FRB CHICAGO

AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO

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Credit conditions at District agricultural banks

The responses of 536 agricultural bankers to a recent survey indicate that farm loan demand remains weak in the face of an ample supply of funds for lending. Interest rates charged on farm loans edged higher during the third quarter, registering a second consecutive quarterly increase. Farm loan repayment rates continued to improve during the third quarter and are expected to remain strong in the coming months.

The measure of nonreal estate farm loan demand at District agricultural banks during the third quarter remained weak, continuing the trend that began two years ago. At 75, the third quarter measure of farm loan demand was unchanged from the previous quarter and represented a composite of the 15 percent of the survey respondents that noted an increase in farm loan demand compared to a year ago less the 40 percent that reported a decline. The remaining 45 percent of the respondents noted that farm loan demand at their banks was unchanged from the comparable three month period last year. Among the District states, farm loan demand remained particularly weak in Illinois, Indiana, and Iowa, with these states reporting loan demand measures below the average. Michigan and Wisconsin bankers, on the other hand, reported somewhat stronger farm loan demand measures, although the proportion of bankers reporting declines from a year ago still exceeded those noting an increase.

The weak farm loan demand reflects the improvement in farm earnings and the growing importance of government programs over the last few years. Curtailed capital purchases, streamlined farming operations and lower costs, along with the idling of large acreages under government programs have all contributed to the drop in farm loan demand. In addition, heavy use of Commodity Credit Corporation loan programs and the flow of government income support payments to farmers have tended to depress the demand for credit from commercial lenders.

As a result of these trends, District agricultural banks continue to report increases in the supply of funds available for lending to farmers. The third quarter measure of fund availability, at 136, is down from the very high levels of last year, but continues to indicate that adequate funding for farm loans is available at District agricultural banks. Only 7 percent of the survey respondents reported a decline from a year earlier in the availability of funds, while 43 percent reported an increase. Half of the bankers indicated that the availability of funds during the third quarter was unchanged from the high level of a year earlier. Across the District states, the measure of fund availability ranged from 124 among reporting banks in Michigan to 148 among Iowa's agricultural banks.

Despite sluggish farm loan demand and ample availability of funds, the ratio of total loans to deposits recorded a second consecutive quarterly increase. At the end of the third quarter, loan-to-deposit ratios at the responding banks averaged 51.5 percent, almost three percentage points above the low recorded at the end of the first quarter. As has been the case throughout the year, agricultural banks in Illinois and Iowa reported the lowest loan-to-deposit ratios, 47 percent and 45 percent, respectively, while Michigan banks reported the highest ratios, averaging almost 64.5 percent. Despite the recent gains, loan-to-deposit ratios at District agricultural banks remain well below the averages that prevailed in the late 1970s.

Furthermore, most of the surveyed bankers expressed a preference for ratios above the current levels. Almost three-fourths of the respondents indicated that their current loan-to-deposit ratio was below the desired level, while only 7 percent indicated it was too high. The remaining fifth of the bankers were satisfied with their loan-to-deposit ratios at their current levels. For the District as a whole, the average of the surveyed bankers' desired loan-to-deposit ratios, at 60.4 percent, was about 9 percentage points higher than the average of their actual ratios, but still well below the 67 percent average ratio that prevailed in the late 1970s. Among individual District states, the desired level of lending expressed as a proportion of total deposits ranged from about 57 percent in Illinois and Iowa to more than 69 percent in Michigan.

