FEDERAL RESERVE BANK OF CHICAGO
AGRICULTURAL LETTER

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AGRICULTURAL CREDIT CONDITIONS among Seventh Federal Reserve District rural banks during the second quarter were characterized by further easing in loan repayment problems, a rise in interest rates, and continuing liquidity pressures. The index of farm loan repayment rates rose to 81 (see chart) in the second quarter. Although this measure indicates the proportion of bankers reporting year-to-year declines in repayment rates still exceeds the number noting an increase, the latest results reflect the best balance between the two views since the fourth quarter of 1976. Moreover, the index has improved considerably from the low point registered during the collapse in farm prices last summer. In conjunction with roughly similar indications of a slowing in loan renewals and extensions, it would appear that the sharp rise in farm commodity prices during the first half of this year has considerably eased the farm loan portfolio problems evident in late 1977.

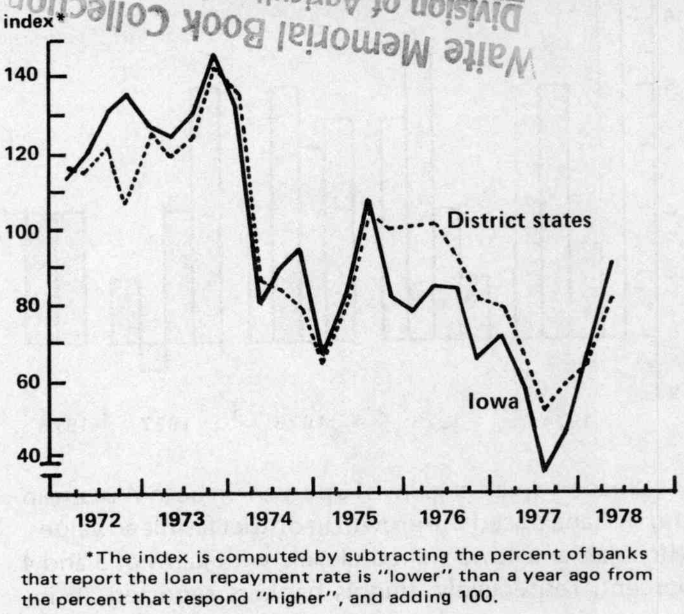
Liquidity pressures at rural banks, however, are still apparent. The average loan-to-deposit ratio rose to a new high of 0.64 at midyear. That is up from the relatively high 0.61 a year before and the more typical level of 0.57 two years before. Moreover, nearly half of the banks consider their current ratio higher than they would like. That is a considerably larger proportion than normally hold such views but close to the proportion for the past three quarters.

Liquidity pressures also are apparent in bankers' perception of the availability of funds for lending. In the most recent survey, 41 percent of the bankers indicated fewer funds available than a year ago. Only 14 percent reported more funds available. That marked one of the strongest indications of tight fund availability since at least the mid-1960s.

Fund availability reflects a number of interrelated factors, including loan demand, deposit growth, and the competitive rates of return between loans and alternative investment opportunities for banks. Responses to the latest quarterly survey indicate farm loan demand is still fairly strong, albeit less intense than in 1977. Deposit growth so far this year appears about parallel that of recent years. However, the mix in first-half deposit growth has shifted. The heretofore sluggish growth in demand deposits has picked up substantially. First-half growth in time and savings deposits slowed from the pace of the previous two years. These developments may partly reflect the increased competition banks face for customer savings as a result of the overall uptrend in interest rates.

The higher structure of interest rates has also affected fund availability by shifting the competitive balance between loans and alternative investment opportunities for banks. Over the past year, interest rates on farm loans have edged higher but not nearly as much as rates on short-term money market instruments (see back of *Letter*). On the one hand, the resulting shift in the competitive balance tends to encourage banks to allocate a larger proportion of new inflows of funds to alternative investments. And on the other hand, because of the potential capital loss on fixed-earnings assets stemming from the uptrend in interest rates, the shift tends to discourage the selling of investments to meet loan demand.

