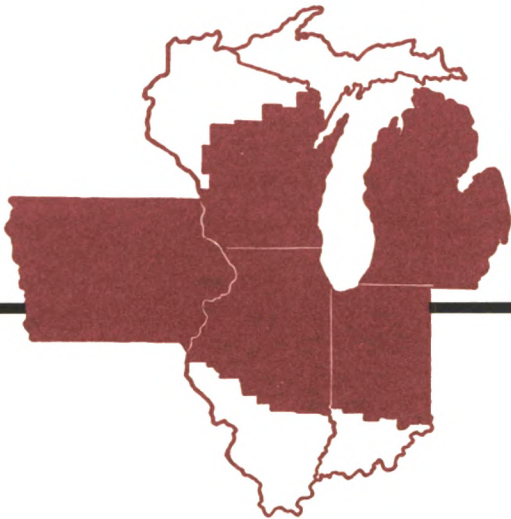


A review by the **Federal Reserve Bank of Chicago**

Business Conditions

January 1969



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THE Trend OF BUSINESS

The new year begins with growing expectations that the patterns of 1968 will be repeated. The outlook is for rising income, higher output, continued pressures on labor resources, and further price inflation. Such prospects may be modified by policy actions, but the momentum generated recently will probably not be dissipated quickly.

Partly because of confidence that fiscal restraints enacted in mid-1968 would eventually take hold and partly because of leveling in some measures of activity, it was widely believed midway in the fourth quarter that the rate of increase in spending was slowing. A marked weakness in business activity, moreover, was indicated by some widely publicized forecasts for the first half of 1969. A revival was projected for the second half, provided fiscal policy was shifted from restraint to stimulus. But in the last weeks of 1968, a wide variety of key business indicators showed renewed strength in spending.

In December, substantial increases in employment, output, construction, income, and prices were reported for October and November. Demands for credit, orders for manufactured durable goods, construction contracts, and investment plans of consumers, businesses, and state and local governments all suggested a continued strong demand for goods and services in early 1969.

Spending and inflation

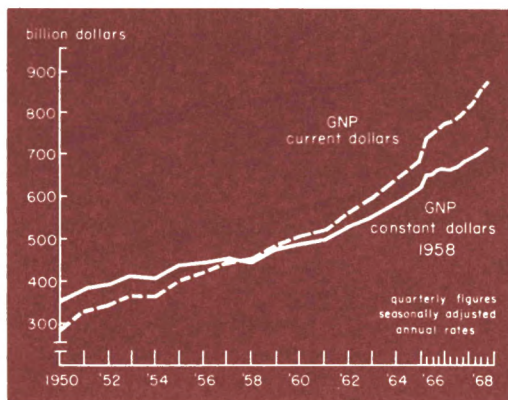
Gross national product—total spending on goods and services—apparently exceeded

\$860 billion last year—9 percent more than in 1967. Higher physical output accounted for about 5 percent of the increase. The other 4 percent could be traced to higher prices.

Output increased about as much as the limits of labor resources would allow. The increase in prices was a disappointment, especially in view of the hope at the start of the year that the inflation spiral would be moderated. The price advance accelerated for the sixth year in a row. The major categories of expenditures—consumer outlays, business investment, and government expenditures—grew about as fast as the total. Purchases of durable goods by consumers rose 14 percent, largely reflecting the surge in auto sales.

On the basis of annual rates, total spending

Rise in total spending in recent years partly reflects higher prices



increased about \$20 billion in the first quarter of 1968 and somewhat faster in the second quarter. In view of the need to dampen inflationary pressures, such a rapid rise—an annual rate of about 10 percent—was clearly excessive. The fiscal package enacted in June, increasing federal taxes and slowing the rise in federal expenditures, was also expected to slow the rise in nonfederal spending.

There was a further expectation that the dampening influence of restrictive fiscal measures would be strongly reinforced after the deadline for a steel strike August 1. Output of steel was certain to decline as inventories of steel were reduced. Many feared the combination of these forces would cause a leveling, or even a decline, in total activity and a sharp rise in unemployment—a possibility characterized as “overkill.”

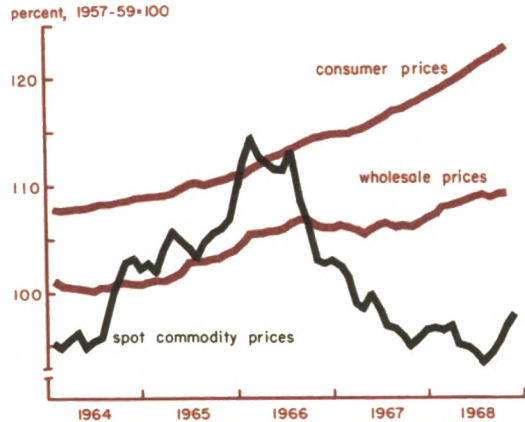
Total spending did slow in the third and fourth quarters, but only slightly, and the rate of gain remained in excess of 8 percent. Moreover, the only spending sector that showed a marked reduction in the rate of rise was the federal government, which curtailed military and other spending programs in accordance with a congressional directive. Non-federal spending increased even faster in the second half of the year than in the first.

