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CREDIT CONDITIONS AT DISTRICT AGRICULTURAL BANKS during the third quarter reflected the financial stress prevalent in the agricultural sector. Weak farm loan demand, sluggish repayment rates, and a high level of refinancings continue to characterize the reports of 575 agricultural banks recently surveyed by the Federal Reserve Bank of Chicago. The October 1 survey also indicated that banks desire to increase their loan/deposit ratios in light of an ample supply of funds. However, rising interest rates charged on farm loans and an apparent cutback in livestock production portend continued weakness in farm loan demand in the current quarter.

The measure of farm loan demand at district agricultural banks held at a low level in the third quarter. The overall measure stood at 81 (see table on page 2), indicating a more sluggish loan demand than in the third quarter of 1982. Less than a fourth of the banks surveyed reported an increase in loan demand over the previous year, while 42 percent indicated farm loan demand had decreased. The remaining 35 percent of the banks noted that farm loan demand was unchanged from a year ago. However, the portfolio of total loans at District agricultural banks—up 3 percent—registered an increase for the third consecutive quarter.

Funds available for lending to farmers remained plentiful during the third quarter. The index of fund availability continued at its record level for the third consecutive quarter. Only 3 percent of the responding banks noted a decrease in the availability of funds from the third quarter of last year, while 60 percent indicated loanable funds had increased. The strong sentiments expressed by surveyed banks regarding funds availability are reinforced by data from District agricultural banks that report weekly on their deposits. Although the rate of growth has slowed from the first-half experience, total deposits at these banks in October were up 11 percent from a year ago. Despite the slowdown in the rate of deposit growth, District agricultural banks appear to have a large supply of funds available for lending and are likely to continue to solicit qualified farm loan customers to capitalize on the favorable returns from lending.

Loan/deposit ratios at District agricultural banks, despite the sluggish demand for farm loans, continued to trend upward during the past quarter. The ending-September ratios reported by the surveyed banks averaged nearly .55, up from a low of .53 six months earlier. Despite the second consecutive quarterly increase, the average ratio still lags the year-earlier level of .58 and is well short of the 1979 peak of nearly .68. Among the five District states, average loan/deposit ratios range from a low of .50 among banks in Illinois to a high of .62 among banks in Wisconsin.

Most of the banks surveyed expressed a preference for substantially higher loan/deposit ratios. Almost three-quarters of the banks reported their loan/deposit ratios to be below the desired level, with only 8 percent reporting higher than desired ratios. The average desired ratio for all banks, at .624, was unchanged from the previous quarter. Banks in Illinois, Iowa, and Michigan exhibited the greatest disparity between actual and desired loan/deposit ratios, expressing a preference for ratios 8 to 9 percentage points higher than those reported. Indiana and Wisconsin banks would have preferred loan/deposit ratios 6 and 4.5 percentage points higher, respectively.

Interest rates charged by District banks on farm loans turned upward again during the third quarter interrupting the downtrend that had prevailed the previous five quarters. Rates on feeder cattle and farm operating loans averaged 13.7 percent at the end of the third quarter, up about 25 basis points from mid-year but still well below the 15.6 percent average of a year ago. Among District states, loan rates ranged from a low of 13.2 percent in Michigan to a high of 14 percent in Iowa. New farm real estate loan rates edged upward about 20 basis points to average 13.4 percent for the five District states.

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
July-Sept	81	156	78	13.70	54.8	8

[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.

Farm loan repayment rates continued slow this summer. A third of the banks reported repayment rates had decreased from the previous year's low level with 12 percent reporting an increase. The remaining 55 percent indicated third-quarter repayments were about the same as a year ago. Similarly, an increase in renewals and extensions of farm loans at 38 percent of District banks overshadows a decrease reported by 10 percent of the banks surveyed.

The continued slowdown in loan repayment rates coupled with increased numbers of farmers restructuring their debt loads reflects the persistence of financial stress in agriculture. Despite the impending benefits to participants in the PIK program, many farmers continue to be pressured by burdensome debt structures. Moreover, with livestock prices below year-ago levels—and expected to remain so until early next year—much of the gains realized by crop farmers in the form of higher prices will be offset by reduced profitability in the livestock sector. In addition, the implementation of the second 50 cent per hundredweight deduction has lowered returns to dairy farmers. These developments suggest that many livestock and dairy producers will continue to experience financial stress and may require some restructuring of their debt load during the fourth quarter.

Activity at other financial institutions that lend to farmers fell sharply for the most part in the third quarter. Loans made by production credit associations (PCAs)—the Farm Credit System's outlet for nonreal estate lending—dropped 11 percent from the level of a year ago. This represents the eighth consecutive quarter that loans made by PCAs have been below year-earlier levels, and leaves the cumulative total of loans made for the year down more than 9 percent from 1982. Associated with this decline, the portfolio of nonreal estate farm loans outstanding at PCAs is down almost 9 percent from the end of the third quarter last year, while the number of borrowers at PCAs is down 7 percent from a year ago and at its lowest level since March 1978.

