

# Monthly Review

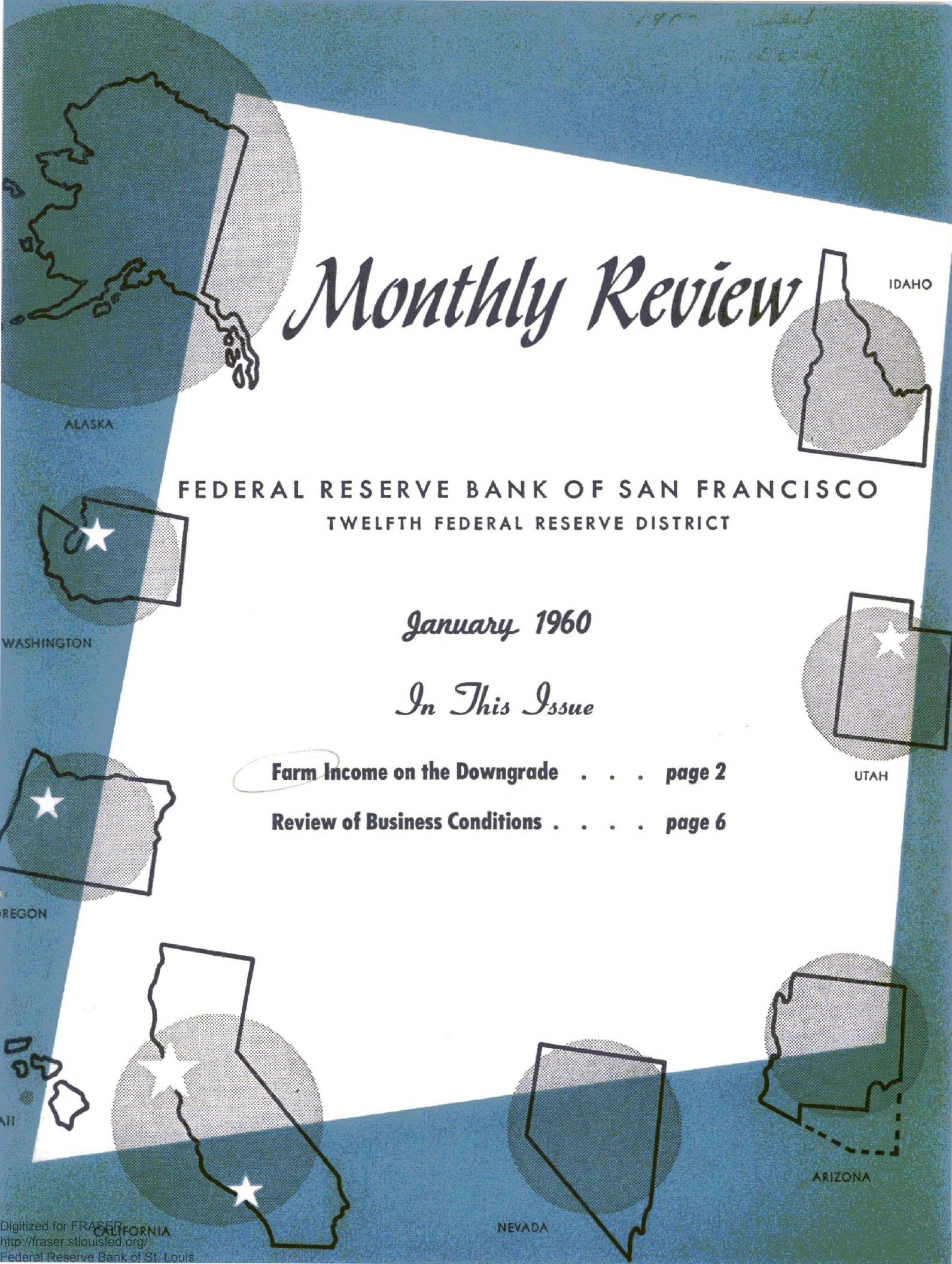
FEDERAL RESERVE BANK OF SAN FRANCISCO  
TWELFTH FEDERAL RESERVE DISTRICT

January 1960

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ALASKA

IDAHO

WASHINGTON

UTAH

OREGON

HAWAII

CALIFORNIA

NEVADA

ARIZONA

# Farm Income on the Downgrade

**I**n our expanding and fluctuating economy, the agricultural sector is continually faced with adjustment problems. Periodically these adjustment problems of a continuing nature are overshadowed by changes within the agricultural sector which may be independent of the cyclical course of general business activity. Conditions now present in the agricultural sector suggest that such changes are underway within agriculture as farm prices and income decline while the rest of the economy shows signs of strengthening.