Consumer buying the focal point

Far from being deterred by the 10-percent surcharge, consumers stepped up their purchases in the third quarter. As a proportion of after-tax personal income, savings had averaged above 7 percent in 1967 and the first half of 1968. This rate apparently declined 1 percent in the second half, which was enough to offset the impact of the tax increase on consumer outlays. In part, the reduction in saving reflected a faster rise in nonmortgage debt.

All major types of retailers shared in the

Price inflation continued rapid pace in 1968



rise in consumer buying. Substantial boosts were reported for sales of apparel, general merchandise, television sets, household appliances, and furniture. The increase in auto sales was especially noteworthy. From July through December, year-to-year increases in retail sales were more than gains in after-tax income—a rare development in the 1960s.

Consumer purchases, together with the business investments in inventory and plant directly related to consumer purchases, account for about 70 percent of all spending on goods and services. Even slight changes in spending relative to income, therefore, have an important impact on the total economy. A number of times in recent years, retail sales have leveled or even declined for two or three months only to ratchet up again. Some analysts emphasized the small September and October declines in retail sales from the extremely high August level as a bearish factor. But November saw another jump to a new record. Preliminary indications showed sales fairly strong in December, with many con-

sumers "trading up" to higher priced merchandise.

Inventory investment

One of the principal destabilizing influences in postwar business cycles has been the change in the rate of business inventory investment. Sharp changes have usually reflected changes in the trend of consumer purchases, although to a magnified extent.

Such a development came in the fourth quarter of 1966, when the failure of retail sales to match expectations was a major cause of the spurt in business inventory investment to the extremely high annual rate of \$20 billion. A similar development in the opposite direction came in the first quarter of 1968, when sales rose more than expected and inventory investment declined to the very low rate of less than \$2 billion.

Business inventories now have a book value of more than \$150 billion, which means that keeping inventories abreast of sales at recent rates of increase requires a rise in investment at an annual rate of about \$12

billion. Actual rates of inventory gain were only about half that much in 1967 and 1968, with the result that the ratio of inventories to sales has tended to decline. In recent months, the ratio for retailers has been near the post-World War II low.

The rate of inventory investment was at \$10 billion in the second quarter of last year, which in view of the buildup in holdings of steel, was not especially fast. Some expected the decline in steel inventories, coupled with other contractionary developments, to reduce total inventory investment to very low rates in the third and especially the fourth quarters. But the rate of business inventory investment dropped only to \$7 billion in the third quarter and was apparently at least as great in the fourth quarter.

Reports of increased inventory investment in late 1968 indicated voluntary attempts to increase stocks in line with prospective sales. This was quite unlike the situation two years before, when accumulations were involuntary. Moreover, by historical standards, ratios of stocks to sales remain low.

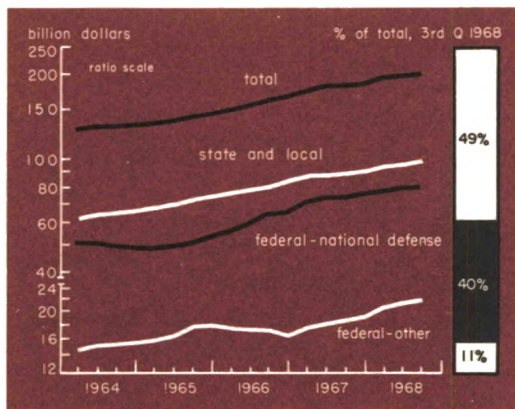
Plant and equipment

Where consumer purchases held the spotlight in the third quarter, attention in the fourth shifted to business investment in plant and equipment. Such outlays are of special interest in the five states of the Seventh District, which together produce a third of the nation's machinery and equipment.

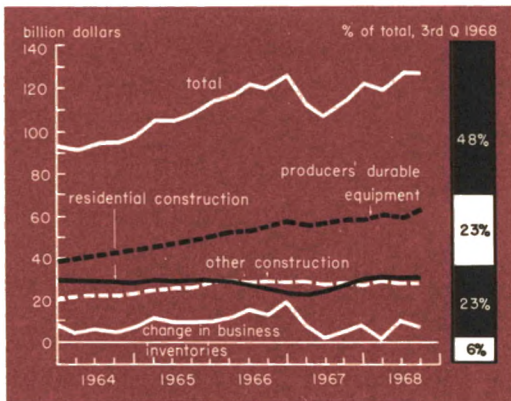
Expenditures for plant and equipment led the upswing in the private economy in 1964-66, rising twice as fast as total expenditures. But from late 1966 until recent months, business fixed investment had been sluggish, rising only about half as much as total spending.

These outlays declined in the second quarter of last year partly because of strikes in the construction industry. The third quar-

Rise in federal expenditures slowed in the third quarter



Investment expenditures in uptrend since mid-1967



ter saw the beginning of a recovery that accelerated sharply in the fourth quarter.

Private surveys taken in the summer and early fall indicated a 6-to-8 percent rise in outlays for plant and equipment in 1969. Results of a later, more comprehensive government survey released in mid-December indicated that outlays in the first half of 1969 would be 10 percent higher than in the first half of 1968. The increase could be even larger for the year as a whole. Such surveys have tended to underestimate final results in periods of rapid expansion.

Public utilities and the airlines increased their spending for plant and equipment substantially last year. Other major industries, including the various manufacturing industries, did not increase their outlays. With the increases in equipment prices and construction costs, there was an actual decline in physical volume.