Recovery in farm loan repayment rate is most apparent among Iowa banks



*The index is computed by subtracting the percent of banks that report the loan repayment rate is "lower" than a year ago from the percent that respond "higher", and adding 100.

Among district states, second-quarter trends in credit conditions produced some notable contrasts. Iowa bankers, in particular, reported some major contrasts relative both to other district states and to recent past trends in that state. For example, the indication of a slowing in farm loan demand was far more pronounced among Iowa banks. Evidence from Iowa also suggests that farm loan portfolio problems have eased far more there than in other district states. Furthermore, liquidity pressures among Iowa bankers appear less widespread than in most other district states. Interestingly, the proportion of Iowa bankers that noted a year-to-year increase in fund availability slightly exceeded the proportion reporting a decline. In the other district states the proportion of bankers reporting declines in fund availability exceeded those reporting increases by substantial margins.

The comparatively strong improvement in credit conditions in Iowa, no doubt, reflects both the severity of the problems in that state last year as well as special circumstances contributing to the recovery there. Problems in Iowa were compounded by drought last year and the mounting losses to cattle feeding, which is far more dominant in Iowa than in other district states. In the intervening period, farmers in Iowa have received a comparatively large inflow of SBA loans and government disaster payments. In addition, cash flows to farmers in Iowa have probably responded faster to this year's uptrend in farm prices because of the greater importance of livestock feeding in that state and the more structured marketing schedules for livestock as opposed to crops. (Cash receipts from cattle and hog marketings account for more than half of total farm receipts in Iowa, nearly twice the proportion in any other district state.) Not all crop farmers have benefited from the recovery in grain and soybean prices. Some sold before the big uptrend, and others are still holding their grain in storage.

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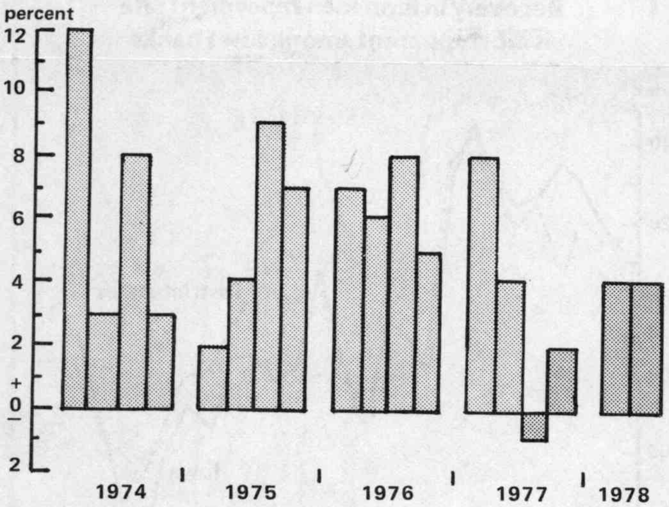
Prices

FARMLAND VALUES registered another large gain during the April-June period. According to a recent survey of approximately 600 rural banks, the midyear value of good farmland in the Seventh Federal Reserve District was 4.3 percent higher than a quarter ago and 8.5 percent above the year-earlier level. Higher-than-expected commodity prices throughout the first half of 1978 have no doubt been the primary factor behind the strength in farmland prices. Bankers' expectations for the third quarter portend further increases in farmland values.

Prices

Second-quarter rise in farmland values equals strong pace of first quarter



Second-quarter gains of 6 percent in both Wisconsin and Indiana paced the growth in district farmland values. Michigan and Iowa trailed closely with gains of 5 and 4 percent, respectively. Illinois bankers reported an increase of only 3 percent, the smallest rise in any of the district states. Year-to-year changes in farmland values ranged from 20 percent in Wisconsin to none in Illinois. The unchanged land values in Illinois reflect the sharp decline that occurred in that state last summer.

Although the second-quarter increase in farmland prices was again surprisingly large, the recovery in crop and livestock prices since last summer has been substantial. Average corn prices at Chicago during the April-June period were 12 percent higher than in the first quarter and 39 percent above the September low. Soybeans were up 16 and 33 percent, respectively. Second-quarter choice Omaha steer prices were a fifth higher than in the first quarter and 37 percent above their average for September. Hog prices were 1 percent above the January-March level and 16 percent above the September average. The higher commodity prices, coupled with the attendant boost in farm earnings prospects, apparently resulted in fairly aggressive bidding for farmland.