Net income of the nation's farm operators in 1958 reached the highest point in six years, but has been trending downward in 1959. If an extended reduction in farm income should materialize, it would not be the first such decline since the end of World War II that began when other sectors of the economy were expanding. The consequences, however, may be more severe for agriculture than earlier in the postwar period.

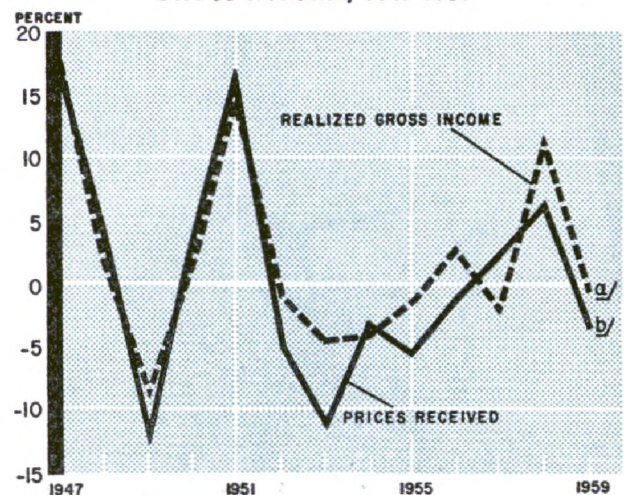
## Farm prices, marketings, and gross income

The level of farm production usually changes only moderately from year to year. This would suggest that minor changes would also occur in gross farm income. However, as shown in Chart 1, changes in farm prices account for much of the annual changes in gross income. Apart from price changes, the relationship between farm production and farm income is modified by additions to or subtractions from farm inventories. For example, an unusually large increase in the production of farm crops will be reflected in increased farm income, if the bumper crops are eligible for price supports. Although direct marketings may also rise, a substantial proportion of the increased marketings flows into Commodity Credit Corporation inventories, and, because the level of price support

is set prior to planting time, any unusual increase in yields which boost production is not promptly nor fully reflected in downward price adjustments at the farm level. For example, the 50 percent increase in wheat production (about 500 million bushels) in 1958 helped boost cash receipts above the level received in the previous year as the actual price to growers declined only 11 percent. To a large extent, the decline in price that did occur reflected an earlier reduction in the level of price support for wheat. On the other hand, an unusually small crop, as judged by previous production standards, may result in only a minor strengthening in price because stocks held by the price support agency can, in some cases, be sold on the domestic market at prices which are not much above the support level. For many crops the policy of the Federal Government regarding the level of price support is the major determinant of prices farmers receive.

The situation in the livestock sector of agriculture is somewhat different. There are

