Research Department
Federal Reserve
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San Francisco

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FRBSF Weekly Letter

The Nation's Food

The grain is in the storage bin, the apples in cold storage, the potatoes are dug, and the sprouted winter wheat lies under its protective cover of snow. Some agricultural activity continues in the Sunbelt, but most farmers have completed their major work until next spring. This would seem, then, an appropriate time to take stock of what 1977 offered and what 1978 promises to those who produce and those who consume the bounty of our North American soil.

Consumers

For consumers, 1977 meant a greater increase in retail food prices than 1976's 3.3-percent rise, but a considerably better picture than the double-digit increases of 1973 and 1974. Food prices rose by some 7 percent during 1977, but American farmers would have noticed it only when they visited the supermarket. U.S. *farm* prices rose only 1 percent (according to the Bureau of Labor Statistics) or 4 percent (according to the Department of Agriculture). The real culprits in the 1977 food-price bulge were not American farmers, but rather imported goods and marketing costs. Coffee accounted for a full 40 percent of the consumer price rise, and fish and chocolate for another 9 percent.

As the processing and distribution components of our food supply have increased over time, retail food prices have become more weakly tied to farm prices. To cite an extreme example, the price of cornflakes was 11.8 percent higher in October than a year earlier, even though the price of corn had actually declined 10 percent over that period. Today, the farm value of food accounts for less than 40 percent of its retail value. A comparable amount goes to food-industry labor costs, and the remainder is allocated to packaging, transportation, advertising, profits, taxes and various minor expenses.

Any analysis of retail food prices thus must consider more than just farm prices. During 1977, food-industry wages rose an estimated 8 percent—the lowest in four years, but still much more than the productivity increase in that sector, which probably averaged around 3 percent. When increased prices of packaging, fuel and other items are included, over half of the rise in retail food prices represented things done to food after it left the farmer's hands.

Producers

While consumers were faced with an uncomfortable food-price increase, farmers were faced with a severe recession. U.S. farmers ended the year with real incomes down roughly 4 percent from 1976 and 25 percent below 1973. The widespread farmer protests observed last month reflected a 5.2-percent decline since 1974 in the prices received by farmers but a painful 23.8-percent *increase* over that period in the prices paid by them.

But the financial burden of the current slump is spread unevenly among America's farmers. For one thing,

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some 55 to 60 percent of all farm income comes from off the farm, reflecting the large number of small farmers with non-farm jobs. Those with such outside sources of income generally did not suffer as much as those earning their whole livelihood from the farm. And while prices of grain, cotton and some other crops tumbled, prices of rice, potatoes, beans, oranges and other fruits climbed — quite sharply in some cases. So some farmers with the right crop mix did very well in 1977. Finally, the weather did not treat all farmers equally. Some areas, especially in the Western United States, faced severe drought conditions which lowered per-acre crop yields and raised operating costs.

Bread

For the second year in a row, the most important factor in the agricultural outlook has been the very large U.S. and world supply of grain. In mid-October, it appeared that the 1977/78 world grain crop — wheat, rice, corn, barley and sorghum — would exceed the previous year's record crop. Since then a 19-million-ton shortfall in the Soviet harvest and downward revisions in Australian and Argentine crop prospects reduced the estimate to roughly 3 percent below that year-ago record.

Reflecting this moderately weakened harvest estimate, U.S. grain prices strengthened — hence the October and November bulges in the farm-products portion of the wholesale-price index. Because grain is a world-traded commodity, domestic prices are rather sensitive to changes in foreign demand (and because the U.S. exports roughly a third of her grain, farm incomes are quite sensitive to changes in foreign demand). However, this recent rise still offers little consolation to farmers — wheat prices are up only modestly from the five-year low they hit last summer, and the prices of most grains are still below year-ago levels.

Will grain prices continue to rise? While further deterioration in Southern Hemisphere crops could cause some strengthening in prices, a record carryover from last year combined with another near-record harvest suggests continued weakness. A glance at the futures market shows that traders, in the aggregate, expect corn and wheat prices to remain virtually unchanged over the next six months.

