlays are expected to decline; output of steel and autos probably will not continue at the high December rates for many months to come; total construction is on a plateau, and residential building has been declining for several months.

But the economy has a strong head of steam. Personal income is rising and consumers have reported plans to increase spending for durable goods. Capital expenditures of business firms are expected to continue to rise for the foreseeable future. States and municipalities are not gaining appreciably on their backlogs of needs. Excise tax cuts are under consideration for 1965 and the extent and timing of these cuts could be scheduled to provide additional stimulation to the economy, if needed. Meanwhile, credit

Output has increased each year since 1958



continues to be readily available despite "a slightly less easy monetary policy."

With full appreciation for the lack of precision of present-day knowledge of our modern economy, it is readily apparent that the experience of the Fifties and Sixties has been highly favorable. The nation experienced almost continuous expansion with impressive

increases in output, employment and living standards. True, prices have tended to creep upward but this has been very gradual since 1958. The nation has achieved an unmatched period of prosperity, and there appears to be a firm basis for looking forward to a continuance of this favorable experience in the years ahead.

Agriculture—review and prospects

Farmers' incomes increased somewhat in 1964 according to preliminary estimates, and early indications suggest a similar experience in 1965. Although total realized net farm income has been close to the 12.5 billion dollar level for the past four years, income per farm has continued to advance as the number of farms has steadily declined. Also, farmers' earnings from nonagriculture activities have increased.

Income per farm from agricultural sources totaled about 3,600 dollars in 1964—about 3 per cent above the year-earlier amount. Income from nonfarm sources presently amounts to more than half of that from farm operations.

Strong demand

Demand for agricultural commodities during 1964 was strong, in part due to the marked advance in consumer income, continued population growth and further expansion in exports. Nevertheless, prices declined under the pressure of increased production, and cash receipts from farm marketings slipped slightly below the record 36.9 billion dollar level in 1963. Government payments

to farmers rose about one-fourth from 1.7 billion dollars in 1963, but this was largely offset by a further increase in farm production expenses although at a slower rate than in the past few years.

In the Seventh District

Farmers in the Seventh Federal Reserve District did not fare quite as well as those in other parts of the nation chiefly because of the greater impact of lower livestock prices. Also, unfavorable weather conditions during the critical growing stages sharply reduced crop yields in many areas of the District from the exceptionally high yields of 1963.

Cattle feeding profits continued under pressure during much of 1964, reflecting the lower prices of slaughter cattle. Farmers marketing top quality fed cattle during the first half of the year realized little or no net return from their feeding operations and many farmers suffered substantial losses. But prices improved during the summer and by fall most cattle feeders were again operating profitably.

Net income from hogs also declined. Al-

though production was slightly below the 1963 level, prices averaged lower because of greater supplies of beef and poultry. Income also was squeezed as a result of the higher feed costs.

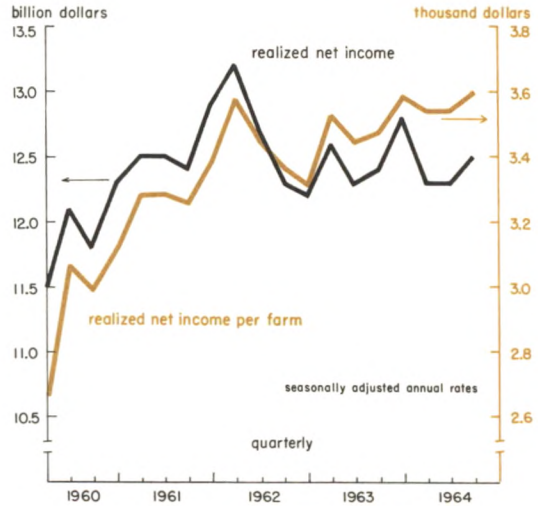
Incomes of dairy farmers were generally improved in 1964 as farmers had larger volume of marketings and received higher prices for milk. Demand for milk during the year was stronger as a result of further population growth, but large Government purchases were required to remove excess supplies from the market and to maintain prices. Government purchases amounted to about 8 billion pounds during 1964, slightly more than a year earlier.

Total crop output in 1964 was reduced from the record 1963 level. Less favorable weather conditions and smaller acreages for some crops influenced this lower output. Corn production in the District states dropped about 10 per cent from the record 1963 levels. Yields were lower in each of the Corn Belt states—declines ranged from 15 bushels per acre in Indiana to 6 in Iowa. Feed grain prices averaged slightly higher in 1964, continuing the gradual upward movement of the past two years.

Government payments to farmers participating in the 1964 feed grain program were well above a year earlier, reflecting changes in both the program and more widespread participation. Payments to District farmers for acreage idled from feed grain production were nearly double the year-earlier amount. About 8 million acres were idled in the five District states—2 million more than in 1963.