CHART 1  
YEAR-TO-YEAR CHANGES IN  
PRICES RECEIVED BY FARMERS AND REALIZED  
GROSS INCOME, 1947-1959



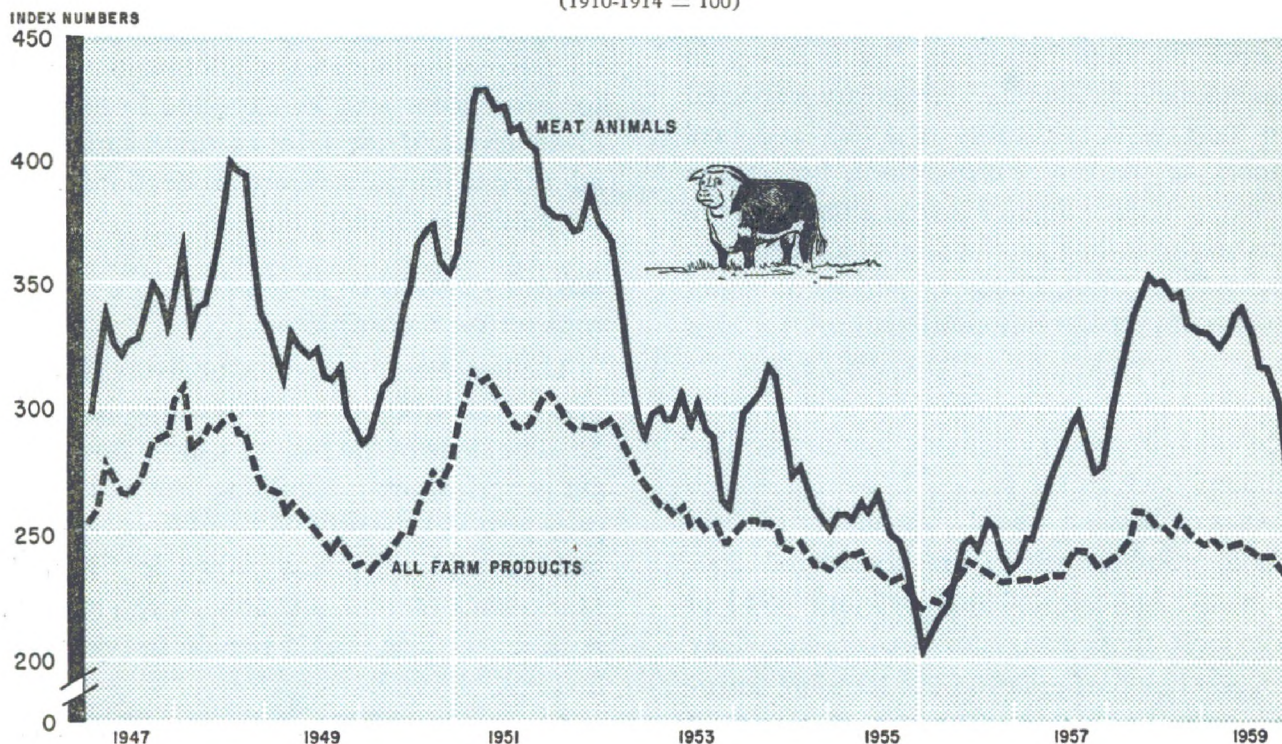
<sup>a</sup>Average for three quarters. <sup>b</sup>Average for 11 months.  
Source: United States Department of Agriculture: *Agricultural Prices and Farm Income Situation*.

no direct price supports for major livestock products such as beef and pork. Hence, the price response to changes in the volume of marketings is much greater than for price-supported crops. Marketings also may vary substantially, but the year-to-year fluctuations may not be as sharp as in the case of individual crops. This is due largely to the relatively long production period before decisions to expand meat animal production are reflected in increased marketings. Reductions in production, however, are not impeded by biological considerations, but, even if production is reduced, marketings may rise for a period of time as farmers reduce their livestock inventories. As livestock prices are quite flexible, particularly meat animal prices, they are closely associated with changes in gross farm income that stem from price changes, particularly changes which persist for longer than one year, as shown in Chart 2.

### Farm prices and net income

Prices paid by farmers for nonfarm goods and services used in agricultural production, including such items as machinery repairs and fuel, have risen 30 percent since 1947-49, thereby tending to exert downward pressure on net farm income. The pressures of these nonfarm cost items have at times been accentuated or modified depending on fluctuations in the prices received by farmers. Farm prices enter the cost side of farming because substantial quantities of agricultural items such as feed, seed, and livestock are involved in transactions between farmers. Since the end of World War II, such transactions have averaged 50 percent of annual current operating expenditures. Hence, during periods of declining farm prices, the cost of agricultural based production items also tends to decline and to offset the effects of rising nonfarm

CHART 2  
 PRICES RECEIVED BY FARMERS FOR MEAT ANIMALS AND ALL FARM PRODUCTS,  
 MONTHLY, 1947 TO DATE  
 (1910-1914 = 100)



Source: United States Department of Agriculture, *Agricultural Prices*.

