ILLINOIS FARM AND FOOD OUTLOOK
COLLEGE OF AGRICULTURE
DEPARTMENT OF AGRICULTURAL ECONOMICS

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ECONOMIC OUTLOOK: WHERE IS THE RECESSION?

THE ADVERTISED SLOW DOWN-RECESSION FOR 1979 is slow in materializing. It may be time to revise our thinking. In terms of farm prices, we have been projecting a small increase in real consumer income during 1979 into the demand for meat and other livestock products and an inflation rate of 8 to 9 percent into price. Both real income and the rate of inflation may be higher than indicated by earlier projections. Nearly all of the general economic forecasts at the end of 1978 were relatively pessimistic. These were based on four factors.

First, the period of rapid expansion was old. Following a decrease of real gross national product of 1.4 percent in 1974 from the boom year of 1973 and a further decrease of 0.9 percent in 1975, increases of 5.3, 4.9, and 4.6 percent occurred during the past three years ending in 1978. It is unusual for such a boom to last past three years.

Second, the boom was fueled by strong consumer demand. Part of the strong consumer demand was based on purchases of big-ticket items in anticipation of more inflation. The result was a set of rapid increases in consumer debt to record levels. Some slowdown in the rate of increase while debts are reduced appears probable, but automobile purchases are still large.

Third, no speedup of business-inventory accumulation was expected because of recession fears and the high cost of financing inventories. But inventories are building up as more and more firms reach productive capacity and attempt to keep supplies on hand for customers. Manufacturers were at 87 percent of capacity at the end of 1978, about the practical top limit.

Fourth, little increase in real spending per capita was anticipated, again because of uncertainty about a possible recession and high interest rates. Early in 1979, a survey by the Department of Commerce indicated intentions of increasing expenditures for plant and equipment by 11 percent, a scant 2 percent above the rise in capital costs. But a spring survey by McGraw-Hill suggested an increase of 16 percent--a real increase of 7 percent, a near-record rate. Intentions in the manufacturing sector were a very large 20 percent, which is consistent with the near-capacity operation rate of plants.

The boom appears to have shifted from consumer demand fed by rapid gains in real income to a capital expansion as shortages of manufactured goods have developed. Because capital expansion has been held at quite low levels in recent years by a combination of inflation, high interest rates, and governmental environmental and safety regulations, there is a lot of catching up to do. This should extend the boom through 1979 and perhaps beyond.

Changes in price levels are closely associated with the money supply. The money supply as measured by cash and checking accounts plus time and savings accounts increased by 53.4 percent between 1973 and 1978. The price level increased 42.8 percent, and the output of goods and services increased by 13 percent. The total of 42.8 and 13 percent (55.8) is just a little above the increase in the money supply (53.4 percent). Prices rose rapidly because the money supply was expanded much faster than the output of goods and service.

The money supply was held basically constant during last December through March, but has been expanding at an annual rate in excess of 10 percent since March. There is no sign of a drop in the real causes of inflation.

If the increase in capital expenditures and the expansion of the money supply at recent rates continue, the current dollar prices of agricultural commodities will be substantially higher a year from now.

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