The increase in plant and equipment expenditures in late 1968 and the increase projected for early 1969 are not only large but also broadly spread through industry groups. Even the railroads, which curtailed their in-

vestments in 1967 and 1968, are participating in the upturn.

Some have cited estimates of unused manufacturing capacity as evidence that the renewed strength in plant and equipment indicated by surveys will not be realized. But companies know that many of their existing facilities fall short of current standards of quality and efficiency. Rapid increases in production costs (especially labor costs), shortages of labor, expectations of further price increases on plant and equipment, and the need to offer competitive delivery times and quality make many new investments essential. Better-than-expected profits are also helping boost plans for new expenditures.

Construction vigorous

Construction activity was hampered last year by strikes in the building trades. After settlements of these disputes, outlays on new work rose to an annual rate of more than \$88 billion in the fourth quarter—up about 10 percent from a year earlier. But perhaps 6 percent of the rise represented higher costs.

Both residential and nonresidential construction increased last year, the strongest rises coming in apartment buildings and commercial structures. Many federal projects were postponed—some of them partially completed—and some nonfederal jobs were held back by rising costs.

There was concern early in the year that a shortage of credit would limit construction, but labor was actually the bottleneck. Carpenters, electricians, iron workers, bricklayers, plumbers, and welders were all reported in short supply. New construction techniques helped maintain activity early in the winter, and contractors' problems keeping adequate crews became even more difficult late in the year.

Shortages of workers were especially severe

in the large metropolitan areas of the Midwest, East, and South. Among these centers were Chicago, Indianapolis, and Detroit. The situation was aggravated in Michigan by a long work stoppage in the spring and early summer. Heavy demands for labor were reflected in increases in worker compensation. Under settlements reached last year, increases for the building trades averaged about 8 percent, and most of these contracts were made for three years.

Demand for residential construction was boosted by low vacancies, an increase in marriages, and rising incomes. The Midwest, and particularly the Chicago area, had especially strong housing markets, with sharp increases in prices of existing homes.

Increases in usury ceilings in some states, a growing acceptance of higher mortgage rates by borrowers, and widespread expectations of further increases in building costs helped maintain the flow of funds to single-family home construction. The proportion of new dwelling units represented by apartments widened, however, partly because of funds supplied by life-insurance companies and other institutional lenders that no longer make a large volume of mortgage loans on single-family homes.

Housing starts exceeded 1.5 million, compared with 1.3 million in 1967 and 1.2 million in 1966, when credit stringencies limited new work. Housing starts jumped to a rate of almost 1.7 million in November.

Construction contracts reported by F. W. Dodge were very large last year. Nationally, for the first 11 months, contracts were 13 percent above the 1967 high. In the Midwest, where the higher rate of performance began earlier, contracts in the first 11 months were 7 percent higher than in 1966. Contracts for apartments and commercial buildings lead the boom.

Because of the expected continued rise in marriages, demolitions, and upgrading of requirements, need for new housing remains substantial. Many public construction projects, including the interstate highway program, have been delayed, despite urgent needs. Plans for new factories and other industrial buildings appear to be increasing. Office space is tight. And vast new urban rehabilitation programs are in various stages of planning or implementation. Barring a significant tightening in the availability of mortgage funds, construction resources will probably continue to be fully used in 1969.

Industrial production spurts

Industrial production began to rise steeply after a dip in August associated with the conclusion of wage negotiations in the steel industry. The Federal Reserve Index of Industrial Production, which measures the physical output of factories, mines, and utilities, reached a new high of 167 in November, based on a scale of 100 for 1957-59. That represents a gain of 5 percent over the year before. Roughly the same rise was probably achieved for the year as a whole.

Gains in output were widespread in both durable and nondurable goods. The most significant increase was in business equipment, which had continued on an irregular plateau for more than a year after receding from a peak reached in late 1966. Production indexes for motor vehicles, household appliances, and furniture either increased or held at fairly high levels. No appreciable weakness has developed in any important industry.

The rise in industrial production was accompanied by increases in orders to manufacturers, which rose sharply in October and remained at a high level in November. Backlogs of orders were also increasing in the fall. Most manufacturers had maintained

delivery schedules at year-end, but continuation of the uptrend in orders could cause a stretchout of lead times.

Surveys of manufacturers indicate substantial increases in demand for their products in 1969. Of the purchasing agents in the Chicago area, 87 percent expect sales to be higher this year, compared with only 2 percent foreseeing a decline. Such confidence is expressed in higher orders to suppliers and steps to increase recruitment of personnel.

The rise in industrial production last year about equaled the rise in total spending on goods and services, adjusted for price changes. Trends in orders and indications of further strength in consumer and business spending on goods suggest a further rise in industrial production this year. Increases in capacity, estimated at about 5 percent a year, indicate that a similar growth in physical output could be achieved. But an increase approaching the 8 and 9-percent gains recorded in 1965 and 1966 would probably be

possible only if manufacturers bid aggressively for additional workers in an already tight labor market.