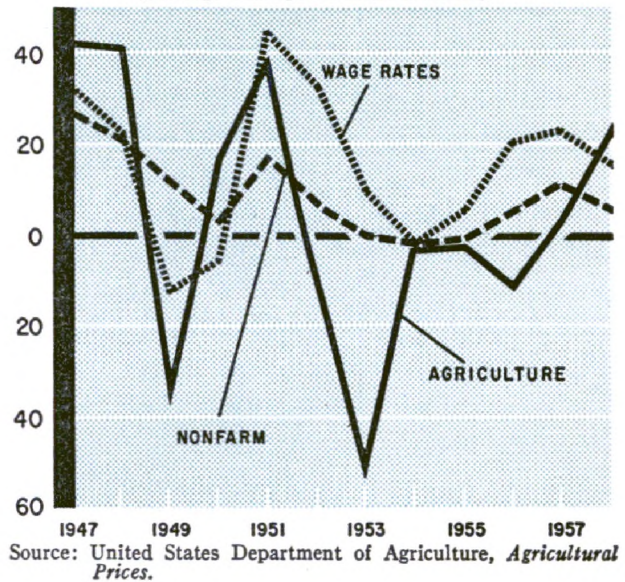
prices on net income. On the other hand, if both farm prices and nonfarm costs rise together, the upward pressure on production costs is accentuated. It is quite evident from Chart 3 that most of the variability in production expenditures results from price changes of agricultural inputs.

When prices received by farmers are declining, the impact is greatest for those farmers producing items primarily for sale to other farmers and relying heavily on production items from the nonfarm sector of the economy. This is because the offsetting effect on their costs which is associated with declining farm prices is relatively minor, while the reduction in prices they receive has a substantial effect on their receipts from sales. However, these farmers reap the benefits from a rise in farm prices for the same reason.

### The current situation

Farm prices have been trending downward since the spring of 1958 but were not fully reflected in cash receipts for 1958 because of heavier marketings. In addition, the inventory of cattle and calves on the nation's farms has been increasing this build-up in inventories, cattle marketings are expected to increase considerably in 1960, and beef prices to weaken. Furthermore, hog prices have been declining for a year along with the expansion in hog production which began in the fall of 1958. Gains in pork production may end in 1960 but continuation of a high level of production in 1960 will have a depressing effect on beef prices, as well as holding pork prices at relatively low levels. Declining beef cattle prices, however, are in prospect beyond 1960. Projections of beef cattle numbers which are considered conservative indicate an expansion until 1963 or 1964. If these estimates are correct, they suggest that beef prices will be trending downward for some time in the future. The cyclical low point in cattle prices usually occurs in the

CHART 3  
YEAR-TO-YEAR CHANGES IN FARM WAGE RATES AND PRICES PAID BY FARMERS FOR NONFARM AND AGRICULTURAL ITEMS  
(Average unweighted index numbers)



contraction phase of the cycle in beef cattle numbers.

Crop prices are also lower than last year. The levels of price support for all price-supported field crops were reduced in 1959, except for corn produced on acreage not in compliance with acreage allotments. Prices for farm crops may be expected to move to lower levels, if the level of price support is adjusted to the point where production will be responsive to market prices.

### Recent periods of cost-price movements compared

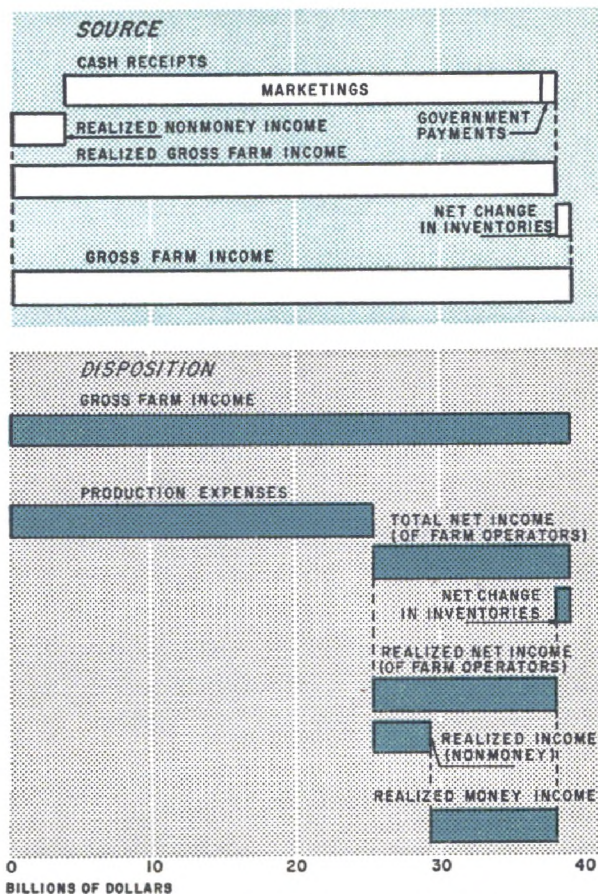
The last prolonged period of diverging farm prices and nonfarm prices occurred in 1951-55. The stage of the livestock cycle now present in agriculture is similar to that which was present in 1951 and 1952 and is reflected in meat animal prices, as shown in Chart 4. Marketings of beef are now increasing and pork marketings should remain heavy in the first half of 1960.

