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Canterbury Chamber of Commerce

Agricultural Bulletin

FARM PRICE CYCLES

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Although all farmers realise that prices change and that the direction of these changes is not definitely predictable, many people make the mistake of estimating that prices will continue to move in the direction in which they are moving at the time. For example, if there is a slump in dairy cattle prices, there is a tendency to think that prices for dairy cattle will continue low; if there is a boom in fat lamb prices, that prices for fat lambs will continue high; if there is a slump in prices for farm land, that prices for farm land will remain low, and so on.

By acting on the supposition that a slump will continue, and, therefore, rushing to sell, and by reducing the number of young breeding stock or by refraining from buying, farmers tend to accentuate the slump. By acting on the supposition that a boom will continue and by rushing to buy and by holding young breeding stock or decreasing sales farmers tend to accentuate the boom.

If all other disturbing factors are eliminated there is an uneven and unpredictable but definite tendency for a cycle of rising prices to be followed by a cycle of falling prices, progress being achieved not smoothly, but by a procession of ebbs and flows. In practice other disturbing factors, political, economic, social, climatic, natural and uncontrollable, do influence the course of those cycles. Nevertheless with all these uncertainties a farmer's production is in advance of and in anticipation of future unknown market prices. For example, in deciding on dairy production a farmer breeds or purchases his calves three years before he can sell the produce from them. He therefore should adopt a more or less fixed long run policy suited to his type of land and to the long run trends of the markets available. He certainly should not make hasty changes in his policy in an attempt to follow the market. If his policy is to be adjusted to changing market conditions he should adjust it after considering not only past, but more particularly probable future price tendencies for those products his farm is fitted to produce. Men of ability do vary their farm policy a little. Their success lies in anticipating and not following market changes. For example, when prices are relatively very high and according to the cycle theory likely to be lower, they may stock a little less heavily and sell more stock, but when prices are relatively very low they may stock a little more heavily and sell less stock.

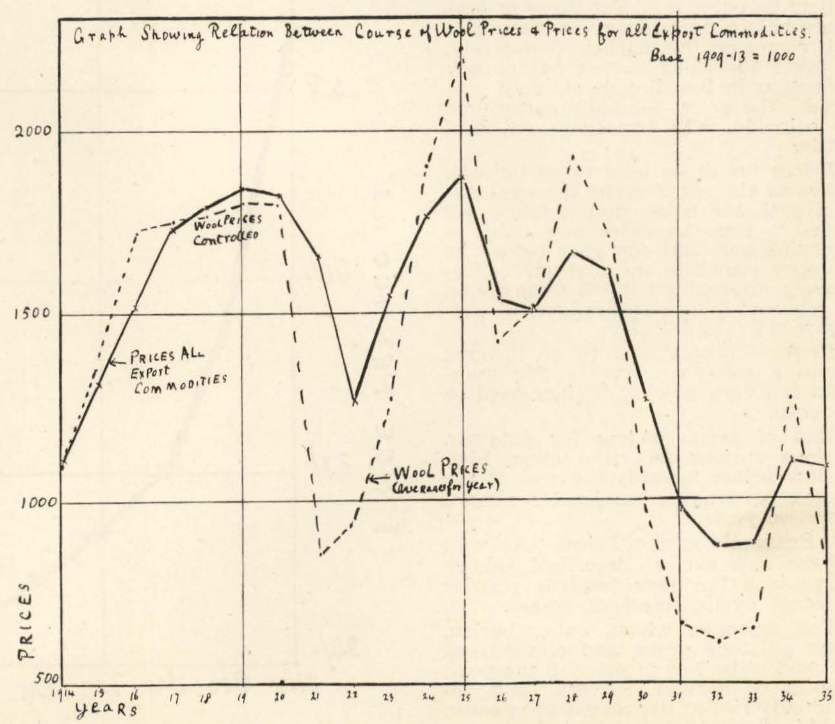
It must be realised of course that prices of our main farm products in New Zealand are influenced to a very much greater degree by world prices for similar goods than they are by purely local conditions of supply and demand.