Job markets tighten

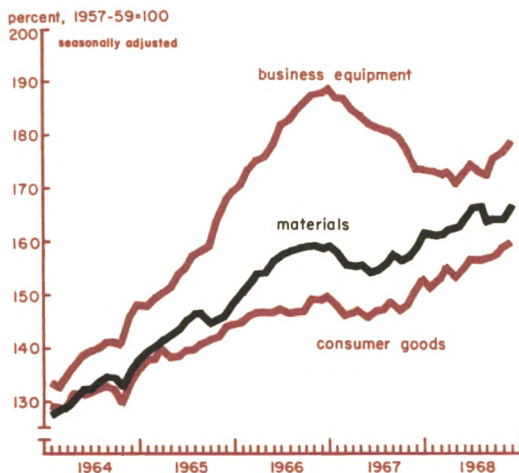
A spectacular development of late 1968 was the decline in the nation's unemployment rate to 3.3 percent of the labor force in November—the lowest level since the Korean War. All major groups of workers—men and women, teenagers and adults, whites and nonwhites—had smaller ratios of unemployment in November than in October. Rates were especially low in the Midwest, where some employers considered demand for workers, skilled or trainable, the strongest since World War II.

The proportion of covered workers receiving unemployment compensation in late November was 1.8 percent for the nation, 1.6 percent for Michigan, and only about 1 percent in Illinois, Indiana, Iowa, and Wisconsin. These rates were all below the levels of a year before and near all-time lows. Only experienced workers, of course, are eligible for unemployment compensation payments. An unemployment rate of 12 percent for people 16 to 19 years old includes many who have never held permanent jobs.

Total employment was estimated at more than 76 million in November—up 1.4 million from a year before. Employers reported employment of wage-and-salary workers totaling over 2 million more than a year before, which may have indicated a further rise in the number of people holding more than one job. Increases in employment in the Midwest were slightly less than for the nation. This, however, reflects not a lack of employment opportunity in the Midwest but greater pressure on the available work force.

Employment increased some last year in almost all manufacturing industries. The

All major sectors of industrial production rose in late 1968



largest increases, however, were in retail trade, the service industries, and in state and local government. Employment by the federal government was down slightly in November from a year before and more than 90,000—or 3 percent—from the peak reached in June.

Projections a few months ago that personal income would rise only slowly in the fourth quarter were based on expectations that employment would level off or decline slightly. Instead, employment increased at least as fast as in the early part of the year.

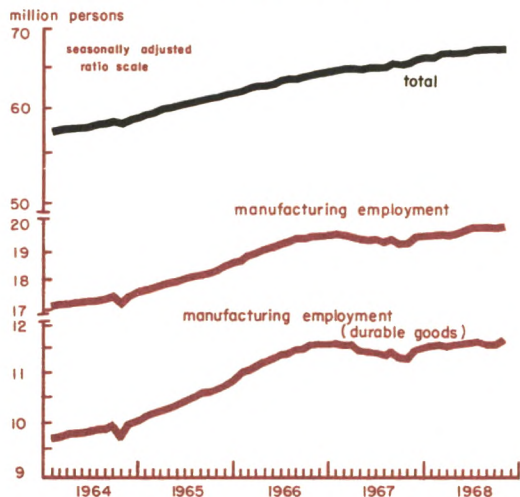
A survey of metalworking companies published in *Steel* magazine in December showed “man power shortages” as the hardest problem these companies expect to face in 1969. Tight labor markets have the effect of increasing absenteeism and turnover, thereby hampering improvements in efficiency.

Collective-bargaining settlements negotiated in the first nine months of last year called for annual increases in compensation of 6 percent. As recently as 1965, negotiated increases in compensation (wages and other benefits) averaged 3 percent, which about matched the growth in output per manhour. Increases granted nonunion workers have approximated those obtained through collective bargaining, and there was no indication at year-end that the uptrend in worker compensation was tapering.

Price rise unabated

The 4-percent rise in the general price level last year, as measured by the gross national product index, was the largest since 1951, the first full year of the Korean War. Toward year-end, additional price increases were being posted for a wide range of products and services, as, for example, chemicals, paper products, building materials, imported autos, metals and metal products, and public

Total employment rose again in 1968 and downtrend for manufacturing was reversed



transportation. Price declines were scattered and relatively unimportant. Much of the sharp reduction in prices of hot rolled steel sheets in November was rescinded in December.

Consumer prices rose about 4.5 percent, compared with less than 3 percent in 1966 and 1967 and less than 1 percent in the early 1960s. At times during the year, consumer prices rose at an annual rate of more than 6 percent, partly because of higher interest charges on home mortgages. Every month, hundreds of thousands of workers are granted wage increases based on the rise in “the cost of living,” the consumer price index of the Bureau of Labor Statistics. This index has increased at least one-tenth of a percent every month since January 1966.

In November, the average of all consumer prices was 4.8 percent higher than a year before. The largest increases were for costs

of home ownership, restaurant meals, and medical care, but every grouping of cost was at least somewhat higher than a year before.

Resistance to price increases was weakening late in the year, replaced increasingly by attempts to maintain buying power by raising selling prices or obtaining wage increases. In short, attitudes of consumers and businessmen alike were increasingly dominated by expectations of still further price increases.

Auto sales surge

Sales of cars and trucks, including imports, were at all-time highs. Output, although up sharply from 1967, was slightly below the 1965 record.