The reduction in net income during the 1951-55 period was associated with declining

prices for livestock products, particularly meat animals. Crop prices also edged downward during this period, although the level of support extended to producers of some of the major field crops was actually higher in 1955 than in 1951. The decline in crop prices, however, was relatively small, although the prices farmers received for major price-supported crops were considerably above support levels in 1951. Decisions concerning the future level of support for price-supported crops will largely determine whether crop prices, except perhaps corn prices, deter a decline in prices received by farmers from 1958 levels to the extent that they did in the 1951-55 period.

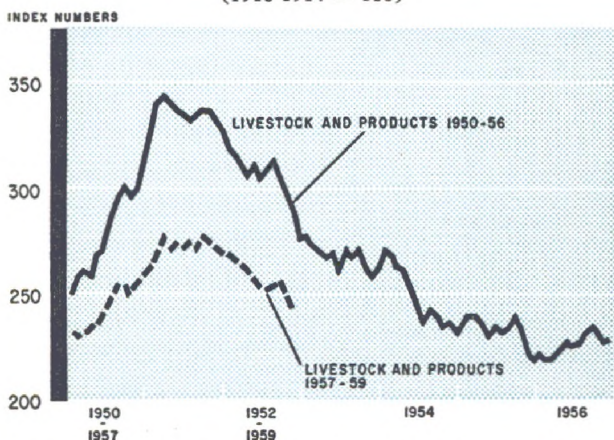
If an extended decline in farm prices should materialize, the current financial position of agriculture is much less favorable than in the early stages of the last period of diverging farm prices and nonfarm prices. When farm prices began to decline in 1951, they were much higher in relation to prices paid by farmers than in recent months. The parity ratio stood at 113 in February of 1951 compared with 82 in the first five months of 1959. Moreover, farm prices were at their peak in Feb-

CHART 5  
FARMER AND HIS MONEY



Note: Data used in this illustration are from 1958 farm income figures.  
Source: United States Department of Agriculture, *Farm Income Situation*

CHART 4  
PRICES RECEIVED BY FARMERS  
FOR LIVESTOCK AND LIVESTOCK PRODUCTS,  
1950-56 AND 1957 TO DATE  
(1910-1914 = 100)



Source: United States Department of Agriculture, *Agricultural Prices*.

ruary 1951. The less favorable relationship between the prices that farmers pay and those they receive may result in substantially higher credit requirements than in 1951-55. In addition, farmers' liquid assets in relation to annual production outlays are lower now than in the early 1950's. Because farm land values are much higher in relation to net income than in 1951-55, farm land may not be as desirable collateral for farm loans. Further, the ability and the willingness of commercial banks to expand loans, as judged by their free reserve positions or loan to deposit ratios, is not as high as in earlier years. Since farmers' liquid assets are also relatively low, the pressure on other farm lending agencies to

provide credit to farmers may intensify as well as pressure merchants to expand the use of trade credit.

