Research Department
Federal Reserve
Bank of
San Francisco

August 4, 1978

FRBSF Weekly Letter

Consumers' Beef

Everyone knows by now that retail beef prices rose sharply during the first half of the year—at more than a 30-percent annual rate, to be precise. The price rise wasn't totally unexpected; after all, the post-1975 decline in the size of the nation's beef herd has been the sharpest in this century. However, the magnitude of the recent price rise has also been much larger than expected.

One major explanatory factor, strangely enough, concerns the nation's pig farmers. Last fall, after surveying the people who put pork chops and bacon on American tables, the experts at the U.S. Department of Agriculture projected a 10-percent increase in pork production in 1978. They expected that consumers would be able to substitute cheap and abundant pork for scarce and expensive beef in their menus, but they were wrong because the little pigs didn't come to market. In fact, the USDA now estimates only a 3-percent rise in pork production for the year. If it weren't for a large increase in chicken supplies, consumers might be paying even more than they have for beef and other protein.

Another factor explaining the larger-than-expected price rise was the impact of two successive winters of severe weather. Last winter's blizzards disrupted marketing, slowed weight gains, and created disease problems among livestock—all of which contributed to lower beef output. Overall, combined supplies of beef, pork and other meats this year probably will fall 3 to 4 percent below last year's level. With demand stimulated meanwhile by rising real incomes and summer cookout weather, prices are likely to remain in the stratosphere.

Where are the boycotts?
But where are the consumer boycotts, such as we had five years ago? One reason may be that the 1973 beef-price upsurge caught consumers unaware, whereas the recent rise was widely heralded by the media. Indeed, today's consumers may have built up some sympathy for cattle producers, with their record of several straight years of red-ink production. Again, household budgeteers may have become more resigned than they once were to the steady flow of price increases. But more to the point, beef prices simply have not risen as fast in this latest episode as they did in 1973. Meat prices rose 41 percent between August 1972 and August 1973, following a 10-percent rise in the preceding 12-month period; in contrast, they rose about 13 percent in the first half of 1978, following an actual decline of 4 percent over the 1976–77 period.

To get a better fix on the price outlook, we should look at one of the most regular of all American economic cycles—the cattle cycle. Movements in the January and July head counts of the nation's cattle herd constitute the basis of the cattle cycle. Each cycle occurring in the post-World War II period

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has lasted exactly ten years, from peak to peak. Since the last peak in 1975, we have witnessed a record decline in cattle population, reflecting the combination of a multi-year Western drought and a three-year period of depressed prices. Herd numbers dropped 7 percent between July 1977 and July 1978, but the trough of the current cycle may be near. By the time of the next count in January 1979, the farm value per head may equal or exceed the 1974 record.

Facts of life

The cattle cycle is what it is simply because biological growth takes time. Unlike most manufacturers, cattle producers must wait many months to accomplish a sustained rise in their output. Suppose beef prices increase, and suppose market participants expect them to stay high for a lengthy period. Cattlemen do not react by sending more animals to slaughter, as any normal, self-respecting capitalist would. Instead, they react by sending less. This of course further exaggerates the price rise which had already begun. Likewise, in the case of falling prices (actual and anticipated), cattlemen again turn the textbooks on their head and send more instead of fewer cattle to market. This, in turn, further depresses prices.

The reason for this bizarre behavior has to do with the nature of the commodity produced by the livestock industry. In this industry, the commodity represents both the output and the major capital input. In short, it takes cattle to make cattle. When prices begin a sustained rise, as they have this year, most cattlemen hold some heifers from the queue going to market and put them to work making babies. But it takes roughly two years from the point of conception to the day when the new cattle are sent off to face the butcher—nine months' gestation plus nine months' weaning plus six months on feed. And if the cattleman starts from scratch by buying a new heifer, he must add almost two more years to this process because of the time needed for the heifer to mature to breeding age.

Those who would forecast future price movements thus must first understand these facts of pastoral life. Even though the trough in the size of the nation's cattle herd may occur next January, increased output and lower prices will not necessarily follow immediately. Quite the contrary. Historically, the herd size increases only through short-run reductions in slaughter, and price rises often continue for a year or more after that trough is reached. So past history would suggest that we won't see any appreciable price relief until well into 1979.

