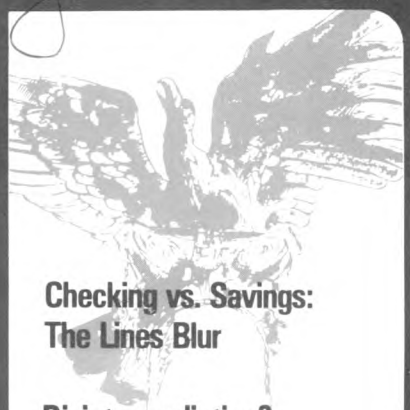


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ECONOMIC REVIEW

**Federal Reserve Bank
of Atlanta**

May/June 1978



**Checking vs. Savings:
The Lines Blur**

Disintermediation?

**Lagging Indicators:
Guide to the Future?**

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Planting Intentions
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**Fewer Cattle = Less Beef =
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Innovations in financial services which combine the benefits of checking and savings accounts are catching on rapidly throughout the nation. The trend may not be a boon to all consumers, however.

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High interest rates once raised the spectre of time and savings deposit losses at banks. But in the past few years, regulatory changes have allowed banks to restructure deposits, reducing their vulnerability to outflows of these funds.

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Several years of hard times for cattle producers have reduced herds dramatically. And the long breeding cycle ensures that the impact on beef availability and prices won't be offset for many months.

CHECKING VS. SAVINGS: THE LINES BLUR

by William N. Cox

A Tennessee credit union permits its members to write a check-like instrument against deposited funds.

A Louisiana bank's automatic teller machines let depositors shift funds between checking and savings accounts.

A Florida savings and loan association allows its customers to pay bills with phoned-in deposit transfers.

A Georgia stockbroker makes it easy for wealthier clients to write checks on their investment balances.

These examples, drawn from hundreds around the Sixth District, have something important in common. They are evidence of a blurring of the distinction between traditional checking and savings accounts. They allow the consumer to combine more conveniently the advantages of each.

If his funds are in a bank checking account, the consumer can transfer them easily to someone else, but they earn no interest.¹ If his funds are in a traditional savings account, he earns interest, but it is relatively awkward and inconvenient to transfer them to anyone else. Most businesses and government units operate on a big enough financial scale that it is worthwhile for them to minimize their noninterest-bearing checking account balances. They can hire managers to ferry funds back and forth from one account to another. Most consumers, however, do not find the small amount of interest earned worth the inconvenience of moving the funds around.

This is all changing. The innovations cited at the beginning of this article all provide more convenient ways for the

consumer to earn interest on transferable funds. They are, in fact, a few local skirmishes pointing the way toward new substitutes for checking and savings accounts in the Southeast. Elsewhere in the country, stiff competitive struggles among various kinds of financial institutions have already moved past or around the judges, legislators, and regulators and into the marketplace.

For several years, commercial and mutual savings banks in New England have been offering "Negotiable Order of Withdrawal" (NOW) accounts. Functionally, these are interest-bearing checking accounts. Consumers there have adopted them enthusiastically. Congress is considering the extension of NOW accounts to the rest of the country. Nationally, a Federal court has approved credit unions' use of the share draft—the "check-like instrument" mentioned in our opening sentence. The Federal Reserve and the FDIC have announced new regulations permitting bank customers to "cover" checking account overdrafts with savings account funds automatically. Each development is somewhat different, of course. But the trend is evident, and the pace is quickening.

Financial institutions in this region and across the country are reassessing their objectives, their powers, their costs, and their markets in the context of a broader competitive struggle. Many banks want permission to underwrite industrial revenue bonds but are looking warily at the movements of investment banks, retailers, and foreign banks toward traditional banking turf. Savings and loan associations generally desire broader lending powers and new types of home mortgages but are anxious to preserve their ability to offer a premium interest rate on savings accounts. Credit unions can now issue home mortgages but are worried about losing their tax advantages.²

Will this be a breakthrough for the consumer? Consumers will benefit from the new competition among institutions,

¹The Banking Act of 1933 says, in part: "No member bank shall directly or indirectly, by any device whatsoever, pay an interest on any deposit which is payable on demand." This is the basic legal impediment to combining checking and savings accounts directly.

²A separate concern relates to monetary policy. Monetary growth, as measured by the Federal Reserve in its M_1 and M_2 definitions, basically means the growth of checking and savings account balances at banks. The spread of the innovations we have been discussing will, at best, add substantial uncertainty to the meaningful measurement of monetary growth.

but it will be no bonanza. It is very likely that the low-balance/high-transactions customer will be worse off, whereas the high-balance/low-transactions customer will be pleased. On a conventional bank checking account, which earns no interest, the bank usually "pays" its depositor by absorbing most of the costs of the checking services provided. On typical accounts, the bank-absorbed costs, over and above service charges, are equivalent

to an implicit interest payment of about 4½ percent.³ But if it turns out that checks can be written on an account bearing explicit interest, financial institutions will have to charge for the services, either directly on a per-item basis or implicitly in the form of minimum account balances. ■

³Stephen H. Axilrod and others, "The Impact of the Payment of Interest on Demand Deposits," Table III-1. This study by the staff of the Board of Governors of the Federal Reserve System was released to the public on February 1, 1977.