Following an extended downturn, interest rates charged on loans to farmers by District agricultural banks have edged higher during the last two quarters. Average rates charged on feeder cattle loans and farm operating loans rose to 11.2 percent and 11.3 percent, respectively, at the end of the third quarter, registering gains of about 25 basis points from three months earlier. Rates charged by surveyed banks on farm real

Selected measures of credit conditions at Seventh District agricultural banks

	Loan demand (index)[2]	Fund availability (index)[2]	Loan repayment rates (index)[2]	Average rate on feeder cattle loans[1] (percent)	Average loan-to-deposit ratio[1] (percent)	Banks with loan-to-deposit ratio above desired level[1] (percent of banks)
1978						
Jan-Mar	152	79	64	8.90	63.7	44
Apr-June	148	73	81	9.12	64.5	46
July-Sept	158	64	84	9.40	65.8	52
Oct-Dec	135	62	93	10.14	65.4	50
1979						
Jan-Mar	156	51	85	10.46	67.3	58
Apr-June	147	62	91	10.82	67.1	55
July-Sept	141	61	89	11.67	67.6	52
Oct-Dec	111	67	79	13.52	66.3	48
1980						
Jan-Mar	85	49	51	17.12	66.4	51
Apr-June	65	108	68	13.98	65.0	31
July-Sept	73	131	94	14.26	62.5	21
Oct-Dec	50	143	114	17.34	60.6	17
1981						
Jan-Mar	70	141	90	16.53	60.1	17
Apr-June	85	121	70	17.74	60.9	20
July-Sept	66	123	54	18.56	60.9	21
Oct-Dec	66	135	49	16.94	58.1	17
1982						
Jan-Mar	76	134	36	17.30	57.8	18
Apr-June	85	136	41	17.19	57.3	14
July-Sept	87	136	36	15.56	57.8	15
Oct-Dec	74	151	47	14.34	55.1	11
1983						
Jan-Mar	69	158	66	13.66	53.3	6
Apr-June	85	157	78	13.49	54.0	6
July-Sept	81	156	78	13.70	54.8	8
Oct-Dec	101	153	78	13.65	53.6	8
1984						
Jan-Mar	131	135	62	13.82	54.4	12
Apr-June	138	128	64	14.32	55.7	14
July-Sept	120	122	59	14.41	57.2	17
Oct-Dec	103	124	49	13.61	55.9	19
1985						
Jan-Mar	107	120	47	13.48	56.1	17
Apr-June	105	133	56	12.93	55.1	14
July-Sept	90	127	59	12.79	55.5	14
Oct-Dec	68	144	97	12.70	52.7	10
1986						
Jan-Mar	74	149	80	12.34	50.9	8
Apr-June	65	152	86	11.81	51.1	6
July-Sept	68	146	87	11.31	51.4	6
Oct-Dec	61	153	107	11.06	49.4	3
1987						
Jan-Mar	71	149	118	10.88	48.8	5
Apr-June	75	140	118	10.98	50.5	6
July-Sept	75	136	134	11.22	51.5	7

[1] At end of period.
[2] Bankers responded to each item by indicating whether conditions during the current quarter were higher, lower, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100.

estate loans averaged 10.7 percent, up about 20 basis points from the end of the previous quarter.

Surveyed bankers once again noted substantial improvement in farm loan repayment rates during the third quarter. At 134, the measure reached an unprecedented level in the 20 year history of the quarterly survey of credit conditions. The third quarter measure is based on the 39 percent of the responding bankers that noted improvement in farm loan repayment rates compared to a year earlier contrasted to the less than 5 percent of the bankers noting further deterioration in repayment rates. The remaining 56 percent of the survey respondents reported no change in the rate of loan repayment compared to the third quarter of 1986. This marks the fourth consecutive quarter in which the proportion of bankers reporting higher loan repayment rates exceeded the proportion reporting declines.

Much of the improvement in loan repayment rates continues to be accounted for by the responses of Iowa banks. Almost 57 percent of the bankers in that state reported higher loan repayments than a year earlier during the third quarter, while less than 2 percent reported declines, bringing the composite measure of loan repayment rates in Iowa to 155. In contrast, the responses of Michigan agricultural banks still reflect the weather related problems that affected last fall's harvest. The Michigan bankers reported that almost 23 percent saw improved loan repayment, but 18 percent noted declines from the comparable period of a year ago.