At the start of the year, industry analysts typically foresaw sales of no more than 9 million cars and 1.6 million trucks. But as the year moved ahead, sights were gradually raised. Final results showed auto sales exceeding 9.6 million and truck sales exceeding 1.8 million.

Auto sales were less than expected in the first quarter, partly because shortages of some models persisted as local-issue strikes hampered production. The real strength of the market was not evident until May, when daily average sales hit a record high. Sales records were also set in June and July.

Some skeptics saw the summer surge in sales as only a temporary development stemming from industry's efforts to reduce heavy inventories of 1968 models before introducing 1969 models. Special incentives, in the form of rebates to dealers and contests for salesmen, were used to boost summer sales. But sales were also high in the fourth quarter.

Heavy use of instalment credit was involved in the record sales. Largely because of increased use of credit in purchases of automobiles, total instalment credit outstanding rose 10 percent, compared with only a

4-percent rise the year before.

Sales of imported cars exceeded 950,000, far more than ever before. The proportion of imports to total car sales was about 10 percent, twice the proportion in 1963 and the largest since the peak reached in 1959. Not included as imports were cars built in Canada by subsidiaries of U. S. companies. Sales of Canadian autos also increased under terms of a trade agreement. By far the largest share of the imports from Western Europe and Japan were small cars of a type not made in this country. The large U. S. auto makers plan to introduce similar small cars starting this year.

Truck sales were boosted by consumer purchases for recreation or other personal uses that may have reached 200,000 units. Sales of heavy trucks for construction and highway hauling also were strong. A large increase was also recorded in sales of truck trailers.

Output of motor vehicles was almost 11 million in 1968, just short of the 1965 record. Truck assembly reached a new high of more than 1.9 million, but at 8.9 million, output of cars was second to the 9.3 million produced in 1965. Imports of cars were less important in 1965, and dealer inventories rose more than in 1968.

Officials of the auto industry appeared confident at year-end that sales this year would not fall much below those of last year, and might equal them. Experience with such forecasts shows them subject to change, however, as sales strengthen or weaken. Tentatively, output of cars in the first quarter is scheduled to exceed the near-record 2.3 million of the same period of 1968.

Steel output recovers

Steel orders and output recovered much faster than expected after negotiations of a new labor contract last summer. Orders

began improving in September, and output advanced in October. The uptrend gathered momentum in the last months of the year, and workers laid off in the late summer were recalled. The recovery—in orders and output—was much faster in the Chicago and Detroit areas than in the rest of the nation.

Inventories of manufacturers using steel increased from 9 million tons at the start of the year to 15 million at the end of July. As steel shipments declined sharply and usage continued high, inventories were reduced to 12 million tons by the end of October. The total was still higher than normal, relative to consumption, but imbalances in inventories caused many users to begin reordering certain types of steel.

The recovery was more rapid than in 1965, another year when inventories were increased in anticipation of a strike. The buildup of inventories was less than in 1968, and the usage of steel was greater.

Production of raw steel exceeded 130 million tons, about the same as in 1965 and close to the record in 1966. Shipments of finished steel from the mills totaled more than 91 million tons, which was second only to the 1965 high of 93 million. (Because of scrap left in the mill, shipments average about 70 percent of raw-steel output.)

Steel produced domestically was supplemented by more than 17 million tons of steel from Japan and Western Europe. Imports increased 50 percent from the record level set in 1967 and amounted to about 16 percent of domestic supplies. As recently as 1964, imports accounted for only 7 percent of the total supply. Ten years ago, they were less than 3 percent.

Steel users received a total of 107 million tons from both domestic and foreign suppliers—far more than ever before. Had steel imports remained at the level of the 1950s,

production, employment, and profits of U. S. producers would have been much larger in recent years. As a result, there have been strong pressures for restrictions on imports.

Foreign producers have recently appeared prepared to limit imports into the United States voluntarily rather than risk a resurgence of protectionist sentiment. Meanwhile, most large steel companies are trying to diversify their operations into more profitable activities not related to steel.

Future steel demand, like auto sales, will depend largely on the prosperity of the whole economy. Counting on another large rise in total spending this year and effective limitations on imports, most industry analysts expect steel output and shipments to at least equal last year's totals.

Prospects for 1969

The season for business forecasting begins in the early fall and continues through January. During that time, a procession of economists and organizations publicize their projections of activity for the year ahead. Some offer only a single figure for total spending, auto sales, or steel output. Others prepare comprehensive tabulations with detailed breakdowns of expenditures, financial flows, and industrial production.

Despite the plethora of independent efforts, a “standard,” or consensus, forecast usually begins to emerge early in the new year, partly because forecasters have, like most mammals, a protective herding instinct. A year ago, the consensus understated the rise in activity and the amount of inflation that would develop. But the performance was not bad, compared with some years.

The standard forecast for 1969 foresees about a 4-percent rise in physical output and a 3-percent rise in prices pushing total spending to \$920 billion. Such a projection can be

approximated by averaging the results of the past several years.

Individual bankers and businessmen can heed the standard forecast as a general guide for planning. But they would do well to stay alert to changes in the environment as the year advances. A new Administration is formulating programs that will influence events increasingly as time passes. A new Congress will try to legislate changes to past trends considered unsatisfactory. And regulatory agencies are re-examining past patterns of policy-actions. By and large, all of the public bodies are dedicated to the search for means to brake (not break) the inflation. Meanwhile, consumers, businessmen, and

financial managers are making adjustments to better cope with the problems of a full-employment, inflation-prone economy. Through the interaction of these public and private decisions, economic trends may diverge substantially from the path commonly projected.

