Farms and Farm Banks are Back on the Path to Prosperity

by Robert Dugger and Carlos Veintemillas

Farm sector earnings during 1988 have had a marked improvement. Farm income has remained relatively high during the past two years enabling farmers to service their debt more comfortably. Higher incomes and debt restructuring have reduced debt burdens in the farm sector which resulted in the improvement of agriculture lenders asset quality. Consequently, profitability at the nation's farm banks[1] has improved significantly since 1983.

Some points of interest on farm bank performance:

· Farm banks continued to show an improvement in profitability during 1988. Return on equity (ROE) at the nation's 4,357 farm banks rose to 9.70 percent in 1988, up from 7.94 percent a year earlier (table 1). The ROE recorded by farm banks in 1988 was the highest since 1984, but still below levels recorded in the 1970s. Nonfarm banks[2], which continue to be influenced by problems in energy related industries, experienced a decline in ROE for the fourth year in a row. Return on equity at these banks fell to 8.69 percent in 1988 from 9.19 percent a year earlier and 11.16 percent four years ago. Rates of return on assets (ROA) at farm and nonfarm banks show a similar pattern.

· Despite large loan losses and low profits experienced during the mid-1980s, farm banks have been successful in augmenting and preserving a strong capital position (table 1). Equity capital as a percentage of total assets at farm banks has steadily risen from 8.75 percent in 1982 to more than 9.0 percent in 1988. It is this strong capital position that has enabled these banks to survive one of the harshest agricultural recessions of the post-World War II period. This shows that in general, farm bankers recognize the need for appropriate capitalization due to the cyclical nature of the farm economy. The equity capital ratio at nonfarm banks rose from 7.97 percent in 1982 to 8.0 percent in 1987, but declined slightly in 1988 to 7.85 percent. Nonetheless, these banks appear to be adequately capitalized.

[1]Ratio of farm loans to total loans exceeds the unweighted average of such ratios at all banks. This ratio stood at sixteen percent in 1988. These banks had less than $500 million in assets.

[2]Banks with less than $500 million in assets.

Table 1.
Comparison of Farm and Nonfarm Bank Performance

Return on Equity

	1982	1983	1984	1985	1986	1987	1988
Farm Banks	13.05	11.56	9.27	6.80	5.72	7.94	9.70
Nonfarm Banks	11.35	11.10	11.16	10.95	9.35	9.19	8.69

Return on Assets

	1982	1983	1984	1985	1986	1987	1988
Farm Banks	1.14	1.02	0.82	0.60	0.50	0.71	0.88
Nonfarm Banks	0.91	0.87	0.88	0.86	0.72	0.73	0.68

Capital Ratio

	1982	1983	1984	1985	1986	1987	1988
Farm Banks	8.75	8.85	8.88	8.82	8.73	8.95	9.12
Nonfarm Banks	7.97	7.83	7.84	7.85	7.69	8.00	7.85

Provisions for Possible Loan Losses as a Percentage of Total Loans

	1982	1983	1984	1985	1986	1987	1988
Farm Banks	0.76	1.00	1.36	2.35	2.45	1.34	0.82
Nonfarm Banks	0.75	0.80	0.77	0.99	1.20	0.95	0.91

Net Loan Charge Offs

	1982	1983	1984	1985	1986	1987	1988
Farm Banks	--	--	1.13	1.13	2.23	1.23	0.74
Nonfarm Banks	--	--	0.60	0.79	0.97	0.80	0.75

Notes

[1]Only banks that were in existence at the end of 1988 are included in these statistics.

[2]Farm banks are defined as having a ratio of farm loans to total loans that exceeds the unweighted average of such ratios at all commercial banks. This ratio stood at sixteen percent in 1988. The majority of banks fitting this ratio had less than $500 million in assets.

[3]Nonfarm banks are those with less than $500 million in assets.

Source: FDIC Call Reports

· Ironically, the 1988 drought contributed to the good showing by farm banks. Thanks to government, drought relief payments crop insurance and higher crop prices, farmers ended 1988 with more cash. Farm income during the year rose to approximately $60 billion from about $57 billion in 1987. This increase in farm income contributed to the decline in the number of financially threatened farms. Consequently, loan quality at farm banks showed improvements during the year. This allowed farm banks to reduce the amounts allocated to loan loss reserves. Provisions for possible loan losses as a percent of total loans fell from 1.34 percent in 1987 to 0.82 percent in 1988. This ratio was also down for nonfarm banks, but only slightly. Provisions for loan losses are taken from the bank's current income and added to the loan loss reserve account. Thus, declines in loan loss provisioning are directly translated into higher after tax income.

· The falling net loan charge off rate at farm banks is another indicator of a much improved farm economy. Net loan chargeoffs (loan chargeoffs minus recoveries) as a percent of total loans at farm banks fell from a 1986 peak of 2.23 percent to 0.74 percent in 1988. Chargeoff rates at farm and nonfarm banks have narrowed significantly during the past three years, suggesting that the worst may be over for nonfarm banks.

· Two hundred banks failured in 1988, down slightly from 203 in 1987. Farm banks accounted for over thirty-seven percent of the bank failures in 1987 but only fourteen percent in 1988 (twenty-eight banks). The outlook for farm banks is encouraging. Farm bank failures should continue to decline due to the recovery in the farm economy and the decline in the number of problem banks. The number of weak farm banks fell from 133 during the first half of 1987 to sixty-three in June 1988, the latest period for which figures are available.

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