Four major causes of price changes will now be discussed. First, changes in the general level of all prices; second, cycles of prices for individual commodities; third, seasonal cycles of prices; and fourth, inter-relation between various commodities.

Changes in the General Level of All Prices

It is not always realised that the value of money itself tends to vary. Those who seek a fixed money return and invest passively by, for example, lending to others, are in effect backing the view that money is likely to be high in value and prices are likely to be low or fall. Those who prefer to take the risks of production and invest actively, by, for example, extending their own farm activities, are in effect favouring the view that money is likely to be low in value and that prices are likely to be high or rise. It is of course realised that many individuals have little choice as to how they shall invest. Normally, in slump periods, too many take the view that money will continue high, or in other words that prices will be low, and they prefer a fixed money return even though this is small. Those, however, who take the long view and buy in the slump period normally secure an appreciation in capital values. Conversely, in boom periods too many back the view that prices will continue high, and these prefer active investment even if they have to borrow. Those who take the long view and sell in the boom period normally secure an appreciation in the purchasing power of their money held and can later actively reinvest more profitably. Quite obviously, if there were more buyers at low prices and more sellers at high prices booms and slumps would tend to be flattened out. In the past farming has tended to be more profitable in one generation and less profitable in the next generation, these variations corresponding to long run periods of falling and of rising values for money. For example, in a broad and general way, from 1820-45 farm-

Graph No. 1.



ing tended to be less profitable; from 1845-75 more profitable; from 1875-1900 less profitable; and from 1900-25 more profitable. These variations in profit were due to changes in the value of money quite apart from any other factors.

2. Cycles in Prices for Individual Commodities.—Just as production for all farm commodities may exhibit a cyclic tendency, so the production of each individual commodity tends to go through periods of apparent over and under stimulation, these periods varying in length with the type of commodity.

Prices for wool appear to follow directly and to accentuate the changes that occur in the general level of prices of all export commodities including some industrial as well as farm goods. The explanation is probably that wool, being storable, buying is affected more directly and quickly by changes in credit conditions and wage levels than are most other farm commodities. Graph No. 1 depicts the changes that have occurred since 1914 in the general level of prices for all export commodities and the yearly average prices for wool.

Prices for work horses appear to vary inversely with the average of the prices for all commodities. The explanation since the advent of tractors is probably that when prices and wage levels rise the use of tractors becomes profitable, and, further, the land previously required for horse keep can be profitably used for the production of other farm commodities. Conversely, when prices and wage levels fall a cash farm income is more difficult to obtain, and horses become relatively more profitable. Another factor affecting the horse price cycle is the length of life of the horse and the time required to replace horses by breeding.

Prices for beef cattle tend to go through a long period cycle rising and falling in relation to other commodities. The length of the complete cycle is approximately 10 to 15 years. The explanation is probably that it takes two to three years to keep an extra calf to breeding age, and three to four years before the progeny of that extra calf comes on the market. Conversely, it takes the same period before any reduction in breeding is actively noticed. The prices for dairy cattle tend to coincide with the cycle for beef cattle.

Prices for sheep tend to go through a five to six years' cycle, the explanation probably being that it takes two years to keep an extra ewe lamb to breeding age, and one year before its progeny comes to the market. Conversely, approximately the same period is required before any reduced breeding is actively noticed.

Prices for pigs tend to go through about a two-year cycle. Pig numbers can very quickly be increased or reduced.

End of season prices for potatoes. It is a curious fact that extra high or low prices towards the end of the season have never persisted for more than two years.

3. Seasonal Cycles of Prices.—As well as the two cycles described above there is a tendency towards regular seasonal cyclic trend of prices.

For example, wheat, oats, barley, peas, potatoes, grass, and clover seed all tend to be low in price in the peak months of harvest delivery and to gradually rise as the season progresses. This is due to the fact that these products are used all the year round, whereas production is seasonal. Unless the farmer himself holds the commodity, a drop in price must occur sufficient to compensate the merchant for the risk of further price falls, for storage and interest, etc., must occur. Wheat is controlled in price, and the fixed price rises from harvest time till the next season more or less in recognition of the principles stated above.

