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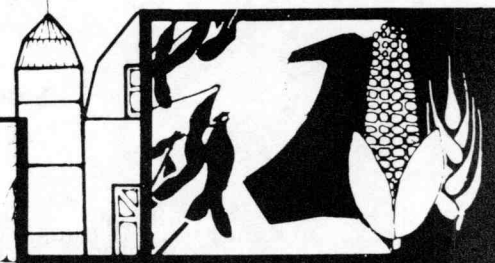
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FEDERAL RESERVE BANK OF CHICAGO

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LETTER

CREDIT CONDITIONS AT DISTRICT AGRICULTURAL BANKS parallel, in several respects, the depressed conditions in the farm sector. A recent survey of nearly 550 District agricultural banks indicates that farm loan demand continued very soft in the fourth quarter, despite some easing in interest rates. Farm loan repayments were abnormally slow and renewals and extensions of existing loans were very high. Most bankers acknowledged that the quality of their loan portfolios has declined slightly. And most indicated that low earnings and related financial problems will push more than the usual number of farmers into liquidating some capital assets in the next few months. The number facing such prospects, however, is still a small proportion of all farmers.

Interest rates charged by agricultural banks on farm loans trended lower in the fourth quarter, but remain at very high levels. The average rate on feeder cattle and farm operating loans at the end of 1981 was about 17 percent, down more than 150 basis points from the peak three months earlier and about 40 basis points lower than a year ago. Rates on farm real estate loans averaged just over 16½ percent, down nearly 100 basis points from three months earlier but still 75 basis points higher than a year ago. The fourth-quarter declines put rates on non-real estate bank loans to farmers in a much more competitive position with respect to rates charged by production credit associations. For several quarters, PCA rates had averaged below bank rates.

Among District states, the average rates on feeder cattle and farm operating loans ranged from a low of 16¾ percent in Illinois and Wisconsin to a high of 17¼ percent in Indiana and Michigan. Farm mortgage rates ranged from 16 percent in Wisconsin to 17 percent in Indiana.

The measure of farm loan demand held at a very low level for the eighth consecutive quarter during the last three months of 1981 (see table on page 2). The measure represents a composite of the 53 percent of the bankers that reported farm loan demand was below year-earlier

levels and the 19 percent that reported loan demand was higher. (The other bankers reported loan demand was unchanged from a year ago). The continued softness in farm loan demand reinforces other evidence that livestock producers cut back production and that capital expenditures by farmers held at a depressed level in the fourth quarter. In addition, the weak loan demand may partially reflect the cash inflows that many crop farmers generated by placing a record amount of grain under loan with the Commodity Credit Corporation in the fourth quarter.

Farm loan repayment rates were apparently very slow in the fourth quarter. At 49, the latest measure of farm loan repayments was down slightly from the previous quarter, marking a new low for the 17-year history of this survey. (Since bankers are asked to compare repayments rates with those of a year earlier, the new low partially reflects the strong repayment pattern that emerged in late 1980 when commodity prices were high). In conjunction with the slow repayments, nearly two-thirds of the bankers reported loan renewals and extensions were up from a year ago. Only 5 percent reported fewer renewals and extensions, while 30 percent reported no change from a year ago. The slow repayments and the increase in renewals and extensions probably stem from the continuing losses to livestock producers that occurred in the fourth quarter, as well as the low crop prices and the reluctance of farmers to sell grain during the latter months in 1981. Loan repayment problems for some bankers, however, were cushioned by the heavy movement of corn under CCC loan. Many farmers used the lower-cost CCC financing to repay higher-priced loans from commercial lenders.

The availability of funds for farm loans at banks held at a very high level in the fourth quarter, a trend that has been evident since mid-1980. Simultaneously, the average loan-to-deposit ratio at District agricultural banks registered an unusually large seasonal decline of 3 percentage points from the ending third quarter level. At .581, the average loan-to-deposit ratio at the end of 1981 was the lowest year-ending figure since 1975.

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)
1977						
Jan-Mar	161	115	79	8.71	59.4	28
Apr-June	169	103	66	8.74	61.2	38
July-Sept	161	77	52	8.79	63.5	46
Oct-Dec	147	86	59	8.85	62.3	41
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

¹At end of period.

²Bankers 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.

Other evidence suggests that the abnormally large seasonal decline in loan/deposit ratios during the fourth quarter stemmed from both a downturn in total loans and a large upswing in deposits. Among banks that are heavily engaged in agricultural lending and that provide weekly reports on assets and deposits, outstanding loans declined 2.5 percent between mid-September and mid-January. In contrast, total deposits rose 4.2 percent. The downturn in loans over the past four months contrasts sharply with the preceding five years when loan growth ranged from 1.2 to 6.0 percent and averaged nearly 3 percent during the same 4-month period. Deposit growth over the past four months, which was augmented by the introduction of All-Savers Certificates and the new IRA accounts, was considerably less than the year before, but still well above the average for the four

years prior to last year.

Banks in all five District states reported similar trends with respect to a soft loan demand, slow loan repayments, further improvement in fund availability, and a large decline in average loan/deposit ratios. Yet the trends reported by bankers in Indiana were more negative than those reported by banks in the other District states. For instance, the measures of loan repayment rates and fund availability reported by Indiana banks were considerably lower than those reported by bankers in the other District states. This may partially reflect the weather-related problems which held 1981 crop production in Indiana below more normal levels.