With gross farm income apt to decline, some reduction in production expenditure might be expected in an attempt to deter a decline in net income. But judging from past experience this is not likely to happen unless farm income declines sharply. Year-to-year changes in production outlays since the end of World War II have been closely associated with changes in gross farm income. However, because of the stronger upward trend, there have not been reductions between years in the annual level of production expenditures except when year-to-year declines in gross income approached or exceeded \$1.4 billion. Annual fluctuations in production expenditures that have occurred resulted largely from variations in prices paid by farmers and not from the quantity of inputs purchased.

Periodic reductions in farm income, which focus attention on the agricultural situation, are generally viewed as evidence of maladjustments between agriculture and the rest of the economy. The characteristics of the current reduction in farm income, however, indicate that it stems largely from maladjustments within agriculture which are temporary in nature, i.e., cycles in livestock production. Fluctuations in livestock numbers are not phenomena which developed with the price support program or any other recent innovation. There is some evidence of cycles in beef production as early as 1880. Since that early date, there have been changes in the amplitude and duration of the cycles, but periodic fluctuations in beef cattle numbers still persist. If the current reduction in farm income does stem primarily from circumstances in the livestock sector of agriculture, past experience indicates that the situation will correct itself.

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## Review of Business Conditions

**I**NCREASED flows of steel during December led to a strong resurgence in economic activity. Industrial production rebounded toward the summer high, the revised index of industrial production reaching 165 percent of the 1947-49 average, one point short of the pre-strike peak of 166 and nine points above the level in November. Employment rose more than seasonally during December to a new high for the month, and unemployment declined slightly in contrast to the usual seasonal rise. Construction put in place, after declining for six months, edged up to an annual rate of \$52.6 billion, and contract awards for new buildings also rose.

Final settlement of the steel dispute in early January assured a continuous flow of steel and permitted many businesses to more rationally plan their operations. Automobile production,

which rebounded in December, was scheduled to reach 700,000 units in January, the highest monthly volume since the spring of 1955. The still low levels of inventories evident in early January in many lines, prospects of a rise in plant and equipment spending, and strong consumer demand suggest an expansionary tone for the economy in the months immediately ahead.

A strong demand for credit was evident in December and early January. Bank credit rose more than seasonally in December, although the major part of the increase in bank loans reflected seasonal forces including borrowing for the December 15 tax date. A net increase of more than \$500 million in member bank reserves, including about \$260 million in vault cash which could be counted as reserves under new rules governing vault cash, was fully absorbed by an increase in deposits. Corporate

flotations of securities ran at a high level in December, and a sizable, though slightly reduced, volume was scheduled for January. The municipal market was congested in mid-December as dealers found retail demand hesitant in the face of the uncertainty as to how far the rise in interest rates might proceed. Price reductions cleared part of the inventories and put dealers in a better position to deal with the rather heavy volume of new issues expected in January.

December closed with interest rates at record levels for the year. A further rise in short-term rates occurred in early January. Prices on Government medium- and long-term securities declined in the first few days of the month, but subsequent to the President's State-of-the-Union message, which indicated a potentially large surplus for fiscal 1961, prices moved up. The overall result was that in mid-January interest rates were generally above the level in mid-December.

### **Twelfth District activity also expands**

Activity increased in most lines in the Twelfth District during December and early January. Though somewhat less important here than nationally, the increased flow of steel led to a resumption or expansion of output in a number of District industries. Lumber production fell substantially less than usual during December, reflecting a strong demand from retail yards. Partial settlement of the dispute in copper mining led to the resumption of output at some mines in Arizona and Nevada. Construction activity strengthened in part because of increased availability of steel. Retail trade was also stronger in December as more automobiles became available and other lines experienced record pre-holiday sales.

### **Year-end employment sets new high**

The Twelfth District closed the year 1959 with a further increase (seasonally adjusted) in employment from the record level of November. Manufacturing employment rose

moderately during December, reflecting additional recovery from the steel industry work stoppage and unusually high employment in the food canning and lumbering industries for this time of year. However, the District's major aircraft firms reported another net reduction in their work forces of nearly 5,000 workers, and this was only partly offset by gains in other defense-oriented industries. Largely because of declining aircraft employment, overall manufacturing employment in December remained about 0.5 percent below the mid-1959 record.