Much of the improvement in farm loan repayment rates is attributed to improved livestock returns and large participation in government price and income support programs. The surveyed bankers indicated that they expect these same forces to continue to improve repayments and reduce outstanding indebtedness among farmers. A majority of the bankers expect farmers' incomes to be up from a year earlier during the fall and winter months. Almost 60 percent expect net cash earnings of crop farmers to be up, while only 12 percent foresee declines from the levels of a year ago. Similarly, 65 percent see continued strength in cash earnings of livestock farmers during the final months of 1987 and early 1988, with about a fifth expecting year-to-year declines. The bankers were somewhat less optimistic about the fortunes of dairy producers with the proportion expecting improved net cash earnings only slightly exceeding the share expecting a decline. However, about two-thirds of the respondents expect net cash earnings of dairy farmers during the fall and winter months to be unchanged from the comparable period of a year earlier.

With net cash earnings expected to be strong, the bankers' responses point to increased loan repayments and a lower level of liquidation of farm assets in the coming months. The volume of farm loan repayments this fall and winter is expected to be above a year earlier by 56 percent of the survey respondents with another 40 percent expecting no change. Only 4 percent of the bankers foresee a drop in the volume of loan repayments among farm customers over the six month period. Almost 47 percent of the surveyed bankers forecast a decline in forced sales or liquidation of farm capital assets among financially stressed farmers while about 9 percent foresee an increase from a year ago. The remaining 44 percent of the respondents indicated that the liquidation of farm assets during the period due to financial stress will be unchanged from last year.

With relatively strong earnings and widespread participation in government price and income support programs enhancing the cash flow of many farmers, nonreal estate farm loan demand is expected to remain weak during the third quarter. Only 11 percent of the surveyed bankers expect the volume of nonreal estate loans to farmers to increase from year-earlier levels during the final months of 1987, while 35 percent expect further weakness. A notable exception to this general trend is the demand for farm machinery loans, which is expected to be up from a year earlier by about a third of the respondents compared to 24 percent expecting further declines. Virtually all of the indicated strengthening in farm machinery loan demand is accounted for by the responses of Iowa bankers, with more than half of the group expecting an increase from last year.

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Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from: Prior period	Year ago	Two years ago
Receipts from farm marketings *($ millions)*	July	10,355	10.4	8	-6
Crops*	July	3,893	13.5	9	-25
Livestock	July	6,182	4.5	1	11
Government payments	July	281	702.9	n.a.	25
Real estate farm debt outstanding *($ billions)*					
Commercial banks	June 30	13.8	5.2†	14	30
Federal Land Banks	June 30	34.5	-3.9†	-17	-28
Life insurance companies	June 30	10.4	0.2†	-9	-15
Farmers Home Administration	June 30	10.2	-0.8†	-3	-1
Nonreal estate farm debt outstanding *($ billions)*					
Commercial banks	June 30	30.4	5.7†	-11	-24
Production Credit Associations	June 30	9.88	2.5†	-22	-41
Farmers Home Administration	June 30	16.6	1.7†	-7	-8
Commodity Credit Corporation	June 30	14.3	-23.9†	-20	62
Interest rates on farm loans *(percent)*					
7th District agricultural banks					
Operating loans	October 1	11.29	2.5†	0	-12
Real estate loans	October 1	10.70	2.2†	-1	-14
Commodity Credit Corporation	November	8.00	6.7	40	0
Agricultural exports *($ millions)*	August	2,135	-10.5	13	8
Corn *(mil. bu.)*	August	112	-17.0	117	22
Soybeans *(mil. bu.)*	August	55	0.5	160	107
Wheat *(mil. bu.)*	August	118	-29.0	-5	32
Farm machinery sales[p] *(units)*					
Tractors, over 40 HP	October	5,586	9.9	10	11
40 to 139 HP	October	3,992	31.1	7	-1
140 HP or more	October	1,594	-21.8	20	56
Combines	October	1,545	11.7	9	7

N.A. Not applicable
*Includes net CCC loans.
†Prior period is three months earlier.
[p]Preliminary

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