FEDERAL RESERVE BANK OF CHICAGO

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CREDIT CONDITIONS AT DISTRICT AGRICULTURAL BANKS in the second quarter continued to reflect weakness in farm loan demand, sluggish—but perhaps improving—farm loan repayment rates, and a generously ample availability of funds for lending to farmers. These represent the consensus views from a July 1 survey of 600 agricultural banks in the Seventh Federal Reserve District. The survey also showed that interest rates charged by banks on farm loans edged slightly lower in the second quarter. However, bank loan rates remain high relative to rates charged by other farm lenders, no doubt contributing to the weak loan demand and the lower-than-desired loan/deposit ratios at many agricultural banks.

The measure of funds available for farm lending in the second quarter stood at 157 (see table on page 2), virtually equalling the all-time high for this measure recorded in the first quarter. The measure is calculated as a composite of the 58 percent of the banks reporting that availability of funds in the second quarter was higher than the year before and the 1 percent reporting that it was lower. The remaining portion, about 40 percent of the banks, reported that fund availability was comparable to a year ago.

A number of related factors, including weak loan demand, a favorable—but narrowing—margin between potential returns from new lending and returns from investing in new securities, and continued deposit growth underlie the bankers views regarding the availability of funds for farm loans. Information from agricultural banks that report weekly on their loans and deposits suggest that total deposits at these banks at mid-year were up 7 percent from six months ago and up 10.5 percent from a year ago. Deposit growth was particularly strong in the first quarter—following the introduction of the new money market deposit account—but tapered off to a more normal growth rate in the second quarter. Nevertheless, with deposit growth outstripping loan growth for the better part of the past four years, agricultural banks have a good supply of funds for lending to acceptable borrowers.

Farm loan demand at banks, although still sluggish, may have held up better than had been expected with the widespread farmer participation in the PIK program. The overall measure was up considerably from the first quarter, but, at 85, still was indicative of a weaker loan demand than in the second quarter of last year. This is not surprising given the substantial declines in 1983 planted crop acreage and the associated declines in farmers' needs to finance purchases of seeds, fuel, fertilizer, and chemicals. However, the portfolio of total loans at District agricultural banks still rose nearly 4 percent in the second quarter, the fastest growth for that period since the late 1970s. This coupled with other evidence that banks are starting to recapture some of the nonreal estate farm debt market—due to cutbacks by production credit associations—suggests that PIK may have had less of an impact on farm loan demand at banks than expected.

Loan/deposit ratios at District agricultural banks edged upward in the second quarter as the sudden surge in loan growth outstripped the slowing growth in deposits. As of mid-year, the loan/deposit ratios averaged .54, up from .533 the previous quarter. Despite the increase, the ratio remains low relative to the peak of .676 established in the summer of 1979 but is roughly in line with what was considered the norm for agricultural banks through much of the 1960s and early 1970s. Among individual District states, the average ratios ranged from a low of .50 in Illinois to a high of .61 in Wisconsin. Relative to the peaks established in the late 1970s, the biggest decline in the average ratio has occurred in Illinois; the smallest decline in Wisconsin.

Most bankers would prefer to have a loan/deposit ratio considerably above the ratio they had at mid-year, particularly those in Illinois and Michigan. Overall, 75 percent of the bankers reported that they desired a higher loan/deposit ratio. Only 6 percent desired a lower ratio and the remainder, 19 percent, had a loan/deposit ratio close to their desired ratio. The desired ratios reported by all bankers averaged .624. The large margin betwen the averages of the desired and actual

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

[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.

loan/deposit ratios also attests to the ample availability of funds for lending. Agricultural banks, no doubt, are seeking qualified loan customers as a means of maintaining earnings in the wake of the deregulatory changes that have raised their cost of funds (deposits).