Small employment gains were reported by most nonmanufacturing industries in Twelfth District states during the month. Despite the downturn in residential housing starts since mid-1959, construction employment has moved up since then, and at year-end reached a new record after seasonal adjustment. Employment in the trade and service industries, including government, was also at a peak level during December, but mining employment continued to be depressed by work stoppages at mines and plants of major copper producers.

The winter upswing in unemployment was more moderate than usual during December, in part because workers idled as a result of steel shortages were being called back to their jobs by mid-month. With outdoor activity, including lumbering and construction, also being maintained at a higher than seasonal level, the rate of unemployment in Pacific Coast states dropped to about 4.4 percent of the labor force, the lowest level since the late summer of 1957. In the second half of December and in early January the weather was not so favorable, but it appears, nevertheless, that the more recent rise in unemployment has been no more than seasonal.

### **Lumber demand stronger in December**

A rise in orders during December, which appeared stronger than the usual year-end

increase, contributed to a smaller decline in District lumber production than is normally encountered late in the year. The stronger demand situation reflected low inventories in retail yards and a higher level of housing starts nationally than had been previously anticipated. District sawmill production during December ran about 10 percent ahead of a year ago. Lumber prices turned up in December, after registering some seasonal decline in the preceding months, and at year-end were about 7 percent higher than at the close of 1958.

Douglas fir plywood prices, which had been increased \$4 per thousand square feet in mid-December, were less firm in mid-January. Adequate stocks in the hands of wholesalers and renewed uncertainty over the outlook for home building restrained demand. Equally as important, according to some observers, was the continuation in growth of output capacity. Producers stated that it was difficult to obtain any substantial bookings at \$72 for ¼ inch sanded plywood and that in some areas, particularly California, the market was really \$68 per thousand despite a higher posted figure.

### **Steel output continues climb**

Steel output of District mills reached a level over 90 percent of capacity in December. Production was still under some restraint as one major producer was unable to approach capacity output. The flow of shipments, however, was close to pre-strike levels and demand was strong for almost all products produced by District mills. Reinforcing bars were reported as one major exception. Foreign supplies and temporary slowing of some types of construction appeared to be responsible for this development. Improved supplies of steel permitted increased production schedules in most major steel-using industries.

### **Production resumed at some copper mines**

A partial settlement of the labor-management dispute in copper was achieved in the

last week of December. Workers returned to Kennecott's mines in Arizona and Nevada in the Twelfth District, and in New Mexico, but workers in Kennecott's Utah division, which accounts for about two-thirds of Kennecott's Western Division output, remained on strike. In mid-January, Magma Copper Company reached a settlement and workers returned to the company's mines and plants in Arizona. Other producers were still negotiating a number of issues, other than wages. Continuation of the reduced level of operations in copper has produced some scarcity domestically but through mid-January quoted prices remained unchanged. The world supply of the metal is quite large and substantial price increases are reported as unlikely in the near future.

One aftermath of the steel settlement has been a resurgence in the demand for lead and zinc. Final settlement of the steel dispute resulted in a buying surge for zinc in early January and prices were increased from 12.5 cents to 13 cents for prime western grades. Lead buying was reported at the best level since August 1959, but prices remained at the reduced 12 cents quotation in effect since late December.

### **Total construction contracts change seasonally, but tightness continues in the home mortgage market**

Twelfth District construction contracts, as reported by the F. W. Dodge Corporation, declined 18 percent from October to November. Residential contracts were down by 20 percent, non-residential contracts by 10 percent, and public works and utilities by 22 percent. A November decline in contracts awarded is typical of past experience for all three of these types of construction. Preliminary indications for December, however, suggest a smaller than seasonal decline in heavy construction. In the case of residential construction, recent weakness was greater than seasonal, reflecting in part continued tightness in the District mortgage market.



The increased cost and reduced availability of mortgage money is evident from several important indicators. FHA applications declined by 40 percent from October to November to a level 45 percent below the same month of last year. Eastern savings banks in early January quoted a price of 92 on FHA 5¾ percent, 30-year maturity, minimum down-payment loans. Some eastern insurance companies quoted higher prices but attached new restrictive credit and property requirements to the loans. The availability of commitments for conventional mortgages in the District was also reduced. District savings and loan associations, a major source of funds for these mortgages, made a record number of loan commitments in the first half of 1959. The associations found, however, that they had over-committed themselves, since the inflow of new savings capital was insufficient to cover these commitments. As a result, they had to increase their borrowings from the Federal Home Loan Bank of San Francisco and reduce the number of new loan commitments. That bank, along with other regional banks, recently increased its rate on advances of less than 2½ years from 5 percent to 5¼ percent and on advances of 2½ years or more from 5½ percent to 5¾ percent. Because of these developments and a reduced rate of increase in savings shares in the closing months of 1959, savings and loan associations have been reducing their new mortgage commitments.

