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Federal Reserve Bank of Chicago - -

April 3, 1970

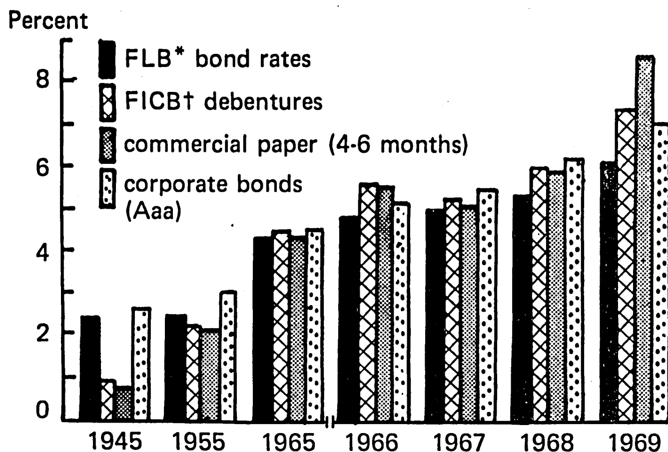
Number 1059

INTEREST RATES are receding from the historically high levels reached earlier this year. But the easing of rates may not be reflected immediately in rural areas. Interest rates in rural areas usually do not vary as often or with as great amplitude as rates in the nation's money centers. Indeed, many rural borrowers have not experienced the full impact of the earlier upsurge in rates. For example, over three-fifths of the agricultural bankers surveyed in the Seventh District were still charging less than 8 percent on feeder cattle loans to farmers at the start of 1970. This compares to an average rate of nearly 9 percent on short-term business loans at large Midwestern city banks.

Commercial banks in rural areas, which account for over two-fifths of all farm credit supplied by institutional lenders, operate in a more localized market. Demand for credit comes from local businessmen, farmers, and individuals, while loanable funds are obtained primarily from depositors in the community. Thus, rates at these banks largely reflect local conditions.

Interest rates in rural areas, of course, have risen, albeit not as much as rates in national markets. In the Seventh District states, the "typical rate" on feeder cattle loans rose from 7 percent at the start of 1969 to around 7.5 percent at the beginning of 1970. Rates at Federal Land Banks and Production Credit Associations reflect national credit conditions more closely. Currently, all but one of the Federal Land Banks are charging 9 percent on new mortgages—up from a range of 6 to 7 percent a year earlier. Most of the Production Credit Associations were charging 8.5 percent on new loans at the start of 1970, compared with almost none a year ago. These lenders rely on the sale of their debt obligations in the national money market to obtain loanable funds and, consequently, their lending rates have followed the uptrend in cost of these obligations.

Money Market Rates Reached Historic Highs in 1969



*Federal Land Banks.
†Federal Intermediate Credit Banks.

The higher interest rates on farm mortgages probably explain the small rise in farm real estate debt. Estimated at $28.7 billion as of January 1, real estate debt rose only $1.6 billion during 1969—the smallest increase in six years. Lending by life insurance companies was most noticeably affected. The amount of new money loaned by major life insurance companies during 1969 dropped nearly a third. In many states, including those in the Seventh District, usury laws that prevented companies from charging the market rate of interest were cited by company representatives as the main reason for withdrawing from farm mortgage lending.

On the other hand, Federal Land Banks, apparently exempt from interest rate restrictions, increased their lending in 1969. New money loaned increased just over 9 percent in 1969, rebounding from a decline of nearly 10 percent the year before. However, lending activity dropped sharply in the fourth quarter of 1969—the period in which most Land Banks raised their rates above 8 percent and adopted a variable-rate feature on new loans.

Although the historically high level of rates probably was the main factor curbing borrowing at Land Banks in the fourth quarter, the variable-rate clause may have also contributed to borrowers' reluctance to make long-term commitments. Given the high level of rates, borrower resistance to a variable-rate clause might have been expected to be at a minimum. Nonetheless, introduction of a variable rate does increase the uncertainty (risk) for the borrower. With a fixed rate, the borrower had a guaranteed maximum rate and, if the level of rates declined in the future, he could usually refinance.

Farmers' use of non-real estate credit, unlike real estate credit, increased at a faster rate in 1969 than the year before, increasing $2 billion compared with $1.3 billion the year before. Because such loans are short-term, interest expense is not as important a consideration. Rather, substantially higher prices for most farm production items was probably the main reason for increased use of non-real estate credit. The high level of rates on real estate loans may also have encouraged farmers to borrow short whenever possible in expectation of lower long-term rates in the future.

An easing of interest rates would likely increase the demand for farm mortgage credit in 1970. However, if inflation is not dampened, the recent easing in long-term rates may be only temporary. Use of non-real estate credit, given the expected larger crop plantings and perennial increase in operating expenses, will likely increase regardless of changes in interest rates.

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