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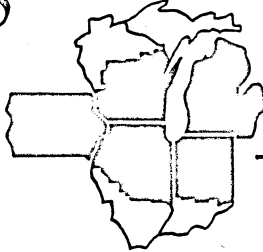
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Federal Reserve Bank of Chicago - -

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S DC BRANCH

Agricultural Letter



Number 1252

CAPITAL EXPENDITURES by farmers rose sharply this year in response to record incomes and expanded crop acreage. According to the Bureau of Commerce, total capital expenditures in the farm sector averaged \$9.8 billion on a seasonally adjusted annual basis during the first three quarters of this year. This 26 percent increase from the corresponding year-earlier level follows a 16 percent advance last year and represents the largest percentage gain since 1948.

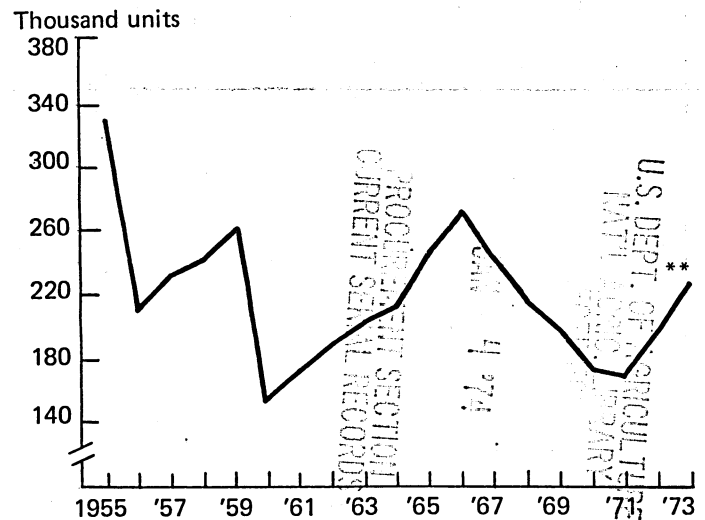
The rising capital expenditures have been particularly evident in machinery and equipment purchases which were at an annual rate of \$8.3 billion through the third quarter—up nearly \$2 billion from last year. According to the Farm and Industrial Equipment Institute, unit retail sales of farm tractors through September were running 25 percent ahead of the rapid pace of a year ago. Similarly, sales of combines and corn heads were up about 50 percent, while unit sales of balers, windrowers, and forage harvesters were all roughly 20 percent ahead of last year's pace.

The two-year surge in sales of farm tractors and equipment has outstripped the gains in manufacturers' production, resulting in depleted inventories, lengthy order times, and higher prices particularly on used equipment. (There have been reports of used equipment selling at a premium over new equipment.) During the first nine months of this year, the indexes of industrial production for both farm tractors and farm equipment averaged about 14 percent ahead of year-earlier levels—well below the relative advances registered last year following the unusually low levels of production in 1971, the lowest since 1960. Nevertheless, total production of farm tractors this year is likely to be the largest since 1967.

The reduced levels of unit tractor production in recent years partially reflect the highly cyclical nature of the farm equipment industry (as indicated in the chart) and the increased emphasis on production of large tractors as opposed to intermediate-size tractors. For example, production of tractors with a rating of 100 horsepower or more increased 2.7-fold between 1967 and 1972, and accounted for nearly 28 percent of total tractor production as opposed to only 8 percent in 1967. In contrast, production of tractors with a rating of 50 to 70 horsepower declined 23 percent over the same five-year period, while production of those with a rating of 70 to 90 horsepower declined 56 percent. Production of small tractors—9 to 40 horsepower—declined nearly 6 percent between 1967 and 1972.

The surge in farm capital expenditures largely reflects the sharp gains in net realized farm income during the past two years. The presently-estimated \$25 billion in net farm income for 1973 exceeds last year's level by 27 percent and the 1967-71 average by 61 percent. Moreover, the availability of the investment tax credit and accelerated depreciation no doubt have been particularly important this year as farmers seek strategies to minimize income tax liabilities. As established by the Revenue Act of 1971, investment credit provides a tax credit equal to 7 percent of the purchase price of farm equipment having a useful life of seven years or more.

Production of Wheel Tractors* in Upswing
From Cyclical Downturn



*Excludes garden tractors and contractors' off-highway tractors.
**Estimate based on first nine months.

For 1974, several factors indicate that capital expenditures by farmers will remain at high levels. Reports of exceptionally lengthy order times have been widespread this year, suggesting that a large portion of deliveries will not be made until next year. Moreover, the elimination of all set-aside requirements for the 1974 feed grain, wheat, and cotton programs indicates another sizable increase in planted acreage next year, which combined with this year's increase might boost planted acreage 12 percent above the 1968-72 average.

Net farm income is expected to remain high next year although some decline from this year's level is anticipated. Preliminary estimates by the U. S. Department of Agriculture suggest that net farm income may fall to around \$21 billion next year. Nevertheless, that would still be the second highest amount on record.

Interest rates may somewhat dampen capital purchases by farmers next year. Although many observers anticipate interest rates may decline in 1974 from current high levels, rates are likely to average above year-earlier levels. Attempts to quantify the impact of high interest rates on farm equipment purchases give widely varying results, but most show some reduction in purchases associated with high interest rates.

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