Soybean acreage was expanded further in the District states as farmers responded dramatically to the high prices during the winter and spring of 1964. Smaller yields, however, held the final production to 5 per cent below the previous year.

Income per farm continues to rise as number of farms declines



Wheat prices dropped sharply following the initiation of the new wheat program. Prices for wheat received by farmers dropped from \$1.88 per bushel in May to about \$1.33 in July, but the effects were offset, in part, by sharply increased Government payments.

Land values and farm debt up further

Despite lower farm income in the District and continued downtrend in many farm commodity prices, farmland values continued to advance in 1964. Reports of country bankers at the end of the third quarter indicated the land values in the Seventh District were about 4 per cent above the year-earlier level.

The trend in farm debt continued upward during the past year, as farmers made greater use of credit to finance agricultural production as well as the purchase of consumer goods. The increase in farm mortgage debt has been especially notable during the past

three years. The higher level of farm real estate values, increased use of credit to finance real estate purchases and an increase in the amount of non-real estate loans refinanced into longer-term farm mortgage loans have all contributed to the increase. Mortgage loan delinquencies and foreclosures, nevertheless, remained at very low levels and repayments on mortgage loans continued high during 1964, even in areas hit hardest by lower livestock prices and by drought.

More of the same?

The general economic climate in which farmers will be operating during 1965 is expected to be quite similar to that which prevailed last year. Domestic demand is expected to expand further but possibly at a slower pace than in the past year. Higher consumer incomes are indicated by the prospects for expanded business activity, high levels of employment and rising wage rates. But farmers, utilizing new technologies and improved practices, are expected to expand the total output of farm commodities further in 1965.

The U. S. Department of Agriculture concluded, at its Annual Outlook Conference in November, that cash receipts from farm marketings in 1965 probably will decline somewhat from the previous year's level. Larger Government payments—primarily for grains—are expected to maintain gross farm income near the 1964 record level. With only a slight increase anticipated in farm production expenses, total realized net farm income probably will continue close to the 12.5 billion dollar level of recent years. Income per farm likely will rise somewhat further.

Foreign trade

6 Export prospects are especially important

to farmers producing such Midwest commodities as feed grains, wheat and soybeans. Even those farmers who produce exclusively for the domestic market, however, cannot afford to overlook the export situation because prices for commodities exported often directly affect those that are not.

Foreign demand for United States farm commodities is expected to continue strong during 1965 although exports may slip from the record level in 1964. Further gains in exports of soybeans, feed grains and oils are anticipated but probably will not fully offset the expected declines in foreign shipments of wheat and cotton.

Livestock outlook improves

The outlook for Midwest farmers is heavily dependent upon livestock since income from this source accounts for about two-thirds of the total. Meat output has been increasing for the past six years but probably will dip slightly in 1965 from last year's record level: probably production of pork and lamb will decline while production of beef and veal will be only slightly higher.

Hog prices rose somewhat in the second half of 1964 and are expected to show further gains in 1965 in response to a reduction in per capita pork supplies. A U. S. Department of Agriculture survey of Corn Belt farmers in September showed a 7 per cent reduction in the number of sows farrowing in June through November 1964 and indicated that 13 per cent fewer would be farrowed during December through February. This indicates significantly smaller hog marketings through most of 1965. Profit prospects from producing hogs in 1965, therefore, appear to be considerably more favorable than in the past two years.

Cattle feeding prospects for 1965 also appear more favorable. During the past fall

feeder cattle could be purchased for \$3 to \$5 per hundredweight below the year-earlier prices, thus reducing the cost of replacement stock \$20 to \$25 per head. Primarily because of these lower prices, farmers likely will realize moderately higher returns from cattle feeding as compared with the highly unfavorable results in 1964. Barring widespread drought that would cause substantial liquidation of cattle herds, beef production is expected to be only slightly larger than last year. In that circumstance, the average level of prices for fed cattle during 1965 would not be expected to differ greatly from the 1964 average.