DISINTERMEDIATION?

by *John M. Godfrey*

When analysts begin to foresee strong public and private credit demands and rising interest rates, their attention quickly turns to the prospect of disintermediation—the shift of consumer funds from banks and other financial intermediaries to higher yielding open market securities that results in a net loss of time and savings deposits. Commercial banks and other thrift institutions experienced bouts of disintermediation in 1966, 1969-early 1970, and, to a lesser extent, in 1973-74 as interest rates rose. Yields obtainable from Treasury bills and notes, commercial paper, and money market mutual funds rose significantly above the maximum rates that the regulated banks and thrift institutions were allowed to pay for deposits subject to interest rate ceilings.

With interest rates higher now than at any time since 1974, disintermediation has become a growing topic of conversation. However, a sustained reduction in interest-bearing deposits at District member banks is unlikely in the near future, mainly because the region's banks have shifted the composition of deposits toward those accounts which are well insulated from withdrawals. Nearly one-half of the time deposits are no longer subject to Regulation Q interest ceilings, and other liberalizations of regulations have allowed banks to offer more competitive rates on

other time deposits. Passbook savings accounts seem to be less sensitive to the level of interest rates than in the past. Furthermore, interest rates have not reached 1974 levels. Even with a further rise in market rates, potential disintermediation problems could be minimized by raising the interest rate ceilings.

Recent History. Building a more stable deposit base has taken time and a number of regulatory changes. In the 1969-70 period, member banks could offer only very limited interest rate incentives to attract and retain longer maturity consumer deposits. They could pay depositors only 4 percent on passbook savings and short maturity time deposits and only 5 percent for time deposits maturing in 90 days or more. Although some banks did establish time deposits that were automatically renewable at each maturity date, the depositor retained the option of withdrawing his deposit each quarter without penalty. When interest rates rose, member banks lost \$300 million (about 7 percent) in savings deposits from late 1968 through early 1970. Banks outside the District's larger cities, however, were able to increase total consumer time deposits.

During that period, the area where banks were most vulnerable to competition from higher open market rates was negotiable CDs in denominations of

\$100,000 or more. Regulations then allowed banks to pay 5½ percent on maturities of less than 60 days and 5¾ percent for those of less than 90 days. (Most large CDs are issued for 90 days or less.) These rates were not sufficient to prevent the loss of over \$250 million (about 40 percent) of these deposits at the larger District banks. Thus, banks lacked the flexibility to offer competitive rates on money market CDs and could not provide adequate incentives for consumers to commit savings to longer maturity deposits.

In early 1970, the Board of Governors recognized this situation and raised the maximum interest rates. It also restructured the rates to provide some incentive for committing funds to banks for two years or more. Later that same year, the ceiling rates on shorter maturity money market CDs were suspended. These actions enabled banks, including District banks, to make significant strides in tying down consumer time deposits for longer periods of time and helped them compete for large CDs.

When by mid-1973 rising market rates once again threatened disintermediation, Regulation Q ceiling rates were raised for the short maturity time and savings deposits and higher rates were set for even longer maturity time deposit categories. These ceiling rates, still in effect today, have allowed District banks to restructure their deposits, sharply reducing the likelihood of significant deposit outflows.

THE DEPOSIT BASE TODAY

Savings Accounts. At year-end 1977, the nearly \$28-billion time and savings deposit base was far more stable, or less vulnerable to runoffs, than in 1969-70 or 1973. Savings deposits comprise nearly \$11 billion, about 38 percent of the total. Nearly all of these deposits are owned by individuals and nonprofit organizations. Corporations and profit-making organizations, which are usually more concerned with yields than are individuals, hold only about \$600 million in such deposits.

Although savings deposits pay only 5 percent and can be effectively withdrawn without notice, the prospect that withdrawals will greatly exceed inflows in the

near future seems unlikely. Higher interest rates have been available from other types of deposits, other financial institutions, and open market instruments for some time. Therefore, liquidity, and not the rate of return, has probably been the overriding reason for placing funds in bank savings accounts.

In earlier years, savings deposits probably contained some interest-sensitive household funds that were subject to being shifted out of these accounts. For example, during the 1969-70 disintermediation period, the 90-day Treasury bill rate peaked at 7.87 percent (387 basis points above the 4-percent ceiling rate for savings accounts) and District member banks experienced net savings deposit losses. By 1974, however, the situation was vastly different: Bank savings accounts apparently no longer contained interest-sensitive funds. The ceiling rate was then 5 percent (changed in July 1973). The Treasury bill rate reached 8.96 percent in August 1974 (396 basis points above the maximum), but District banks actually had net savings deposit inflows of nearly \$400 million. Discounting seasonal influences, District member banks, as a whole, had no net outflows from savings accounts during any single month of 1974, although some individual banks did. In light of the 1974 experience and since short-term interest rates are substantially below their previous peak, there seems to be little reason to expect consumer savings deposit inflows (nearly \$400 million in the first quarter of 1978) to deteriorate into sustained outflows during this year. Since 1974, however, business firms and governmental units have been allowed to hold passbook savings accounts. While these funds may be more interest-sensitive than consumer deposits, they comprise only a small portion of District banks' total savings deposits.