### **Bank loans expand in December**

Banks were confronted by a strong credit demand during December, and total loans of weekly reporting member banks in the District rose \$253 million in the four weeks ending December 30. While a major portion of the rise reflected seasonal forces and the December 15 tax date, the increase was more than usual. Business loans led the rise with an increase of \$92 million, and sales finance companies increased their bank borrowings by

\$54 million. All other types of loans, except loans to banks, also increased during the month. To finance part of the increased loan demand, weekly reporting banks in this District sold \$68 million in securities.

Despite the strong demand for bank credit in the closing quarter of 1959, rates on business loans rose only slightly. Average rates on short-term loans increased from 5.54 in the first half of September to 5.57 in the first half of December. The 0.03 percent increase was about one-tenth that in the preceding quarter. The unchanged prime rate over this period may have contributed to this steadiness. Interest rates on long-term business loans rose more sharply in the closing quarter from 5.28 percent to 5.62 percent. These loans, however, accounted for only 3 percent of the dollar volume reported in December by 24 large banking offices in five major cities of the District.

In early January, commercial banks in this District were confronted by a rise in withdrawals from savings accounts. Total time deposits of weekly reporting member banks in the District fell by more than \$260 million in the first two weeks of January 1960 compared with \$70 million in the same weeks of 1959. Higher rates of returns on Government securities and savings and loan shares induced some investors to shift their savings from time deposits at commercial banks to other types of assets. In particular, the volume of small orders placed by individuals for various types of Treasury securities rose sharply.

### **Retail sales in upswing**

December retail sales were up sharply in the District from November. A larger volume of automobile sales, as more cars became available, and a greater than seasonal increase in most other trade lines brought dollar volume well above the November level. Department store sales, after a slow start in holiday shopping during November, rose about 7 percent in December, producing a Christmas sea-

son increase of 6 percent over 1958. Total dollar volume at District department stores, after allowance for seasonal forces, was still below the all-time highs recorded in mid-summer, but it was the best Christmas on record. The gain in December auto sales over the prior month was less than dealers had expected, but inventories were low during most of the month and may have restricted consumer choices excessively.

### **Record flow of cash to District farmers**

Following a new high in District cash receipts from farm marketings for any October on record, cash receipts in November slipped slightly but were at the highest November level since 1951. For the first 11 months of 1959, District farm cash receipts were about \$100 million higher than for any comparable period.

The higher level of cash receipts, however, was not general among District states. Only Oregon and California had higher cash receipts than a year ago for the 11-month period. The increase in District cash receipts resulted primarily from higher farm returns in California, where heavy marketings of cotton have been the chief supporting factor during recent months. Oregon's increase reflected higher average prices for feed grains, and increased production of fruit, nut, and seed crops. Weakness in the price of meat animals continued,

however, reducing farm receipts in a number of states.

### **Heavy volume of January municipal bond issues**

Municipal bond offerings by District governmental units swung into high gear in the first half of January, following a virtual absence of new flotations in the last part of December. District governmental units had sold \$164 million in bonds in issues of \$5 million or larger by January 18, with another \$38 million in prospect later in the month. This \$202 million in new bonds represents about a fourth of the offerings scheduled for the nation in January.

Attracting most attention was \$100 million in State of California bonds which had been postponed from December. This represents the first part of \$450 million to be issued by the State in 1960. The January issue, \$50 million in Veterans' bonds and \$50 million for State construction, was favorably received and sold out quickly. Net interest cost to the State was 4.0186, compared with the 4.009 percent the State paid last September when it put out a similar issue.

California municipal bond yields increased in late December and early January to the high point reached last September. This level is about one-third of a percent higher than a year ago.