Other food

For the second year in a row, cattlemen have used up principal — i.e., the total slaughter of cattle and calves has exceeded the new calf crop. In fact, during 1977 the total slaughter equalled 39 percent of the total (January) inventory of cattle and calves — the largest such reduction since 1957. Normally this situation would lead to sharp rises in beef prices, but two factors should spare consumers such a fate in 1978. First, the decline in grain prices has reduced the cost of producing a pound of beef to the lowest level in four years, thus stimulating a sharp expansion in the number of cattle placed on feed. Consequently, 1978 beef production may decline only about 5 percent below its 1977 level. Secondly, substantial increases in supplies of pork and poultry—beef's chief substitutes—should prevent any beef-price increase from getting out of hand. Hamburgerphiles take note: due to strong demand, ground-beef prices will rise more sharply than prices of prime cuts.

Consumers have paid—and growers have received—considerably more for their fruits this past year than the year before. Grower prices for fresh and processed fruits averaged 30 percent higher than a year ago during the third quarter. Unfortunately for consumers, this trend should continue into 1978. The 1977-78 citrus crop may be 6 percent smaller than last year's; in fact, Florida's early and mid-season orange crop (an important part of the juice supply) is the smallest in six years' time, being 23 percent below last year's record crop. Also, non-citrus production may be slightly below the previous year, though some individual fruits, such as apples, appear to be in greater supply.

While the January 1977 freeze sent the prices of many vegetables skyrocketing, quick replanting of the frozen Florida crop, increased plantings in other states, and larger Mexican imports later sent prices tumbling to about year-earlier levels. Vegetable supplies today are generally large. The fall potato crop is just under last year's record, and canned vegetable supplies are roughly 3 percent above last year's levels. Barring a repeat of last January's weather, vegetable prices should not face any significant upward pressures in 1978. As for other items, U.S. sugar prices should rise from recent depressed levels, given both the 50-percent increase in the sugar tariff and the price supports incorporated in the new farm bill; coffee prices should fall (by 42 percent by the end of 1978, says the futures market) given the expected rebound in world production; and cocoa prices should fall at least modestly from their 1977 peak.

What this all boils down to is another year of depressed farm prices and low farm incomes, some easing in the prices of those imported goods which played the villain last year, and thus a more moderate rise in the prices consumers will pay for their food. Given the cost pressures in the food marketing sector (contracts covering a quarter of a million workers will expire in 1978 and overall wage increases are expected to average 7-8 percent), retail food prices will probably rise about 1 percent each quarter over the next year.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 12/21/77	Change from 12/14/77	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	106,692	+ 294	+ 12,774	+ 13.60
Loans (gross, adjusted)—total	82,175	+ 140	+ 11,823	+ 16.81
Security loans	2,086	− 478	+ 459	+ 28.21
Commercial and industrial	25,163	+ 356	+ 2,023	+ 8.74
Real estate	27,195	+ 185	+ 5,773	+ 26.95
Consumer instalment	14,478	+ 107	+ 2,380	+ 19.67
U.S. Treasury securities	9,621	+ 240	− 821	− 7.86
Other securities	14,896	− 86	+ 1,772	+ 13.50
Deposits (less cash items)—total*	104,122	+ 1,008	+ 10,685	+ 11.44
Demand deposits (adjusted)	29,197	− 541	+ 2,834	+ 10.75
U.S. Government deposits	674	+ 381	+ 298	+ 79.26
Time deposits—total*	72,346	+ 1,071	+ 7,162	+ 10.99
States and political subdivisions	6,577	+ 480	+ 817	+ 14.18
Savings deposits	31,107	− 65	+ 556	+ 1.82
Other time deposits‡	31,639	+ 528	+ 5,230	+ 19.80
Large negotiable CD's	14,525	+ 655	+ 3,929	+ 37.08

Weekly Averages of Daily Figures	Week ended 12/21/77	Week ended 12/14/77	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves(+)/Deficiency (−)	+ 69	+ 66	− 7
Borrowings	53	24	0
Net free(+)/Net borrowed (−)	+ 16	+ 42	− 7
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+)/Net sales(−)	+ 1,549	+ 351	+ 613
Transactions with U.S. security dealers			
Net loans (+)/Net borrowings (−)	+ 593	+ 655	+ 165

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

Editorial comments may be addressed to the editor (William Burke) or to the author. . . .
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