The performance of other agricultural lenders during the latter months of 1981 was somewhat mixed. Most

striking, however, was the sharp downturn in lending at production credit associations—the nonreal estate lending arm of the Cooperative Farm Credit System. PCA lending initially slowed during the latter half of 1980 and then showed signs of rebounding in the first half of last year. But loans made by PCAs began to slow again this past summer and in the fourth quarter fell 3.6 percent short of the year before. The decline marked the first year-to-year downturn in loans made by PCAs for any quarter in at least two decades. In line with the fourth-quarter slowing, outstanding PCA loans at the end of 1981 were only 7 percent higher than the year before, the smallest annual rise for PCAs since 1954. In District states, PCA outstandings rose only 6 percent last year, reflecting an even sharper cutback in fourth-quarter lending.

Among other nonreal estate farm lenders, activity at the Farmers Home Administration no doubt slowed in the fourth quarter after surging in the earlier months of the year. However, CCC lending accelerated as farmers enrolled a record amount of corn in CCC loan programs.

In farm real estate mortgage lending, activity at federal land banks remained quite brisk during the latter months of 1981, although December was weak. For the entire fourth quarter, new loans made by FLBs exceeded the year-earlier level by 24 percent. The increase was slightly larger in District states. For the year, outstanding loans at FLBs rose 21 percent nationwide and 23 percent in District states. That marked the third consecutive year that FLB outstandings have risen 20 percent or more nationwide and the eighth consecutive year of such growth in District states.

Activity at other major farm mortgage lending institutions has been weak for two or three years, with no evidence yet of a turnaround. Reflecting this, farm mortgages acquired by life insurance companies in the first 11 months of 1981 were down a fourth from the same months a year earlier and down nearly 60 percent from two years earlier. In line with the continuing downturn, outstanding farm mortgages held by life insurance companies at the end of November were less than 2 percent higher than the year before. Outstanding farm mortgage debt held by banks at the end of the third quarter was down 1 percent from the year before.

The financial position of farmers has been undermined by two years of very depressed earnings. Equity, or net worth, in farm sector assets remains at a very high level following the acceleration in land values during the 1970s. However, the real purchasing power of the equity

in farm sector assets has been reduced the past couple years as the rise in asset values fell short of the rise in inflation. Prospects for this year are bleak, with little hope for a significant recovery in farm earnings and with considerable weakness now apparent in farmland markets. These developments and prospects have triggered considerable concern about the willingness of bankers and other lenders to continue serving farmers and about the likelihood that many farmers will not be able to ride out the current downturn.

Farm lenders will no doubt be looking for additional collateral or other means of reducing repayment risks from farm loan customers this year. But as yet, it does not appear that agricultural bankers have become unduly concerned about the quality of their agricultural loan portfolios. Judged in terms of collateral value, timeliness of repayments, risk of default, and other related elements, less than a tenth of the bankers that responded to the latest survey characterized the decline in the quality of their nonreal estate farm loan portfolios as substantial. Another 30 percent felt the quality was the same or better than a year ago. The remaining 60 percent of the bankers regarded the decline in the quality of their nonreal estate farm loan portfolios as slight. Regarding other loan portfolios, the bankers indicated the decline in the quality of business and commercial loans over the past year was more than that for farm loans.

There is little doubt the depressed conditions in agriculture will lead to more than the usual number of forced sales of capital assets among farmers. However, it appears that the proportion of farmers who will have to liquidate some capital assets in the near future is still quite small. Bankers who responded to the latest survey were asked to indicate the proportion of the farmers in their area that normally liquidate some capital assets because of financial problems and what proportion are likely to do so in the first half of this year. Their responses suggested that normally about 1 percent of the farmers liquidate some capital assets because of depressed earnings and other related financial problems. For the first half of this year, the bankers expect about 3 percent of farmers to face the prospects of liquidating some capital assets. These measures signify a considerable increase from the norm, but still suggest that the magnitude of the problem may be somewhat less than is typically assumed. Nevertheless, the problems are real and will likely become more apparent if farm earnings persist for another year or two at the low levels of the past two years.

Gary L. Benjamin

Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from	
				Prior period	Year ago
Farm finance					
Total deposits at agricultural banks†	1972-73=100	January	245	+ 1.2	+ 6
Total loans at agricultural banks†	1972-73=100	January	263	- 1.0	+ 3
Production credit associations					
Loans outstanding					
United States	mil. dol.	December	21,042	- 1.0	+ 7
Seventh District states	mil. dol.	December	4,356	- 2.3	+ 6
Loans made					
United States	mil. dol.	December	3,611	+57.4	- 5
Seventh District states	mil. dol.	December	698	+54.6	-11
Federal land banks					
Loans outstanding					
United States	mil. dol.	December	43,658	+ 1.0	+21
Seventh District states	mil. dol.	December	10,428	+ 1.0	+23
New money loaned					
United States	mil. dol.	December	645	+ 3.7	- 1
Seventh District states	mil. dol.	December	141	- 6.4	+ 3
Interest rates					
Feeder cattle loans††	percent	4th Quarter	17.75	- 2.2	+12
Farm real estate loans††	percent	4th Quarter	17.01	+ 0.5	+16
Three-month Treasury bills	percent	1/28-2/3	13.17	+14.9	-11
Federal funds rate	percent	1/28-2/3	14.77	+13.8	-14
Government bonds (<i>long-term</i>)	percent	1/28-2/3	14.18	+ 1.4	+14
Agricultural trade					
Agricultural exports	mil. dol.	December	3,596	- 4.7	-16
Agricultural imports	mil. dol.	December	1,381	+13.0	-10
Farm machinery sales^P					
Farm tractors	units	December	8,128	+14.4	+19
Combines	units	December	1,921	-44.5	+14
Balers	units	December	234	-28.7	-43

†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 at beginning and end of quarter.

^PPreliminary.

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