Pig prices tend to fall from October to January, with a rise again to March, a fall again to May, and a rise again from May to October. The explanation is probably that pigs are dearest early in the milking season, fall in value as pig numbers coming on the market increase and milk supply lessens in January, rise temporarily as stubble feed becomes available, fall again as stock are reduced preparatory to the winter, rise again to compensate for the increased cost of carrying pigs through the winter.

Fat lamb prices tend to be highest in October, with a slight fall in January, on the average a steady price from January to March, with a very slight fall again in May or June as the remainder of the season's production of lambs are disposed of prior to winter, and a rise for fat hoggets from then on till next season's early lambs come on the market about October.

Prices for fat bullocks tend to be highest about October, to become lower from January to May or June, and to rise again from May or June to October as provision of fat cattle for the market becomes more difficult. To have a bullock fat early in October it must have been kept fat all through the winter, and as a result cattle tend to be "dearest when grass is greenest." Graph No. 2 depicts the average seasonal variations that have occurred in prices for prime steers per 100lb at Addington over the last 27 years.

Inter-Relations Between Various Commodities.—On most farms, and particularly on mixed agricultural farms, various alternative commodities may be produced, and there is a tendency for these products to approach to an equilibrium level in prices.

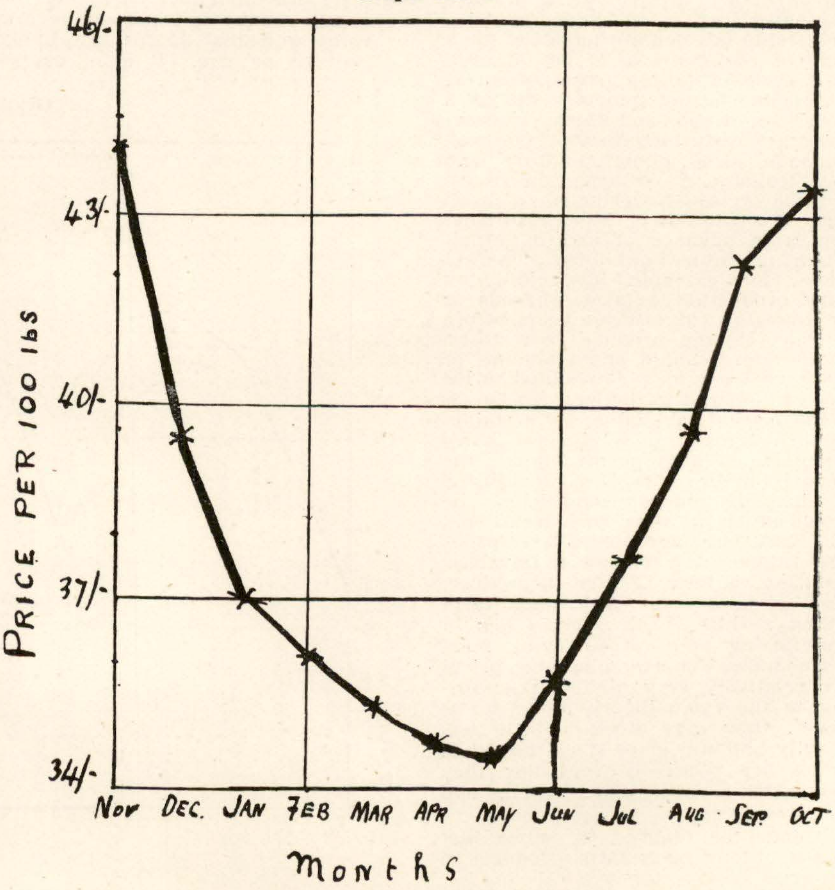
If, for example, prices for fat lambs are extra high or rising relative to wheat, the area in wheat tends to decrease. Conversely, when fat lambs are relatively cheap or falling, the area in wheat tends to increase. Graph No. 3 shows an almost perfect inverse correlation over the past few years, whatever the cause may be, between the price of prime fat lambs in March and the area sown in wheat the following May onwards.