Interest rates charged by banks on farm loans edged slightly lower in the second quarter, in contrast to the slight uptrend in overall market rates of interest. As of mid-year, the typical rates on feeder cattle and on farm operating loans charged by District agricultural banks averaged 13½ percent. That represents only a modest decline from the average of 13-2/3 percent three months ago but is substantially below the averages of nearly 17¼ percent a year ago. Among the five District states, bank loan rates varied from a low of 13 percent in Michigan to a high of 13¾ percent in Iowa.

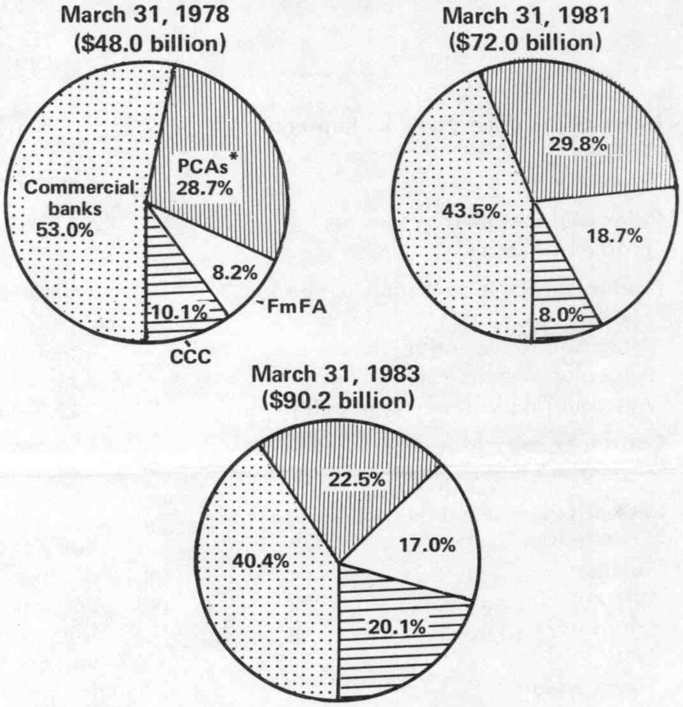
Evidence of lending activity at other institutions that serve farmers shows mixed trends. While second-quarter tabulations are not complete for most lenders, it is clear that nonreal estate farm lending by production credit associations (PCAs) continued to slide through mid-year. For example, the dollar value of loans made by PCAs nationwide in the second quarter was down 12 percent from the year before. That marks the seventh consecutive quarter in which loans made by PCAs have lagged the year-earlier level. In conjunction with this abnormally-prolonged cut, the portfolio of nonreal estate farm loans held by PCAs as of the end of June was down 8 percent from the year before and the lowest for that date since 1979. The reduction in the portfolio of PCA loans has been associated with a decline of nearly 7 percent in the number of borrowers with outstanding PCA loans.

The decline in PCA lending is particularly interesting since PCA loan rates apparently still lag below the rates charged by agricultural banks. PCA loan rates are established in accordance with rates charged by Federal Intermediate Credit Banks, the institutions that fund most PCA loans. In July, the FICB base rates applicable in areas covering the five District states ranged from 9¾ to 10½ percent. While the margins vary, this suggests that the effective rates for most PCA borrowers in July—including stock purchase requirements—probably ranged from 11 to 13 percent.

The two major governmental agencies that lend to farmers—the Farmers Home Administration and the Commodity Credit Corporation—have recorded contrasting trends recently. Following three consecutive quarters of decline, the portfolio of nonreal estate farm loans held by the FmHA was only 1.5 percent higher than the year before as of the end of March. In contrast, the portfolio of nonreal estate farm loans held by the Commodity Credit Corporation as of the end of March was up 63 percent from the year before and more than three times the level of two years ago. In the past two years ending with March, the CCC accounted for over two-thirds of the rise in nonreal estate farm loans held by all reporting lenders (reporting lenders account for about 82 percent of all outstanding nonreal estate farm debt). In that two-year span, the CCC's share of all nonreal estate debt owed to reporting lenders jumped from 8 percent to more than 20 percent, nearly equalling the 21.5 percent share owed to PCAs. Moreover, the combined shares of the FmHA and the CCC nearly equal the 40.5 percent share held by commercial banks.