Inflationary forces may be brought under control in 1969. What seemed to be inexorable, uncomfortably steep uptrends in prices have been reversed three times since World War II—in 1949, 1954, and 1958. In each case, the uptrend in prices ended in business recession. A recession can probably be avoided, but even a slowing of the rate of increase in activity would find some sectors vulnerable.

Farm outlook

The farm economy bounced back in 1968 from its slowdown the previous year. Bolstered by higher prices for many agricultural commodities and more liberal government payments, gross income to farmers rose to nearly \$51 billion—almost \$2 billion more than in 1967 and over \$1 billion more than the record set in 1966.

Production expenses also advanced, but considerably less than in the preceding two years. As a result, net farm income increased from \$14.2 billion in 1967 to nearly \$15 billion, making 1968 next to the highest paying year for farmers since the early 1950s. Only in 1966 was net income better.

The number of farms continued to decline, resulting in higher incomes for those remaining. Income per farm rose nearly \$375 from the year before, to around \$4,900, an amount exceeded only by the 1966 average of \$5,000.

Farmers' nonfarm earnings also advanced as the booming nonagricultural sector of the economy provided abundant opportunities for employment off the farm. As a result, disposable income per person living on farms rose to an estimated \$2,200—about 8 percent more than in 1967 and about twice that at the beginning of the decade.

Not as good in district

Farmers in the states of the Seventh District generally fared less well than those in the nation as a whole. But the trends were different for different types of farmers. Live-stock feeders had generally higher incomes, as did dairymen. And while incomes of poultry producers were low at the beginning of the year, they improved as the year progressed. Crop producers, however, were plagued with low prices, reflecting the record

supplies from 1967 and the bumper crop harvested in 1968.

Livestock profits up . . .

Fattening of cattle was generally more profitable than in 1967. Prices for high-quality "fed" cattle averaged higher, while costs of both feed and feeder animals were lower. Although slaughter weights averaged slightly less than the year before, largely reflecting the big increase in heifer slaughter, total beef production was nearly 4 percent higher. While the supply increased about 3 pounds per person, very strong consumer demand—strengthened apparently by rapidly rising incomes—nevertheless pushed beef prices higher than the year before. Prices of choice cattle at Chicago, for example, averaged nearly \$2 per hundredweight higher than the year before.

Hog prices were also bolstered by very strong consumer demand. Although averaging slightly less than in 1967, pork prices

were still fairly strong—especially in view of the more than 3-percent increase in production. Production increases are typically associated with fairly large declines in prices. With fairly stable prices and increased production—along with lower feed costs—hog producers had better incomes than in most recent years.

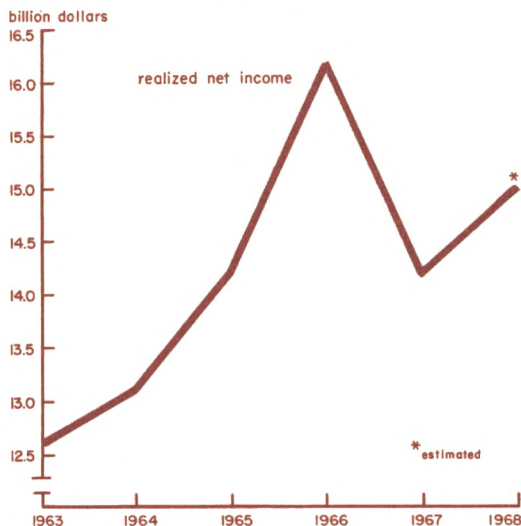
Incomes to poultry producers varied widely. The year started with supplies of poultry and eggs large and prices depressed. But profit margins improved as supplies were gradually worked down and production adjusted to the lower prices. In the fourth quarter, egg prices were about 30 percent higher than a year before and broiler prices were up about 10 percent. While turkey prices were still less than in 1967, they were over 20 percent higher in the fourth quarter than at the start of the year.

Dairy farmers also benefited from higher prices. Their gain, however, reflected the increase in the government price support, rather than improved demand. The support price for manufacturing milk was raised in early April from \$4.00 to \$4.28 per hundredweight. Demand for dairy products declined, partly because of higher prices and partly because of increased use of substitute products. To maintain prices at the higher level, it was necessary for the government to remove large amounts of dairy products from normal market channels, even though the output of milk was less than the previous year. The number of dairy cows continued to decline but not as fast as in other recent years, apparently because of the more favorable milk prices.