Time Deposits. District banks' time deposits—other than savings accounts—now total about \$17.1 billion, and the banks have considerable latitude in their ability to pay rates sufficient to attract and retain these funds. Time deposits in denominations of \$100,000 and over are exempt from maximum interest rate ceilings; these account for about \$8.2 billion, or 48 percent of total time

deposits. In addition, District banks hold about \$3.8 billion in deposits of state and local governments (many are large-denomination deposits and are included in the \$8.2 billion above) on which they are permitted to pay up to 8 percent for any maturity. Therefore, a large volume of District banks' time deposits is effectively insulated from high market rates if the banks are willing to pay competitive rates. This flexibility contrasts sharply with previous disintermediation periods when no time deposits were exempt (1969) or only one-third were exempt (1973) and when holdings of public deposits were less significant.

Therefore, only about one-half of District banks' time deposits—\$8.9 billion—are subject to interest rate ceilings and might be withdrawn because banks cannot pay competitive rates. However, slightly more than \$4 billion of these deposits are long maturity. Four-year deposits may carry $7\frac{1}{4}$ percent yields and six-year maturities, $7\frac{1}{2}$ percent. Severe interest penalties make premature withdrawals from these deposits unlikely. The present competitiveness of these rates and the advantages of holding funds at banks should allow banks to continue to draw funds into these long maturity accounts. And on June 1, banks' ability to compete for even longer maturity funds will be further enhanced when they will be able to offer an eight-year maturity deposit at $7\frac{3}{4}$ percent. (When the interest is compounded, the effective yield will be slightly more than 8 percent.)

About one-half of the remaining time deposits mature every quarter and currently carry rates of $5\frac{1}{2}$ percent. Depositors are attracted to these 90-day accounts because they offer a slightly higher yield than passbook savings but are only slightly less liquid. That these deposits from households have remained

relatively constant in dollar volume since the early 1970s indicates that they are not very interest-sensitive.

The remaining small-denomination time deposits are about evenly split between those maturing in one year and paying 6 percent and those maturing in two and one-half years and paying $6\frac{1}{2}$ percent. Savers who commit their funds to these deposits are probably more concerned with yields than with immediate availability. Since open market rates on investments of the same maturities are presently higher, inflows may well slow down during coming months and some of these deposits might not be rolled over at maturity.

Recent Regulation Q changes mean that after June 1, banks will be better able to compete for "intermediate" size, short maturity funds that are currently channeled into the commercial paper or Treasury bill markets. The new deposit should be attractive to investors with enough resources to purchase a minimum denomination Treasury bill but not enough to purchase the \$100,000 CDs that are issued without Q ceilings. Banks will be able to offer the new six-month money market time certificate in a minimum \$10,000 denomination, with the maximum rate of interest tied to the average yield for the most recent six-month Treasury bill auction. Based on mid-May auction yields, that rate would be about 7 percent.

Although District banks' adjustments of time and savings deposits have made large losses unlikely, deposit inflows may not remain adequate if market rates rise significantly. In that case, further elevation of interest rate ceilings may become necessary to allow banks to compete for funds and to provide equitable returns to small depositors who cannot take advantage of higher returns available on open market financial instruments. ■

LAGGING INDICATORS: GUIDE TO THE FUTURE?

by Charles J. Haulk

An indicator of business cycle turns that is getting more attention lately is the ratio of the composite index of coincident indicators to the composite index of lagging indicators. This ratio has been a good predictor of changes in real growth three to four quarters ahead. Year-long declines in the ratio have been followed, on the average, by real growth reductions of three percentage points. If past relationships hold, the decline in the ratio, which began in the second quarter of 1977, is signaling a weakening economy in 1978.

Background. Components of the coincident composite index include: non-agricultural employment, personal income less transfer payments in 1972 dollars, industrial production, and manufacturing and trade sales in 1972 dollars. The selection of these variables as components of the index was based on the commonly held view that the purpose of economic activity is to produce goods, services, and income for the population. Hence, income, industrial production, sales, and employment are obvious choices—employment is related to both output and income. A preferable, narrower coincident indicator would be GNP. However, GNP data are only available quarterly, and it is desirable to have more frequent measures of coincident activity.

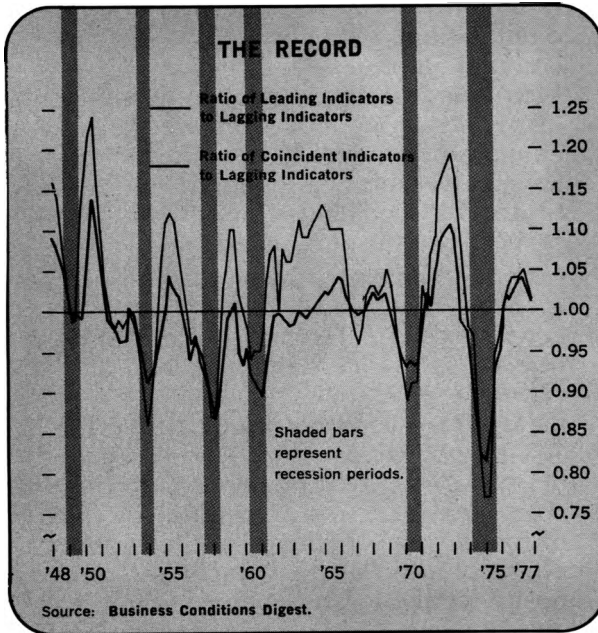
The components of the composite lagging index include: the average duration of unemployment, manufacturing and trade inventories in 1972 dollars, unit labor costs in manufacturing, the average prime

rate, commercial and industrial loans outstanding at large weekly reporting commercial banks, and the ratio of consumer instalment debt to personal income. Lagging indicators are those economic variables whose movements have been empirically determined to trail those of the coincident indicators by several months or quarters.