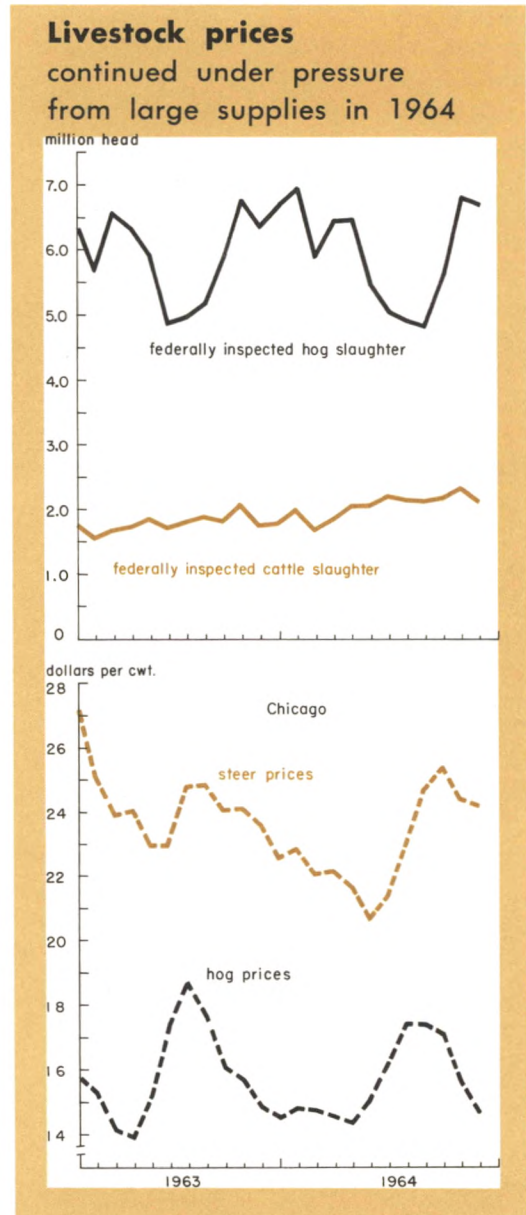
Further increases in poultry and egg production are indicated for 1965. With larger supplies, prices of turkeys and eggs are likely to decline from the 1964 levels. The expansion in broiler production, however, may be small and an anticipated strengthening in demand may result in some price improvement, although modest.

Milk production in 1965 probably will match the nearly 126 billion pounds produced in 1964. A further decline in number of milk cows is in prospect, continuing the downward trend that began following World War II. Anticipated gains in output per cow, however, due to better quality cows, higher grain rations and more efficient production practices, are expected to maintain milk production.

The demand for dairy products is expected to rise further, reflecting primarily population growth. But, as in the past several years, consumption is likely to be well below available supplies and large Government purchases will be necessary to maintain prices.

Crops

Midwest cropland is used largely to produce livestock feed. Total supplies of feed



for the current feeding year are about 5 per cent below the 1963-64 level and the smallest since 1958-59. Corn supplies—the major feed ingredient—are about 7 per cent below

the year-earlier level. Although consumption of feed and feed concentrates also is expected to be below the past year's level, primarily reflecting the reduced production of hogs, it undoubtedly will exceed the 1964 crop output and result in some decline in carryover of feed grains into this fall. Under the provisions of the feed grain program, the Commodity Credit Corporation's minimum sale price of "certificate" grains must equal the loan rate plus allowances for season and location. The higher loan rates for 1964 crops, as well as an increase in carrying charges, will give higher minimum prices for CCC sales this year and probably will push prices above the year-earlier average.

Production and marketing of the 1965 feed grain crop will again be covered by a Government program similar to that of last year. Price support loan rates for 1965 crops were reduced, but compensatory payments were raised. (For corn, the loan rate was lowered 5 cents to \$1.05 per bushel while the compensatory payment was increased to \$1.20 from \$1.15.) Also, for the first time, farmers participating in the feed grain and wheat programs may substitute wheat and feed grain acreages. If the drought conditions which prevailed over many sections of the country during the fall of 1964 should continue through sign-up time, a further increase in participation in the Government program may occur. This would tend to reduce production of feed grains.

Soybean production has followed an upward trend, and a further increase in acreage is in prospect for 1965. Supplies of soybeans

for the current year are estimated at about 732 million bushels, 2 per cent more than last year's total and about in line with the expected expansion in foreign and domestic demand. Because of the close balance between supply and demand, soybean prices to farmers are expected to continue strong averaging substantially above the support price of \$2.25.

Wheat supplies continue large but are well below a year earlier. Domestic consumption is expected to be somewhat larger in 1965, reflecting an anticipated sharp increase in wheat fed to livestock. Exports, however, are expected to decline as purchases by the Soviet Union have been terminated.

Farmers producing winter wheat have agreed to idle about 5.5 million acres under the Government's 1965 program. This is well above the total acreage of both winter and spring wheat idled under the 1964 program. Even allowing probable spring wheat participation, total wheat acreage may be somewhat larger than last year. This prospect is indicated by two changes in the provision of the 1965 program: substitution of wheat on feed grain acreage for farmers, who have both a wheat allotment and a feed grain base, and overproducing the farm wheat allotment under certain conditions without losing eligibility for price support loans and marketing certificates.

In brief, the overall outlook for agriculture in 1965 could be characterized as one of little change from the past year although sizable shifts may occur for individual areas, crops and classes of livestock.