. . . but crop profits down

Crop farmers, on the other hand, were plagued by lower prices for the major Midwest crops—corn and soybeans. Prices re-

Net farm income up in 1968

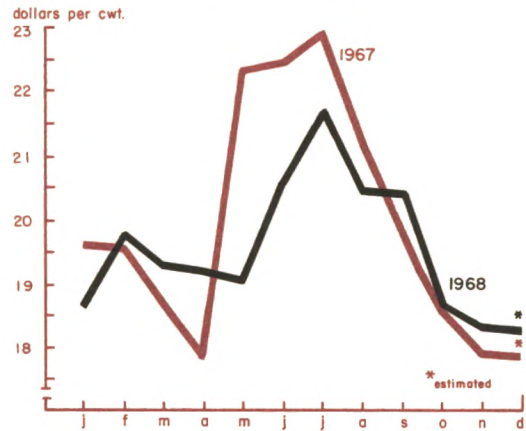


flected the large carryovers from the bumper harvests in 1967 and the large crops grown in 1968. Corn prices at Chicago averaged around \$1.14 per bushel for the year—16 cents less than the year before and the lowest average since 1962.

Prices of soybeans averaged about 14 cents lower. Despite lower prices through the planting season, soybean acreage was expanded further, especially in the Midwest. Acreage was up nearly 6 percent or more in states of the Seventh District and 3 percent nationally. Because of the large acreage and increased yield, production for the first time totaled more than a billion bushels—about 11 percent more than in 1967.

Higher government payments and poor price prospects induced feed-grain producers to divert a record acreage from production. Despite a 7-percent reduction in the acreage of corn harvested, another year of favorable weather combined with continued improvements in farming practices to push yields per

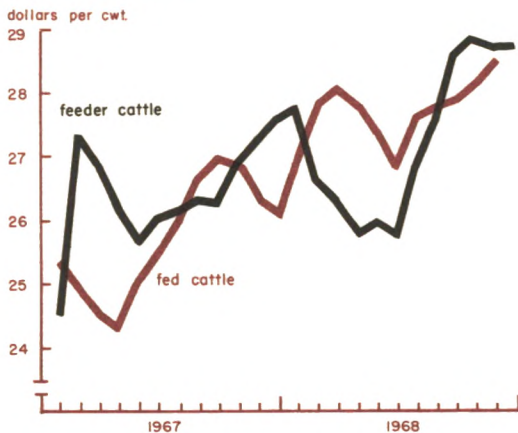
Hog prices were strong and more stable in 1968



Note: Prices at Chicago.

acre of the Midwest's principal feed grain to record highs in every state of the district but Illinois. As a result, production of feed grains in the district was only 5 percent less than the bumper crop in 1967. For the nation, production was down only 3 percent.

Cattle feeders' margin less favorable



Note: Prices are for choice grades—fed cattle at Chicago; feeders at Kansas City.

Capital expenditures lower

Many farmers' investment decisions were apparently influenced by the less favorable conditions surrounding grains. Expenditures for most major categories of capital items were off from the relatively high levels of the two preceding years. Through October, tractor purchases, a major capital expenditure, were running about 23 percent less than the year before. Purchases of combines and balers, also big expenditure items, were off 15 percent and 7 percent, respectively.

In addition to the less favorable situation in grains, the market for farmland was also influenced by continued tight credit. Pressures to enlarge farms continued strong, but because of reductions in offerings as well as

demand, transactions were fewer. Although land prices in Illinois, the leading producer of corn and soybeans, declined in the third quarter, prices throughout the district remained higher than the year before. Prices in Iowa and Indiana, the district's other major grain producing states, made statewide gains of less than 1 percent, however. Larger gains were made in Michigan and Wisconsin, where cash grain farming is less important.

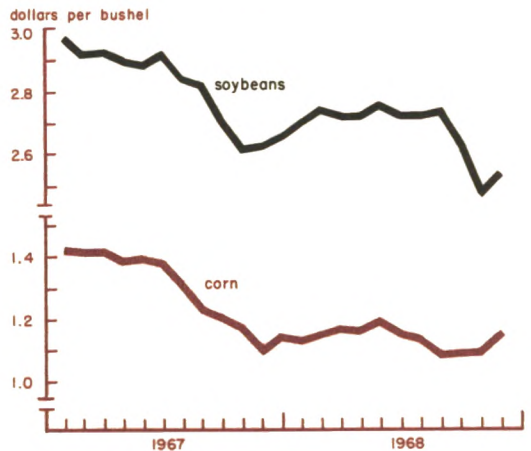
What's next?

Consumer expenditures for food rose nearly 7 percent last year, but that is not likely to be repeated this year. There are also few prospects for large increases in farm exports. World grain supplies are large, economic activity continues to lag in several countries, and many of the uncertainties affecting tariffs, quotas, and other trade regulations have still not been resolved. The result is an outlook for only slightly stronger demand for farm products in 1969, the gain mainly reflecting population growth. And, for that reason, farm prices and income will be determined mainly by the supply of agricultural products.

Production upswing

Livestock production is being stimulated by favorable relationships between livestock prices and feed costs. Placements of cattle in feedlots were up sharply in the third quarter, boosting total numbers on feed to record levels. Still larger shipments of feeder cattle were being made into the Midwest in the fourth quarter, with the result that large supplies of beef over the next several months are likely to weigh down fed-cattle prices. The extent of the downward drift in prices will depend largely on the weights of the cattle marketed and the orderliness of the marketings. But in any event, with changing rela-

Prices of principal Midwest crops were depressed during 1968 . . .