Only in an economy which had reached a completely steady state would all economic variables grow at constant rates. Interest rates would be unchanging. In an economy given to cyclical behavior, some measures of economic activity will lag. The rate of change of the lagging indicators relative to movements in the coincident indicators illustrates the degree of balance or imbalance in the economy. Thus, the ratio of the coincident composite to the lagging composite index (RCL) is a measure of economic balance. It moves up when the coincident indicators rise faster than those which lag or when the coincident indicators are falling more slowly than the lagging. The RCL declines when the coincident indicators rise more slowly or fall more quickly than the lagging.

Three of the lagging indicators are measures of conditions in credit markets. When these three are rising more rapidly than the coincident index, it indicates that the financial markets are beginning to come under stress and that growth in the real sector is nearing a cyclical limit. In general, a steady decline in the RCL means that economic activity has peaked or is about to peak. Only a slowdown sufficient to relieve financial market strain can return the coincident indicators to a faster rate of growth than the lagging indicators.

Historical Behavior. From 1948 to 1976, the RCL had eight peaks, six of which appear to be major and two temporary aberrations (see chart). After each major peak, there was a recession. The lead time from the peak of the RCL to the beginning of the recession has varied from one to four years. Before the 1953-54 and the 1970 recessions, a major war effort intervened between the time of the peak in the ratio and the eventual recession. Those two cases aside, the lead time from the peak of the RCL to the onset of recession



has averaged slightly more than a year, with the 1957-58 recession lagging two and one-fourth years and the others one year each.

More to the point, however, the year following a year of increase in the RCL has been one of good to strong real growth and the year after a decline in the RCL has been one of weak or negative growth. Declines in the ratio have not always been followed immediately by full-fledged recessions, but, in every instance except 1963, they have been followed by slowdowns in the economy. Generally, the weakness in the economy has appeared three or four quarters after the RCL began to fall. Regression results confirm a highly significant three-quarter lead of the RCL on real growth. On the average, a year of declines in the RCL has been followed by a reduction of the rate of real GNP growth by three percentage points the next year. And the greater the rate of decline in the RCL the greater the drop in real growth the following year.

To carry the idea a little further, we also examined the ratio of leading to lagging indicators. If the ratio of coincident to lagging indicators is a measure of imbalance in the economy, then the ratio of leading to lagging indicators might provide an even earlier signal. However, a plot of

this ratio from 1948 to date suggests that it offers little additional information. The primary difference from the RCL is that the swings have been greater in amplitude. The turning points have been very nearly the same at the peaks and perhaps slightly ahead at the troughs.

Outlook. Based on the RCL decline in 1977, the slowing of growth in the first and second quarters of 1978 will not be precipitous. But further rapid decreases in the RCL in the first quarter of 1978* would augur ill for fourth quarter 1978 and first quarter 1979.

How likely are further declines? One of the components of the lagging indicator index is manufacturing and trade inventories. Careful monitoring of inventories thus far in the current expansion suggests that the excesses of 1973-74 may not happen again, but slower, better managed inventory growth will probably occur. Also, the ratio of consumer instalment debt to income, another lagging component, may be close to a peak and, therefore, may not contribute very much to further increases in the lagging indicator. However, with wages and interest rates subject to upward pressures, unit labor costs and the prime rate could increase further, pushing the lagging indicator up faster than the leading or coincident indexes. So, the leading indicators may continue to rise after the RCL has signaled a downturn.

As with any set of findings about the relationship of economic indicators, the usual caveats must hold. The past is not a perfect guide to the future. Relationships change, and shocks from external or unexpected sources can undermine the usefulness of predictors. As with any forecasting tool, once it is widely observed and heeded, it could lose its effectiveness. However, the reliable past performance of the RCL gives us confidence that it will be a useful tool for predicting directional changes in the economy for some time to come. ■

*Preliminary first-quarter results obtained just prior to publication show the RCL dropped to 0.978 (about 3 percent), the largest quarterly decline in the current downward trend

IMPLICATIONS OF FARMERS' PLANTING INTENTIONS IN 1978

by Gene D. Sullivan

To plant or not to plant is a question that has been discussed often in farming circles in recent months. News accounts of strike threats have left the public wondering whether and how much plantings might be reduced when the season for sowing seed actually arrived.

A survey of farmers themselves registered planting intentions as early as January 1, 1978, and again at the beginning of April. Interestingly enough, those surveys reveal little evidence of intent to hold land out of production. Instead, farmers indicate that they will be shifting acreages from those crops which yielded poor returns in 1977 to crops that appeared to offer brighter alternatives as the planting season approached.

Table 1 shows the April survey results for selected crops of importance in Sixth District states. Planting intentions of southeastern farmers are compared with plans of all U. S. producers of the same crops. District farmers plan sharp increases in plantings of soybeans and rice, while acreages of nearly all other crops are to be reduced or unchanged. At the national level, plans are similar. Acreages of cotton and corn, crops that are traditionally important in the Southeast, will be greatly reduced in the District and, to a lesser degree, in the nation.

