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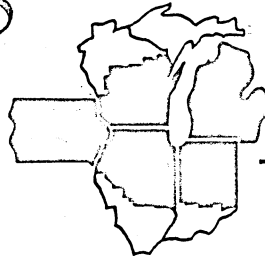
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Federal Reserve Bank of Chicago - -

November 30, 1973

Agricultural Letter

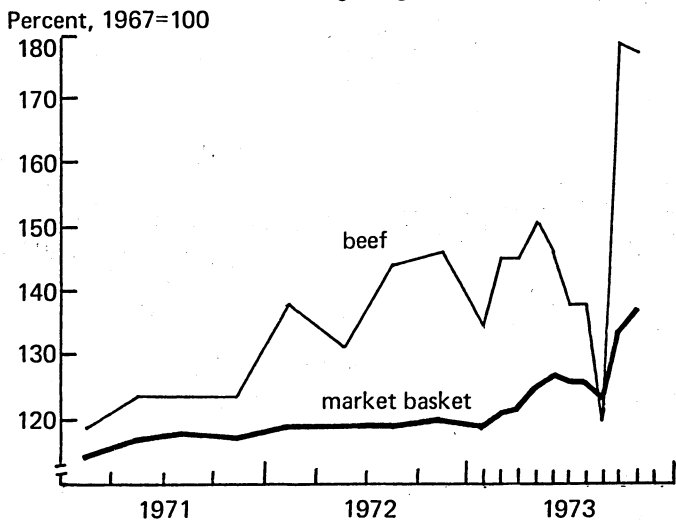


Number 1250

FOOD PRICES in grocery stores declined marginally for the second consecutive month in October, while prices of food eaten away from home continued to advance sharply. These developments left the overall index of food prices just under the August peak and nearly 19 percent above the October 1972 level. For all of this year, food prices are expected to average about 14 percent above a year ago. The recent declines in food prices are modest compared to the substantial declines in farm-level prices. As a result, marketing spreads have widened significantly.

Meat and poultry prices have paced the recent softening in prices of food consumed at home, offsetting gains in dairy products and in cereal and bakery products. Retail prices of beef and veal during October declined 3.6 percent from the September peak, while pork and poultry prices extended their September declines by falling 10 and 30 percent, respectively, from August peaks. Despite these declines, beef prices still exceeded the October 1972 level by 24 percent, while pork and poultry prices were up approximately 40 percent.

Beef Paces Gains in Widening Marketing Margins



Note: 1971 and 1972 by quarter; 1973 monthly.

Farm-level prices have registered a much larger decline since August than have retail food prices. As a result, the farm-to-retail spread in the value of a market basket of farm foods—a rough measure of the costs and profits involved in processing and distributing food—widened further in October. The latest increase in the spread follows a large surge in September when Phase IV controls first permitted pass-throughs of all costs. The farm-to-retail spread—which accounts for over one-half of the retail value of the market basket of farm foods—averaged 13 percent above year-earlier levels during September and October, compared to a 5.5 percent average for the first ten months of this year and a rather stable average annual gain of 2.6 percent during the past ten years.

Higher margins for beef continue to pace the year-to-year gain in the overall farm-to-retail spread in the market basket. The spread for beef averaged 53 cents per pound dur-

ing September and October, about 21 percent above year-earlier levels. Pork margins, after falling sharply in July and August, have also exhibited comparatively large gains recently.

Several factors no doubt support increased marketing margins, but the magnitude of the recent gains appears unusually large. For example, the relative increase in hourly earnings of employees in firms processing and distributing food products has been slightly below last year's pace during the first eight months of 1973. Nevertheless, unit labor costs probably have increased somewhat more than normal, reflecting continued slower gains in labor productivity and reduced supplies moving through the food marketing system. Overall, labor costs account for nearly one-half of total food marketing costs.

Larger-than-normal gains also have been evident in such costs as transportation, container and packaging materials, fuel, and electricity—factors absorbing around 30 percent of the total food marketing bill. During the third quarter, for example, the index of prices paid by food marketing firms for fuel, power, and light rose 9.5 percent above the year-earlier level, nearly double the annual gain registered in 1972. A continuation of large gains in the costs of these inputs can be expected under present conditions.

Widening profit margins—which account for only about 6 percent of the total food marketing bill—may also be contributing to the recent surge in the farm-to-retail market spreads. Some improvement could be expected at the retail level, however, since profits fell to unusually low levels in 1972 and the first half of 1973 due to extremely competitive conditions. For example, after-tax profits of 15 retail food chains declined to 6.1 percent of stockholder equity last year, compared to an average of 10.7 percent during the latter half of the Sixties.

On balance, it appears that the recent surge in food marketing margins is unusually large and holding retail food prices well above the levels suggested by farm prices. If the margins were to narrow, further reductions in retail food prices may be evident yet this year since farm-level prices are expected to remain stable. Further gains in food prices are expected in the first half of 1974, however, as lagging red meat supplies are likely to result in higher prices. Higher prices of dairy products and some processed fruits and vegetables are also anticipated in conjunction with tight supplies and strong demand.

Gary L. Benjamin
Agricultural Economist