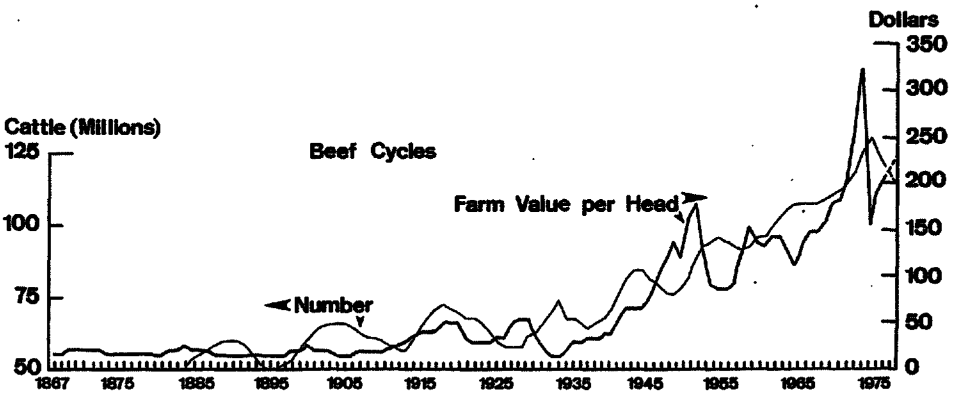
Facts of foreign life

But can't we obtain some price relief by shipping in more beef from abroad? Actually, the Administration on June 8 announced a 15-percent increase in beef-import quotas, which would increase our potential beef supply by about one pound for each American stomach. But although the market reacted rather strongly to this announcement, its actual impact may be rather modest—even apart from the rather small amounts involved.

First, our traditional foreign suppliers may not be able to provide the additional 200 milion pounds allowed to them under the expanded quotas. Australia and New Zealand, which account for more than two-thirds of our beef imports, both find themselves at the same stage of the cattle cycle as we do. For that reason, Washington's recent announcement immediately sent prices soaring in Sydney, which naturally made Australian consumers unhappy. Meanwhile, a growing Middle Eastern demand for mutton has caused New Zealand livestock producers to reduce their production of U.S.-bound cattle and to increase their production of petrodollar-bound sheep and lambs. Thus, neither Australia nor New Zealand may be able to do much to ease the U.S. beef shortage in the immediate future.

Altogether, we may not have seen the end of the beef-price rise of 1978. There may be no immediate upsurge, because of heavy marketings by producers anxious to take advantage of the present high level of prices. But the fundamentals suggest a further increase over the next year or so—perhaps as much as double the overall rise in consumer prices over that period.

Michael Gorham



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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 7/19/78	Change from 7/12/78	Change from year ago Dollars	Change from year ago Percent
Loans (gross, adjusted) and investments*	114,053	+ 374	+ 15,576	+ 15.82
Loans (gross, adjusted)—total	91,998	+ 264	+ 16,219	+ 21.40
Security loans	1,857	+ 36	+ 38	+ 2.09
Commercial and industrial	27,911	+ 88	+ 4,240	+ 17.91
Real estate	31,305	+ 224	+ 6,514	+ 26.28
Consumer instalment	16,502	+ 90	+ 3,660	+ 28.50
U.S. Treasury securities	8,201	+ 120	− 579	− 6.59
Other securities	13,854	− 10	− 64	− 0.46
Deposits (less cash items)—total*	110,935	− 565	+ 13,784	+ 14.19
Demand deposits (adjusted)	30,397	− 911	+ 2,676	+ 9.65
U.S. Government deposits	639	+ 223	+ 170	+ 36.25
Time deposits—total*	77,969	+ 18	+ 10,918	+ 16.28
States and political subdivisions	6,572	+ 37	+ 927	+ 16.42
Savings deposits	31,654	+ 21	− 299	− 0.94
Other time deposits‡	36,844	− 5	+ 9,293	+ 33.73
Large negotiable CD's	17,852	+ 85	+ 7,778	+ 77.21

Weekly Averages of Daily Figures	Week ended 7/19/78	Week ended 7/12/78	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves(+)/Deficiency (−)	+ 88	− 44	+ 74
Borrowings	57	34	6
Net free(+)/Net borrowed (−)	+ 31	− 78	+ 68
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+)/Net sales(−)	+ 80	+ 205	+1,364
Transactions with U.S. security dealers			
Net loans (+)/Net borrowings (−)	+ 647	+ 43	+ 244

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

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