Patterns for individual states are similar in the direction but variable in the degree of change. For example, soybean acreage is indicated to be 24 percent higher in Georgia but only 5 percent higher in

Louisiana. By contrast, corn acreage is to be cut by 20 percent in Georgia while Tennessee's reduction will be 8 percent. Plantings of cotton, long the mainstay of southern agriculture, are to be cut by 10 percent in the District and by 39 percent in Georgia, while Mississippi's acreage should drop by only 1 percent. The U. S. acreage will fall by 6 percent, with more than one-third of this reduction occurring in the states of the Sixth Federal Reserve District.

A summary of the indicated changes in crop plantings is shown in Table 2. The increase in soybean acreage will more than offset the reductions in other crops in Alabama, Louisiana, and Mississippi. However, large reductions in corn acreage will outweigh the rise in soybean plantings in Georgia and Florida; Tennessee farmers do not intend to expand acreage of any of the selected crops. Thus, total plantings in the District may be expected to fall this year. A 14-percent decline in winter wheat acreage that occurred last fall accounts for most of the drop in nationwide plantings. The cutback largely reflected the withdrawal of acreage that was required to participate in the government's income support program for wheat producers.

What will be the impact of acreage changes on District agriculture? The most broadly felt influence is likely to be a decrease in crop production expenditures. Generally, southeastern farmers will be shifting from crops which call for relatively high production expenditures to

TABLE 1
PLANTED ACREAGES OF SELECTED SOUTHEASTERN CROPS
WITH U. S. COMPARISONS

State	Area Planted			1978/77 (percent)
	1976	1977 (000 acres)	Indicated April 1978	
Soybeans				
Alabama	1,200	1,650	2,000	121
Florida	259	334	390	117
Georgia	890	1,250	1,550	124
Louisiana	2,280	2,750	2,900	105
Mississippi	3,335	3,750	4,000	107
Tennessee	1,920	2,300	2,300	100
Total Sixth District States	9,884	12,034	13,140	109
Total U. S.	50,226	59,080	63,664	108
Rice				
Louisiana	570	480	540	113
Mississippi	145	112	125	112
Total Sixth District States	715	592	665	112
Total U. S.	2,489	2,261	2,594	115
Upland Cotton				
Alabama	460	430	340	79
Florida	7	6	5	80
Georgia	255	255	155	61
Louisiana	570	545	500	92
Mississippi	1,530	1,380	1,370	99
Tennessee	420	325	275	85
Total Sixth District States	3,242	2,941	2,645	90
Total U. S.	11,610	13,637	12,843	94
Corn				
Alabama	880	840	680	81
Florida	542	623	436	70
Georgia	2,300	2,240	1,800	80
Louisiana	90	86	70	81
Mississippi	240	250	200	80
Tennessee	890	900	830	92
Total Sixth District States	4,942	4,939	4,016	81
Total U. S.	84,374	82,680	80,237	97
Winter Wheat¹				
Alabama	140	135	130	96
Florida	19	19	17	89
Georgia	150	135	160	119
Louisiana	45	45	40	89
Mississippi	150	140	100	71
Tennessee	365	373	310	83
Total Sixth District States	869	847	757	89
Total U. S.	57,668	55,980	48,141	86

TABLE 1 CONTINUED

State	Area Planted			1978/77 (percent)
	1976	1977 (000 acres)	Indicated April 1978	
		Oats¹		
Alabama	90	92	92	100
Florida	33	33	25 ²	76
Georgia	140	130	135	104
Louisiana	19	19	19 ²	100
Mississippi	30	30	25 ²	83
Tennessee	102	108	90	83
Total Sixth District States	414	412	386 ²	94
Total U. S.	16,734	17,793	16,408 ²	92
		Barley¹		
Georgia	7	9	9 ²	100
Tennessee	25	24	23	96
Total Sixth District States	32	33	32	97
Total U. S.	9,157	10,586	9,998 ²	94
		Rye¹		
Georgia	390	425	490	115
Tennessee	22	22	22	100
Total Sixth District States	412	447	512	115
Total U. S.	2,652	2,652	2,860	108
		Grain Sorghum		
Alabama	65	75	65	87
Georgia	85	75	70	93
Louisiana	45	35	35	100
Mississippi	71	60	50	83
Tennessee	45	40	40	100
Total Sixth District States	311	285	260	91
Total U. S.	18,639	16,994	15,925	94

¹ Includes acreage planted in preceding fall.

² Estimated.

Source: USDA.

soybeans, a crop requiring substantially lower financial outlays for most production inputs.

Table 3 shows the estimated production expenditures for southeastern crops in 1977. Cotton is one of the most expensive crops to produce, entailing especially heavy production outlays for fertilizers and chemicals. With variable costs estimated at \$203 per acre, a reduction of 296,000 acres in the District states will decrease total cash expenditures for cotton production by \$60.1 million (see Table 4).

A reduction of 923,000 acres of corn will lower the variable production expenses for that crop by \$97.8 million, or an estimated \$106 per acre. The combined reduction of \$163.3 million in corn, cotton, and wheat outlays will not be fully offset by the cost of the 1,106,000 additional acres to be planted in soybeans and the 73,000-acre expansion in rice. With variable expenditures of \$68 per acre, the additional expenses incurred by the larger soybean crop will be about \$75.2 million; expanded rice acreage will add another \$16.9 million.

