ILLINOIS FARM AND FOOD OUTLOOK

COLLEGE OF AGRICULTURE
DEPARTMENT OF AGRICULTURAL ECONOMICS

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INFLATION INDICATORS ON THE INCREASE

RECENT MONTHLY REPORTS ON WHOLESALE AND CONSUMER PRICES have shown higher rates of price-level increases than were the case only a few months ago. Much of this rise has been blamed on the unusually severe winter, which temporarily interfered with the nation's ability to produce goods and services. However, a close look at the recent direction of key economic indicators reveals trends that lead to a forecast of higher inflation rates for the next few years.

The rate of increase in the money supply is the best single indicator of future inflation. America's economy needs the constant creation of new money to finance the annual 3 to 5 percent growth in production of goods and services. When the money supply rises faster than the rate of real economic growth, inflation results. Such has been the case for the past 20 years or more.

Recently, real growth in production has been in the area of 4 percent a year while the money supply has risen at a faster 10-percent rate. The 6-percent difference between these two rates has been the approximate rate of inflation for the past year.

Growth of the money supply is the responsibility of the Federal Reserve System, or the Fed as it is sometimes called. The Fed accomplishes this task by purchase and sale of federal government debt. If the Fed wants to expand the money supply, it buys federal debt on the open market, just as any company or individual can. When the Fed buys the debt, however, the check it writes is new money, because the Fed's check is cashable for currency at any bank; currency that did not exist before the Fed's debt purchase.

Of the more than $650 billion in federal debt, the Fed currently owns about $100 billion, with the balance of $550 billion owned by banks, businesses, private citizens, and government agencies. In only the last two years, the debt has increased by about $150 billion, and a further increase of $65 billion is budgeted for the coming year. With a weak economy, most of the $150 billion increase was bought by business firms not anxious to invest profits in new equipment.

But with a stronger economy in 1977 and 1978, the budgeted debt for the next year will not be purchased by firms wanting to use profits for investment in plant and equipment. This will put pressure on the Fed to increase its debt holding. If

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the Fed yields to the pressure, resulting increases in the money supply could easily boost inflation rates to 8 or 9 percent by the beginning of 1978, and higher afterwards.

During the last round of high inflation rates in 1972-1973, incomes of most farm families zoomed with commodity prices. This was a result of both the inflation and a boom in grain export markets. Although costs increased in these years, commodity prices went up faster.

With large carryover stocks of U.S. grain in 1977 and good weather world-wide, higher inflation rates next year could boost costs more than revenues for cash-grain producers. However, if inflation-swelled consumer incomes meet smaller beef supplies in prospect for 1978, the result could be substantially higher cattle and hog prices next year.

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