Similarly, there is a tendency towards an equilibrium level between the price of sheep and dairy cattle. For example, it is evidence of a definite lack of equilibrium when cows are at about the same value as sheep a head. There is also a tendency for an equilibrium to be attained between various crop products.

A similar tendency towards equilibrium exists between the prices of stock of the various ages, e.g., as between calves and three-year-old cattle, lambs, and five-year breeding ewes. For example, there is a normal relation between the price of fat lambs, ewe hoggets, two-tooth ewes, four-year ewes, and sound-mouth ewes, and if this relation is widely departed from there will be a tendency for its re-establishment.

Conclusion.—Although price cycles have tended to occur in the past, as stated above, there is no certainty that they will continue regularly, because

Graph No. 2



very many other factors, such as quotas, levies, tariffs, trade agreements, fixed prices, drought, monetary policies, wage policies, public work policies, etc., may affect the actual course of prices in a quite unpredictable way. It is, however, suggested in considering the price of any commodity, that the stage of the business or monetary cycle itself, and the tendency towards a recurring cycle in the production of that commodity should also be considered.

The foregoing will assist to explain some of the predictable causes for the changes that occur in prices. By recognising that certain changes tend to recur, a farmer can act in advance of market changes, or at least refuse to follow market changes, and by this means the fluctuations in prices to some extent would be flattened out and the tendency to over-accent booms and slumps would be reduced.

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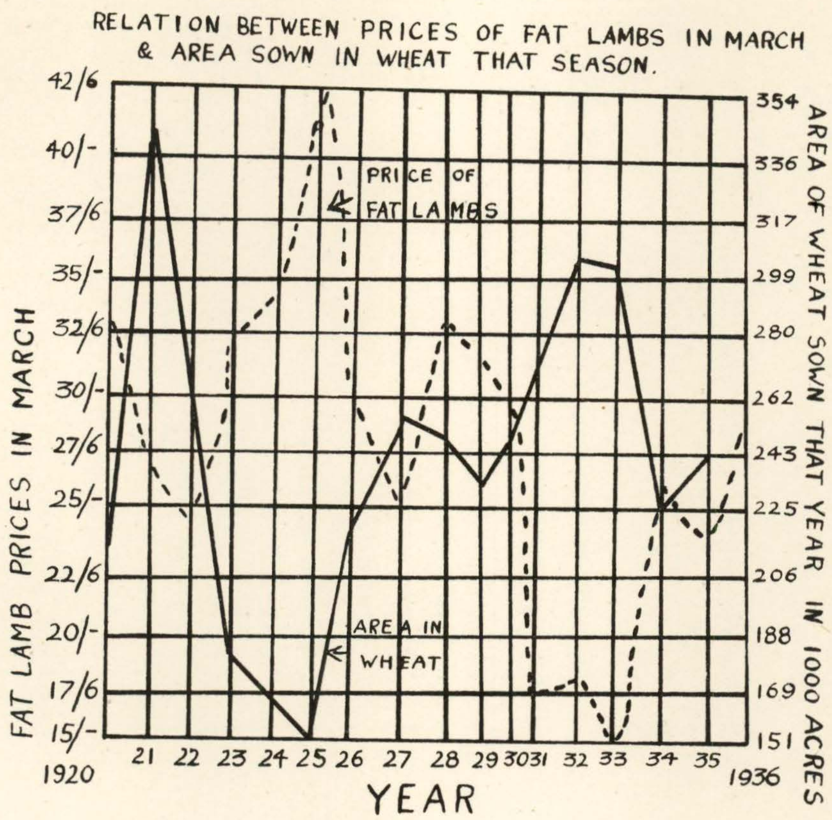
Graph No. 3



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