TABLE 2
SUMMARY OF INDICATED CHANGES IN CROP PLANTINGS, 1978

Item	Alabama	Florida	Georgia	Louisiana	Mississippi	Tennessee	Sixth District States	U.S.
				(000 acres)				
Soybeans	+ 350	+ 56	+ 300	+ 150	+ 250	0	+ 1,106	+ 4,584
Rice	—	—	—	+ 60	+ 13	—	+ 73	+ 333
Upland Cotton	- 90	- 1	- 100	- 45	- 10	- 50	- 296	- 794
Corn	- 160	- 187	- 440	- 16	- 50	- 70	- 923	- 2,443
Winter Wheat	- 5	- 2	+ 25	- 5	- 40	- 63	- 90	- 7,839
Oats	0	- 8	+ 5	0	- 5	- 18	- 26	- 1,385
Barley	—	—	0	—	—	- 1	- 1	- 588
Rye	—	—	+ 65	—	—	0	+ 65	+ 208
Grain Sorghum	- 10	—	- 5	0	- 10	0	- 25	- 1,069
Total	+ 85	- 142	- 150	+ 144	+ 148	- 202	- 117	- 8,993

— Signifies no production.

Source: Calculated from data presented in Table 1.

TABLE 3
**ESTIMATED VARIABLE COSTS OF PRODUCING
SELECTED CROPS IN SOUTHEASTERN STATES**

Item	Upland Cotton	Corn	Small Feed Grains ¹	Winter Wheat	Soybeans	Rice
			(\$ per acre)			
Seed	5.64	8.19	4.56	7.50	6.12	22.38
Fertilizer and Lime	36.70	41.26	17.21	27.04	10.86	39.45
Chemicals	66.01	14.98	2.04	.48	16.48	24.59
Custom Operations	17.50	8.82	6.16	2.99	5.69	18.99
Labor	17.72	12.19	9.85	8.60	12.26	33.67
Fuel and Lubricants	9.40	7.19	5.66	5.24	7.38	31.72
Repairs	20.25	7.83	5.86	5.68	7.61	14.47
Ginning/Drying	24.75	2.79	.49	—	—	33.09
Other ²	4.89	3.15	1.78	2.55	1.87	13.07
Total Variable ³	202.86	106.40	43.61	60.08	68.27	231.43

¹ Oats, barley, rye, and grain sorghum. Estimates of some components of these costs were adapted from regions nearest to the Southeast.

² Includes interest on operating capital and miscellaneous expenses.

³ Fixed costs for machinery, equipment, land, and management are not included. Once incurred, fixed costs do not influence decisions of which crops to plant in a given year.

Source: Committee on Agriculture and Forestry, United States Senate.

Thus, the indicated planting cutbacks in the Southeast should trim production expenses by \$70.5 million from 1977's level. Although per acre costs of production differ at the national level, there, too, the additional 4.6 million acres of soybeans will not make up for the nearly 12 million-acre reduction in plantings of cotton, corn, wheat, and oats.

Are actual plantings likely to differ significantly from announced intentions?

Evidence indicates that farmers base their actions on the prices of their products that prevail during the three months just prior to planting and on their most recent production experiences. For example, those farmers who experienced disappointing yields of cotton and corn in 1977 because of the drought may turn to other crops they perceive to be more successful. In Georgia particularly, the poor returns from cotton and corn in 1977 are no doubt the

TABLE 4
IMPACT OF ACREAGE CHANGES ON PRODUCTION
EXPENDITURES FOR SELECTED SOUTHEASTERN CROPS

Item	Variable Cost per Acre	Acreage Change Indicated	Projected Expenditure Change
Upland Cotton	\$203	- 296,000	- \$60,088,000
Corn	106	- 923,000	- 97,838,000
Small Feed Grains*	54	+ 13,000	+ 702,000
Winter Wheat	60	- 90,000	- 5,400,000
Soybeans	68	+ 1,106,000	+ 75,208,000
Rice	231	+ 73,000	+ 16,863,000
Total Change in Production Expenses			- \$70,553,000

*Oats, barley, rye, and grain sorghum.
Source: Drawn from data presented in Tables 2 and 3.

major influence behind a massive shift in crop acreage to soybeans in 1978. Soybean yields were not depressed nearly as much by last year's dry weather as were yields of other crops.

The commodity for which prices changed most from December to April is soybeans. The average price of \$6.05 per bushel during the first quarter of the year was 33 cents per bushel above the December price level, and prices were rising with each successive month. A continuation of that rate of gain could encourage farmers to plant even more acreage in soybeans than they planned in April, especially if conditions prove unfavorable for planting of corn and cotton through the normal planting time. The

exceptionally dry weather in March and early April that prevented emergence of seeds in the southern areas of the District (north Florida, south Georgia, and south Alabama) could intensify the shift to soybeans.