The survey results indicate that district agricultural bankers expect farmland prices to rise still further in the current quarter. Twenty-three percent of the responding bankers felt that the trend in the third quarter would be up, while 3 percent thought it would be down. This represents the largest positive net response from bankers in a year. Wisconsin bankers were the most optimistic of continued upward pressures, while Illinois bankers were the least.

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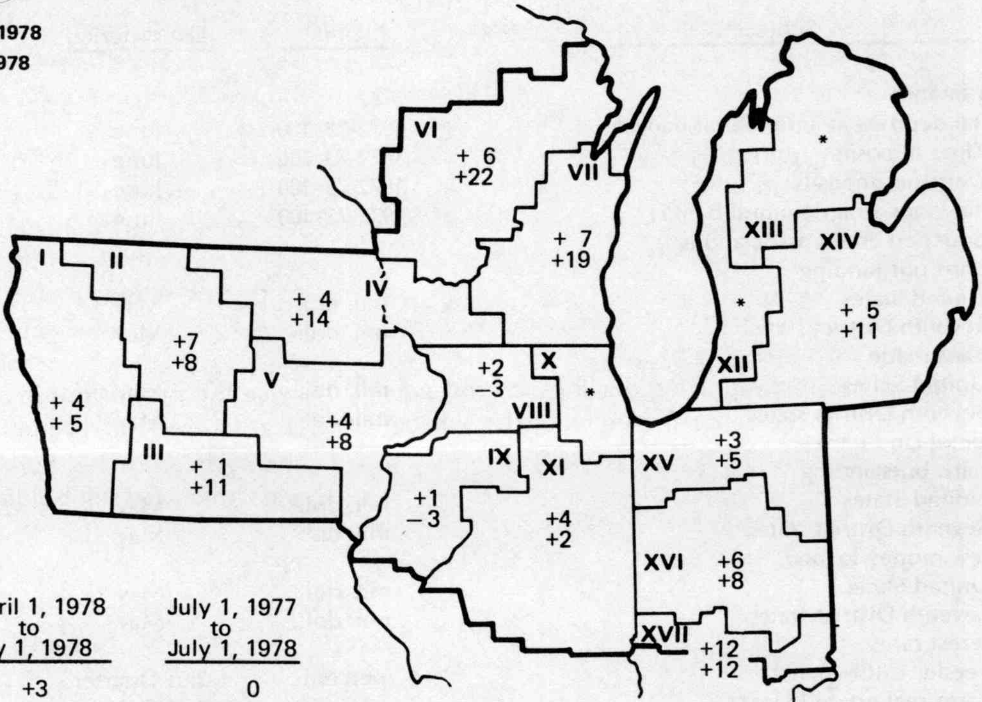
Percent change in dollar value of "good" farmland