The stagnant farm real estate market has contributed to marked declines in lending by the major institutions serving the market. New money loaned by federal land banks and their associations continued its almost two-year long slide in the third quarter with a 23 percent year-to-year decline. The sustained fall off has resulted in a 39 percent cut from last year's level in new money loaned through the first nine months of 1983. Despite the large reductions in new loans, outstanding real estate debt held by FLBs is up 2.5 percent from a year ago. In contrast, life insurance companies, an important source of farm real estate funds, have experienced a prolonged decline in outstanding farm mortgages. While figures for reporting insurance companies are not completely tabulated for the third quarter, the amount of farm mortgages outstanding through August was down 2 percent from a year ago. However, August marked the third consecutive monthly rise in farm mortgage acquisitions by life insurance companies.

Indications are that activity at both major governmental institutions that lend to agriculture—the Farmers Home Administration and the Commodity Credit Corporation—will exhibit significantly different trends from recent quarters. Following year-to-year declines in the second and third quarters, lending by the FmHA will rebound in the months ahead as Disaster Loans covering losses on summer drought are dispersed to eligible farmers. In addition, the FmHA will abide by a court ruling to disperse $600 million in Economic Emergency Loan funds to farmers. In contrast, the large portfolio of outstanding farm loans carried by the CCC will continue the decline that began in the second quarter with the transfer of PIK entitlements and the repayment of CCC loans on grain released from the reserve.

In the quarter ahead, credit demand at District agricultural banks is expected to remain weak. About a third of the banks surveyed expect demand for all nonreal estate loans to be lower than in the fourth quarter of 1982, while only a fourth expect demand to be higher. Among individual District states, banks in Michigan appear to exhibit slightly higher demand expectations, perhaps reflecting the relatively more favorable growing conditions experienced in the state this summer. Very few banks expect to see a pick-up in feeder cattle, dairy, or crop storage loans. Wisconsin, where 24 percent of the banks anticipate an upturn in dairy loans, is an exception to this trend. On the other hand, prospects seem brighter in many bankers' estimations for an increase in operating and farm machinery loans. Operating loan increases are expected by a third of the banks while only 9 percent foresee a decline. Sentiments for an upturn in farm machinery loans are not as strong, but 26 percent of the survey banks expect demand for this type of loan to be up in the fourth quarter and 35 percent expect demand will be unchanged from a year ago. As a result, the index of anticipated farm machinery loan demand recorded its highest value in four years.

The survey responses evidence a shift in financial stress from crop farmers to livestock and dairy producers. Sharply higher crop prices and the lower incentives to participate in acreage reduction programs foreshadow a rebound in 1984 crop acreage. An increase in planted acres points to a corresponding rise in loan demand to finance the higher operating expenses. High feed costs, however, have contributed to reduced or negative margins for dairy and livestock farmers already pressured by lower prices for their products. With margins continuing to narrow and producers trimming their herds, an upturn in credit demand by crop farmers is likely to be partially offset by growing weakness in livestock and dairy producers' loan demand.

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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	October	289	+ 1.8	+11
Total loans at agricultural banks†	1972-73=100	October	299	− 0.1	+ 5
Production credit associations					
Loans outstanding					
United States	mil. dol.	September	19,887	− 1.3	− 9
Seventh District states	mil. dol.		N.A.	N.A.	N.A.
Loans made					
United States	mil. dol.	September	1,828	− 6.1	−12
Seventh District states	mil. dol.		N.A.	N.A.	N.A.
Federal land banks					
Loans outstanding					
United States	mil. dol.	September	48,061	+ 0.2	+ 2
Seventh District states	mil. dol.		N.A.	N.A.	N.A.
New money loaned					
United States	mil. dol.	September	241	−16.7	−17
Seventh District states	mil. dol.		N.A.	N.A.	N.A.
Interest rates					
Feeder cattle loans††	percent	3rd Quarter	13.60	+ 0.1	−17
Farm real estate loans††	percent	3rd Quarter	13.28	− 0.4	−18
Three-month Treasury bills	percent	11/3-11/9	8.75	+ 0.7	+11
Federal funds rate	percent	11/3-11/9	9.36	− 1.1	- 1
Government bonds *(long-term)*	percent	11/3-11/9	11.88	+ 3.4	+13
Agricultural trade					
Agricultural exports	mil. dol.	September	2,973	+13.8	+24
Agricultural imports	mil. dol.	September	1,319	− 5.3	+ 2
Farm machinery sales[p]					
Farm tractors	units	September	8,737	+15.8	− 5
Combines	units	September	1,486	+34.2	−18
Balers	units	September	534	−45.7	−25

†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.

[p]Preliminary.

N.A. - Not available.

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