The final planting decisions of farmers will not be known until the acres are counted at the end of June. It seems certain, however, that those numbers will show reductions in acreages of most crops in favor of soybeans. That, in turn, will have reduced crop expenditures and the needs for production financing during the 1978 crop year. The latter may be an especially welcome development in those areas where farmers have not yet been able to repay 1977 loans. ■

FEWER CATTLE = LESS BEEF = HIGHER PRICES

by Yvonne F. Davies

Beef supplies will be less plentiful in coming months as a result of the prolonged period of economic adversity that has affected cattle producers throughout the country. Over the past four years, depressed cattle prices and rising production costs have induced cattlemen to reduce the size of their herds; some ceased operations altogether when

they were no longer able to survive the heavy losses. The adjustment in cattle numbers, which began with a plunge in cattle prices in 1974, reached its most severe proportions during 1977.*

* Although producers began inventory adjustments in 1974, inventories continued to rise in 1975 because of breeding decisions made when prices were high

**JANUARY 1 CATTLE INVENTORIES BY CLASSES
DISTRICT STATES AND U. S.**

State or Area	1975	1976	1977	1978	Percent Change	
					1975 to 1978	1977 to 1978
		(thousand head)				
All Cattle and Calves:						
Alabama	2,700	2,850	2,360	2,130	-21	-10
Florida	2,950	2,920	2,800	2,350	-20	-16
Georgia	2,420	2,370	2,300	1,975	-18	-14
Louisiana	1,832	1,880	1,700	1,425	-22	-16
Mississippi	3,000	2,723	2,670	2,130	-29	-20
Tennessee	3,300	3,100	3,000	2,700	-18	-10
Total District States	16,202	15,843	14,830	12,710	-22	-14
Total U. S.	132,028	127,980	122,810	116,265	-12	-5
Beef Cows:						
Alabama	1,238	1,310	1,093	1,015	-18	-7
Florida	1,468	1,419	1,378	1,212	-17	-12
Georgia	1,060	1,037	961	839	-21	-13
Louisiana	909	952	856	727	-20	-15
Mississippi	1,458	1,325	1,325	1,100	-25	-17
Tennessee	1,349	1,338	1,300	1,155	-14	-11
Total District States	7,482	7,373	6,913	6,048	-19	-13
Total U. S.	45,712	43,888	41,389	38,747	-15	-6
Replacement Beef Heifers:						
Alabama	257	199	182	138	-46	-24
Florida	265	258	232	181	-32	-22
Georgia	184	180	164	128	-30	-22
Louisiana	183	152	136	106	-42	-22
Mississippi	336	231	246	184	-45	-25
Tennessee	300	257	208	199	-34	-3
Total District States	1,525	1,277	1,166	936	-39	-20
Total U. S.	8,884	7,196	6,529	5,834	-34	-11

Nondairy females that have calved.

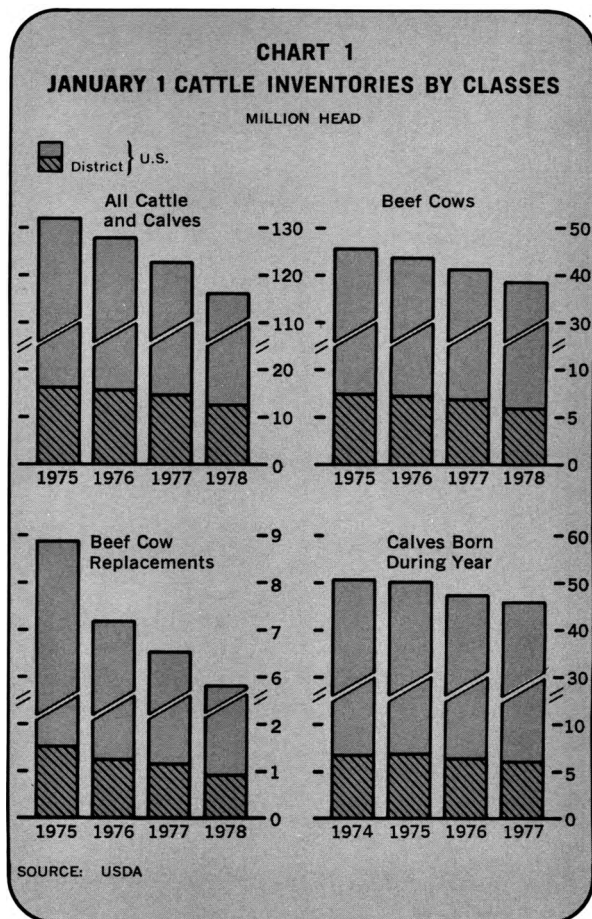
Young cows that have not calved and weigh at least 500 pounds.

Source: Economics, Statistics, and Cooperative Service, U. S. Department of Agriculture.

The unusually harsh weather in January and February of 1977 made for poor grazing conditions. Then, a summer drought hit the Southeast and West, causing shortages of forages. These setbacks, along with continuing low production returns, forced a larger-than-normal movement of cattle to slaughter and to feedlots last year. As a result, the January 1, 1978, inventory showed a decrease of over six million head, a 5-percent drop from the previous January and the sharpest one-year decline on record (see table). That number represents a 12-percent reduction from the all-time high January 1, 1975, cattle count.

