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Farm Credit System notes continued improvement

The performance of the Farm Credit System (FCS) continues to recover from the widespread problems encountered during the farm sector's financial downturn in the early 1980s. The latest report from the System's Funding Corporation notes that further declines in problem loans and lower interest expenses contributed to stronger first-half earnings. Moreover, the total portfolio of loans held by the various lending components of the FCS edged above the year-earlier level during the first half of 1990, reversing the downtrend that had prevailed since 1983.

The FCS is a nationwide system of lending institutions and other affiliated entities. The various banks and associations of the FCS provide loans to farmers, agricultural cooperatives, and—on a far more modest scale—to rural homeowners, farm-related businesses, aquatic-related entities, and rural utilities. In general, the banks and associations are owned cooperatively by their borrowers. The lending operations of the FCS are funded primarily through the sale of debt securities to various investors. The debt securities represent the joint and several obligations of the banks in the FCS.

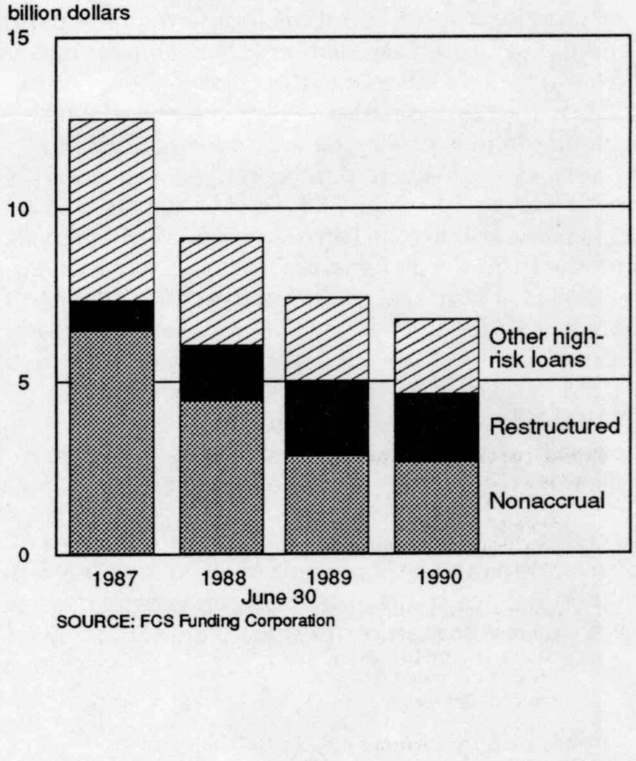
When the FCS was confronted with crippling losses in the mid 1980s, Congress came to its rescue with legislation in late 1987 that provided up to $4 billion in federal financial assistance. Since the System has benefitted from an unexpected recovery in the interim, only about $1.2 billion of the financial assistance has been utilized so far. The authority for utilizing the remaining federal assistance does not expire until 1992. But some observers believe that little, if any, of the remaining federal assistance will be utilized.

The 1987 legislation also contained provisions for consolidating the number of lending institutions in the FCS in order to cut costs and achieve better operating efficiencies. Over the past two and a half years, the number of lending entities has been reduced from 427 (comprising 37 banks, 231 federal land bank associations, and 159 production credit associations) to 317. Loans to agricultural cooperatives, previously handled by 13 banks, are now provided by 3 banks, each with nationwide lending authority. And in all but one of the 12 Farm Credit districts, the farm lending functions of the former Federal Land Bank and the Federal Intermediate Credit Bank have been consolidated into one Farm Credit Bank for each district. An assortment of some 300 associations currently serve as the link between the banks and local farm borrowers.

The recovery in the FCS began in 1988 and largely stemmed from the turnaround in the farm economy. The rise in farm sector earnings and asset values in recent years has helped to shore-up the quality of the FCS loan portfolio, both in term earnings and the value of the collateral securing those loans. Reflecting the improved quality of its loan portfolio, the recent report noted that the FCS had about $6.8 billion in nonaccrual, restructured (with monetary concessions), and other high risk loans as of the end of June. That marked declines of 9 percent from a year earlier and a decline of nearly 50 percent from the peak in 1987. Although these high-risk loans still account for a sizable 13 percent of the FCS's total loan portfolio, the proportionate share has declined from nearly 24 percent in early 1987.

The improved quality of its loan portfolio and somewhat lower interest expenses have helped to buoy net interest income for the FCS. During the first half of this year, net interest income for the FCS approximated

Problem loans held by the FCS



SOURCE: FCS Funding Corporation

$616 million. That compares to less than $500 in the same period a year ago and about $260 million in the first-half of 1987, the year that net interest earnings for the FCS hit a low.