The extraordinary growth in CCC lending to farmers reflects the CCC's role in carrying out government price support programs for farmers. With grain prices depressed the past couple of years by surplus stocks, farmers have heavily utilized the programs that allow them to pledge their crops as collateral for nonrecourse CCC loans. However, the rapid growth in the CCC loan portfolio probably ended in the first quarter. Although new lending to farmers completing the 1983 winter wheat harvest has apparently been strong recently, the pending transfer of PIK entitlements to farmers and the triggering of the release of corn held in the three-year

Shares of nonreal estate farm debt owned to reporting lenders have changed markedly in recent years



*A small portion of the shares shown for PCAs includes loans discounted by FICBs for financial institutions other than PCAs.

reserve foreshadows a net paydown in the CCC portfolio of outstanding loans in the months ahead. This may result in a fairly sudden pickup in farm loan demand at commercial lenders such as PCAs and banks.

In the months ahead, the agricultural bankers are looking for a continuation of recent trends. Over 40 percent of the bankers believe farm loan demand in the third quarter will be no higher than a year ago and a similar proportion believe loan demand will be even weaker. In particular, demand for crop storage loans and farm machinery loans are expected to be down the most from last year.

About three-fourths of the bankers believe deposit growth at their banks will hold at normal levels over the next three to six months. The remainder were about evenly divided as to their views about faster- and slower-than-normal deposit growth. About two-thirds expected interest rates they charge on farm loans to remain about the same over the next three to six months. But of the remainder, those expecting to charge higher rates outnumbered those expecting lower rates by a margin of 5.5 to 1. About 60 percent of the bankers felt that the quality of their farm loan portfolio would remain the same over the next three to six months. Of the remainder, however, those expecting an improvement in quality outnumbered those expecting declines by a margin of 4.5 to 1.

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Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from Prior period	Percent change from Year ago
Index of prices received by farmers	1977=100	July	131	– 2.2	– 4
Crops	1977=100	July	123	– 2.4	– 2
Livestock	1977=100	July	139	– 1.4	– 5
Index of prices paid by farmers	1977=100	July	160	0	+ 2
Production items	1977=100	July	152	– 1.3	+ 1
Producer price index* *(finished goods)*	1967=100	June	285	+ 0.2	+ 2
Foods	1967=100	June	261	– 0.6	– 1
Processed foods and feeds	1967=100	June	254	– 0.7	– 1
Agricultural chemicals	1967=100	June	282	– 0.4	– 4
Agricultural machinery and equipment	1967=100	June	326	– 0.2	+ 5
Consumer price index** *(all items)*	1967=100	June	298	+ 0.3	+ 3
Food at home	1967=100	June	283	– 0.3	0
Cash prices received by farmers					
Corn	dol. per bu.	July	3.12	+ 2.6	+25
Soybeans	dol. per bu.	July	6.11	+ 3.4	+ 2
Wheat	dol. per bu.	July	3.37	– 4.0	+ 3
Sorghum	dol. per cwt.	July	5.10	+ 0.8	+29
Oats	dol. per bu.	July	1.50	0	– 4
Steers and heifers	dol. per cwt.	July	59.80	– 3.9	– 5
Hogs	dol. per cwt.	July	43.50	– 0.9	–25
Milk, all sold to plants	dol. per cwt.	July	13.20	0	0
Broilers	cents per lb.	July	30.7	+ 8.5	+ 9
Eggs	cents per doz.	July	57.5	– 2.2	+ 4
Income *(seasonally adjusted annual rate)*					
Cash receipts from farm marketings	bil. dol.	2nd Quarter	141	– 0.6	0
Net farm income	bil. dol.	2nd Quarter	26	+ 6.5	+55
Nonagricultural personal income	bil. dol.	June	2,681	+ 0.5	+ 6

*Formerly called wholesale price index.

**For all urban consumers.

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