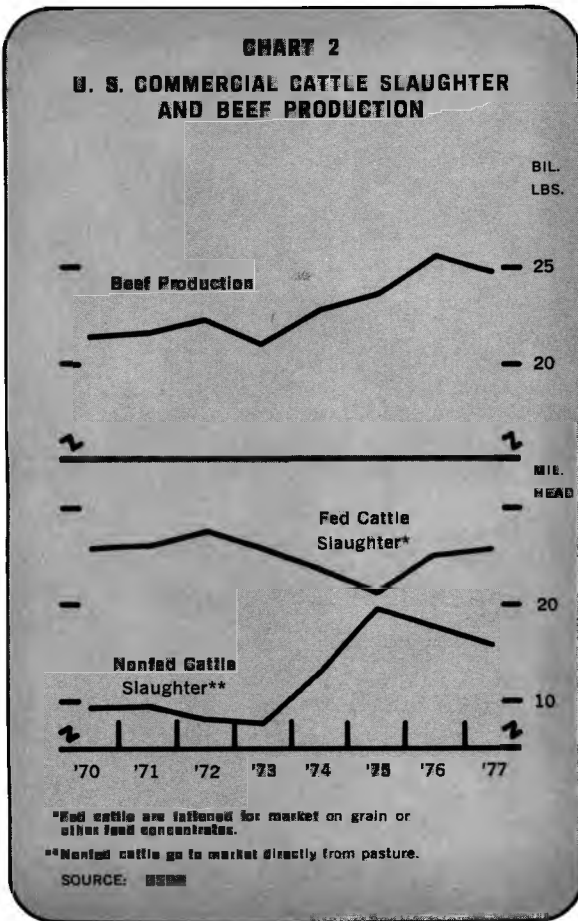
Rapid liquidation of the cattle herd over the past three years contrasts sharply with the 2- to 5-percent annual inventory gains of the early 1970s, when production was in an expansion phase. Cattle production is characterized by cycles, with herd expansion occurring during periods of strong prices and contraction when prices are less favorable. The last expansion phase began in 1967 and ended in 1975. During the herd build-up, cows were held for breeding purposes and slaughter slowed. In the recent liquidation phase of the cattle cycle, cattlemen stopped holding extra animals for future herd expansion and began heavy culling of the breeding stock. Some producers eventually sold entire herds. The result has been a relatively high slaughter rate. In 1977, total commercial slaughter of cattle and calves reached 47.4 million head, or 39 percent of the January 1, 1977, herd. This was the highest rate in 20 years and marked the second straight year in which total slaughter exceeded the new calf crop. Such imbalances rapidly diminish the inventory on which future beef production depends.

In the Sixth District states, producers trimmed their cattle numbers by 2.1 million head during 1977. The 14-percent rate of liquidation greatly outpaced the national rate. In comparison, the District had led the national trend of herd reduction only slightly in 1976 but had trailed it in 1975 (see table). Mississippi and Florida accounted for nearly half of the area's 1977 decline in cattle numbers. In contrast, Alabama and Louisiana had the smallest herd reductions, possibly



because they had led the downturn in 1976 and were further along in the adjustment process. Except for Georgia and Tennessee, where fed cattle numbers increased, all District states reduced their inventories in each cattle class and for total cattle.

An examination of the inventories of the different cattle classes shows the District paralleling the nation in the relative size of each class reduction. For both the U. S. and District, the largest decrease in numbers occurred in beef cows, calves born, and beef cow replacements, in that order (see Chart 1). The substantial reductions in the beef breeding stock reflect the poor financial condition of many cattlemen and indicate declining beef supplies for the next few years, especially after 1978. By January 1, 1977, the District states' share of the nation's beef cow inventory and calf crop had ceased to rise and, by the beginning of this



year, had fallen. This interruption of a long-term trend is likely to be only temporary, however, because the Southeast has an advantage over most of the rest of the nation in grass production. As grass-fed beef increases in importance, the cattle industry of this region is likely to continue to grow. Recent rises in feeder cattle prices suggest improved returns for cow-calf producers in the Southeast. Profitability hasn't returned, but the outlook is certainly brighter for the District's cow-calf operations than it has been since early 1974. With higher prices for calves and larger supplies of forage, cattlemen will probably halt herd liquidation this year and start to rebuild their stocks.

Earlier, massive herd liquidation and heavy slaughter had boosted beef production through 1976. (See Chart 2). But, by 1977, cattle inventories had been trimmed so much that beef supplies began to fall. Further declines are expected for the next few years because of the long lead time required to increase production. For example, breeding decisions made in the Southeast on April 1, 1978, won't result in an increase in the supply of feeder calves for 18 months. The beef supply will not be increased until 24 months into the future. The lead time consists of a 9½-month gestation period, a 9-month weaning period, and 6 months on feed. Beef production will also be limited by the withholding of females for breeding stock when the expansion phase of the cattle cycle gets under way.

The short supply of cattle has important price implications for cattlemen and for consumers. Prices of live cattle and retail beef have already begun to rise and are expected to continue their ascent. The amount of the increase in beef prices at the supermarket will depend on the supply of competing meats, primarily pork and broilers. Prices of hamburger and other lean beef cuts should rise at a faster rate than the more expensive cuts due to the sharp drop in the slaughter of grass-fed beef, the major source of lean beef. With more cattle fattened in feedlots and fewer slaughtered directly from pastures, the beef supply for the next few years will consist of more fed beef and less nonfed beef.

Summary. The long period of economic hardship may finally be ending for cattle producers. Reaching this turnaround point has required massive reductions in cattle numbers since 1975, with the most drastic herd liquidation occurring in 1977. For consumers, the resulting short supply of cattle will mean less plentiful supplies of beef and higher beef prices at the supermarket. To cattle producers, it means the first real improvement in cattle prices in four years and a brightening of prospects for the future. ■