Top: April 1, 1978 to July 1, 1978
Bottom: July 1, 1977 to July 1, 1978

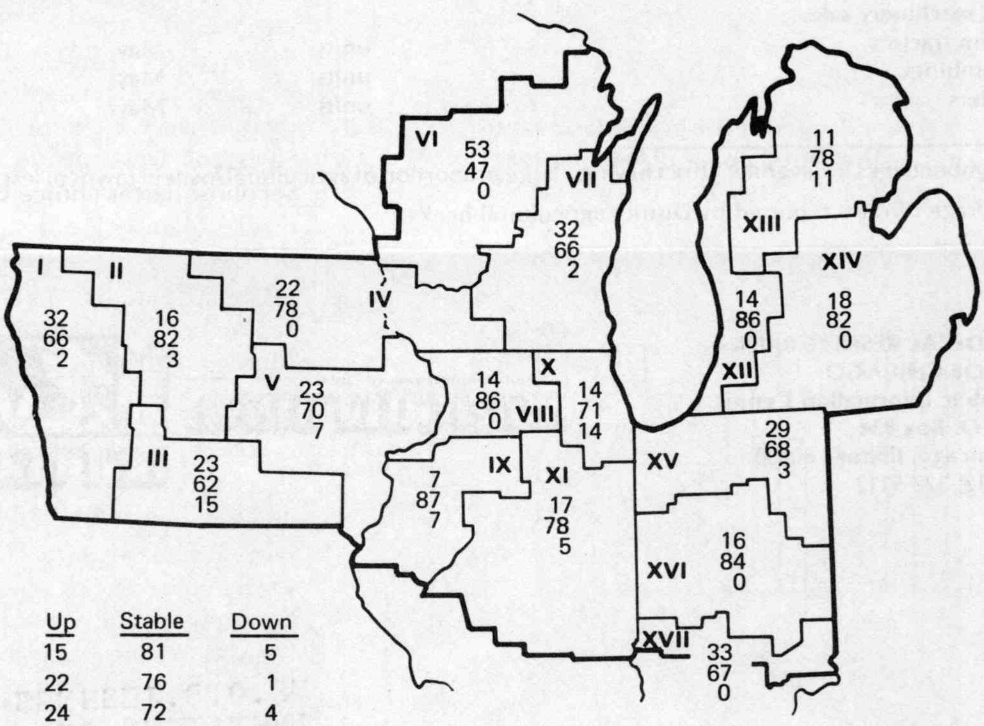


	April 1, 1978 to July 1, 1978	July 1, 1977 to July 1, 1978
Illinois	+3	0
Indiana	+6	+ 7
Iowa	+4	+ 8
Michigan	+5	+ 9
Wisconsin	+6	+20
Seventh District	+4	+ 8

*Insufficient response.

Percent of banks reporting the current trend in farmland values is;

Top: Up
Center: Stable
Bottom: Down



	Up	Stable	Down
Illinois	15	81	5
Indiana	22	76	1
Iowa	24	72	4
Michigan	16	82	2
Wisconsin	38	61	1
Seventh District	23	74	3

Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from: Prior period	Percent change from: Year ago
Farm finance					
Total deposits at agricultural banks†	1972-73=100	June	182	+ 1.4	+ 9
Time deposits	1972-73=100	June	211	+ 0.5	+10
Demand deposits	1972-73=100	June	133	+ 3.9	+ 6
Total loans at agricultural banks†	1972-73=100	June	215	+ 1.6	+13
Production credit associations					
Loans outstanding					
United States	mil. dol.	May	13,909	+ 2.0	+ 4
Seventh District states	mil. dol.	May	2,668	+ 0.5	+ 7
Loans made					
United States	mil. dol.	May	1,909	− 5.8	+16
Seventh District states	mil. dol.	May	381	−16.1	+13
Federal land banks					
Loans outstanding					
United States	mil. dol.	May	22,807	+ 1.5	+15
Seventh District states	mil. dol.	May	4,780	+ 2.0	+20
New money loaned					
United States	mil. dol.	May	454	+20.7	+12
Seventh District states	mil. dol.	May	122	+12.2	+19
Interest rates					
Feeder cattle loans††	percent	2nd Quarter	9.02	+ 1.6	+ 3
Farm real estate loans††	percent	2nd Quarter	9.19	+ 1.7	+ 3
Three-month Treasury bills	percent	7/13-7/19	7.80	+ 9.1	+50
Federal funds rate	percent	7/13-7/19	7.94	+ 2.7	+48
Government bonds *(long-term)*	percent	7/17-7/21	8.69	− 0.3	+14
Agricultural trade					
Agricultural exports	mil. dol.	May	2,729	+ 8.8	+24
Agricultural imports	mil. dol.	May	1,277	− 2.4	+ 2
Farm machinery sales					
Farm tractors	units	May	13,040	−37.1	+17
Combines	units	May	979	−29.4	− 3
Balers	units	May	1,645	+27.5	−17

†Member banks in Seventh District having a large proportion of agricultural loans in towns of less than 15,000 population.

††Average of rates reported by District agricultural banks.

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