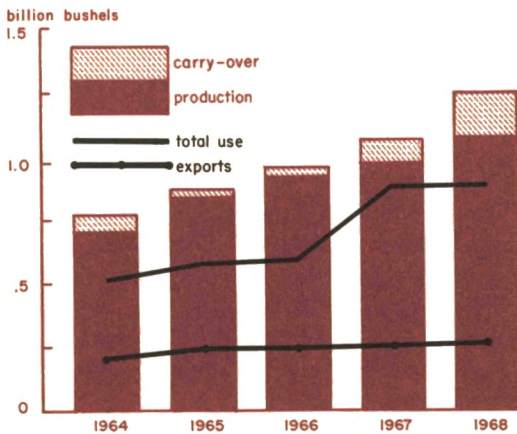
Note: Prices at Chicago.

tionships between prices of feeder cattle and fattened cattle, cattle feeders' profits are likely to be lower, even though feed-price relationships continue fairly favorable.

Larger pork supplies are also expected. Farmers increased pork production throughout 1968 and had plans in the late fall for further expansion. Indications were that 4 percent more hogs were farrowed in the second half of the year. With increased supplies in prospect (these hogs will make up most of the marketings in the first half of 1969) hog prices will probably trend downward, averaging less than year-before levels. Continued low feed costs will probably allow farmers fairly favorable returns through at least the first half of the new year. These returns are apt to encourage further production increases, however, and result in lower prices and reduced returns later in the year.

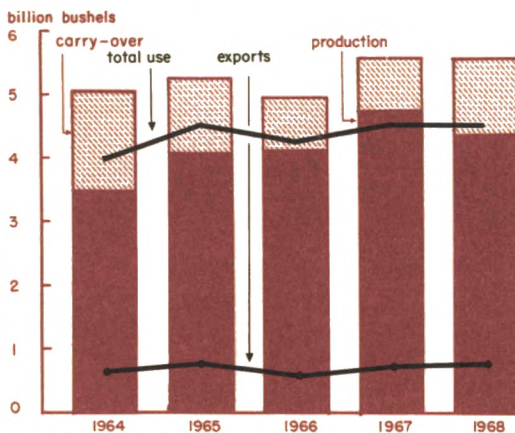
Prospects for poultry producers are generally favorable, at least for the first half of 1969. Egg prices will probably follow a pat-

. . . reflecting large carry-overs of both soybeans . . .



tern the reverse of that last year. Reduced supplies are likely to hold prices well above year-before levels in the first half, but later in the year expanded production will probably force prices under those of 1968. This is especially true of turkey prices. The expansion in broiler supplies underway at the end of 1968 will probably carry over well into

. . . and corn



1969. With the expected increase in meat supplies overall, lower broiler prices are indicated.

Milk production may rise this year as the output per cow increases and the decline in number of cows slows further in response to the continued favorable returns to dairymen. Because of the higher government support price, prices received for milk will continue through March higher than a year ago. After that, prices will probably be about the same as last year, unless the support price is changed. Since the demand for dairy products is not expected to strengthen, government purchases of dairy products will no doubt continue to be necessary to the maintenance of prices.

Government a major factor

Crop prices will also be influenced in large measure by support-price levels for the 1968 crops and provisions of the 1969 programs, which have not been announced for feed grains and soybeans. Because of the larger numbers of livestock and the favorable livestock-feed ratios, consumption of feed grains is expected to increase. Exports may hold close to last year's shipments, provided shipments are not interrupted by a dock strike. If so, total use should about equal this year's production but still be well below the total supply. Supplies of wheat are also very large, and while total wheat consumption may be increased some by its greater use as livestock feed, it, too, will fall short of the large supplies. Supplies of soybeans are also substantially greater than needed to meet the only slightly stronger demand expected.

Because of lower prices around harvest time, large amounts of grain were placed under price-support loans. With larger proportions of the supplies held by the Commodity Credit Corporation, which cannot

sell stocks into the market for less than 105 percent of the support prices plus storage and handling costs, prices may tend to strengthen early in the year. On the national average, corn prices are supported at \$1.05 a bushel, wheat at \$1.25, and soybeans at \$2.50. As usual, prices later in the year will be influenced more by the potential size of the harvest, which will be determined by the weather and the amount of acreage idled under government programs.

Because of the buildup in grain supplies last year, the government has made changes in its production-control programs, and more changes are expected. The national wheat allotment has been reduced 8 million acres from the 68 million acres allotted in 1968. Normal participation in the program and normal growing conditions would put a crop of 1.3 billion bushels in the offing for 1969. Such a crop would, of course, strengthen wheat prices markedly.

Any changes affecting the feed-grain program and the level of price support for soybeans are expected to be announced early in

the year. Many observers expect revisions in the feed-grain program designed to encourage greater acreage diversion. Such changes might not be feasible, however, in view of budgetary restraints. Lowering of the soybean support is also widely viewed as a strong possibility.

Removal of more acreage from feed-grain production would no doubt strengthen feed-grain prices later in the year. Soybean prices, however, would probably decline from current levels. A decline is already reflected in distant soybean futures contracts.

With prices of livestock under downward pressure and only slight improvement expected for crop prices in the next several months, prospects for the incomes of most district farmers are not as favorable as a year ago. The large volume of expected marketings will hold up farmers' gross income, and government payments to crop farmers may rise further. But because of both increased prices and larger purchases, farm costs are expected to continue their rapid rise, leaving net returns to most farmers, especially livestock farmers, poorer this year than last.

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