The improved quality of the loan portfolio has further added to the FCS's total net earnings by permitting a decline in the allowance (or reserve) for loan losses. During the mid 1980s, large charges were expensed against earnings to build up the reserve. But since loan losses have been well below of expectations, the System has elected to reduce the reserve for loan losses. This practice added a substantial component to the FCS's total net earnings of about $700 million in both 1988 and 1989. In recent quarters, the drawdown in the reserve, and the resulting contribution to net earnings, has fallen off sharply. Nevertheless, total net earnings for the FCS during the first half of this year reached $362 million, up slightly from the same period a year ago.

The total of all loans held by the various institutions within the FCS moved ahead of the year-earlier level during the first half of 1990, reversing the string of uninterrupted declines recorded since 1983. As of June 30, total loans in the FCS approximated $51.2 billion, up 1.6 percent from a year earlier. Gains in loans to cooperatives and short- and intermediate-term loans (mostly to farmers) more than offset the continuing decline in long-term real estate loans (mostly to farmers). As of June 30, FCS loans to cooperatives reached $11.1 billion, up 13 percent from a year ago. Short- and intermediate-term loans totaled over $10.5 billion, up more than 5.5 percent. The remaining portfolio of long-term real estate loans, at $29.6 billion, was down nearly 3.5 percent from a year earlier.

The farm loan portfolios of the four farm credit banks (and their affiliated associations) that serve farmers in Seventh Federal Reserve District states show similar year-over-year comparisons as of the end of June. Among the four banks, the year-over-year gain in nonreal estate loans to farmers ranged from nearly 3 percent at the Farm Credit Bank of St. Paul to well over 10 percent at both the Farm Credit Bank of Louisville and the Farm Credit Bank of Omaha. Conversely, the portfolios of farm real estate mortgages at all four banks recorded further declines, ranging from nearly 1 percent at the Farm Credit Bank of Louisville to more than 5 percent at the Farm Credit Bank of St. Paul With the exception of the Farm Credit Bank of Louisville, the decline in farm mortgages more than offset the rise in nonreal estate farm loans.

Recent tabulations by the USDA indicate that the FCS accounts for about 23 percent of all outstanding farm debt in the five states of the Seventh Federal Reserve District. The proportionate share of farm debt owed to the FCS in individual District states ranges from a low of 17 percent in Iowa to 30 percent in Wisconsin and 38 percent in Michigan. In comparison, commercial banks account for about 38 percent of all farm debt in District states. The commercial bank share for individual District states ranges from 22 percent in Michigan to 45 percent in Illinois. Nationwide, about a third of all farm debt is owed to commercial banks and about 26 percent is owed to the FCS.

Grain prices retreat with bumper world harvest prospects

Grain production estimates, both for the U.S. and worldwide, were revised upward in the U.S. Department of Agriculture's latest tabulations. For the United States, the estimate of total wheat and coarse grain production was raised to 310 million metric tons, up 3 percent from the August estimate and up 12 percent from a year ago. Foreign grain production is now forecast to be up 3.5 percent from last year, with most of the rise in wheat. The combination of gains both here and abroad foreshadows a worldwide wheat and coarse grain harvest of 1.41 billion metric tons in the 1990/91 world crop year, up 5 percent from last year and up 14 percent from two years ago. In anticipation of larger supplies, grain prices have retreated sharply.

Domestically, the latest estimates reflected upward revisions for both wheat and corn. The U.S. wheat harvest estimate was raised nearly 2 percent. At 2.76 billion bushels, this year's wheat harvest would mark a 35 percent rebound from last year's weather-

World grain production, consumption, trade, and carryover stocks

	1987/88	1988/89	1989/90	1990/91*
	(------------million metric tons----------)			
Production				
Wheat	501.5	500.7	538.1	586.9
U.S.	57.4	49.3	55.4	75.0
Foreign	444.2	451.4	482.7	511.9
Coarse grains	793.4	730.5	799.6	821.6
U.S.	217.0	149.7	221.4	235.3
Foreign	576.4	580.8	578.2	586.3
World consumption				
Wheat	530.5	531.9	538.6	563.6
Coarse grains	814.4	797.8	826.2	823.5
World trade**				
Wheat	105.0	96.9	97.0	97.2
U.S. exports	43.4	37.6	34.0	30.5
Coarse grains	83.2	94.5	101.5	90.8
U.S. exports	53.5	61.3	69.2	60.7
World carryover stocks				
Wheat	147.5	116.3	115.8	139.0
Coarse grains	213.1	145.8	119.2	117.3

*USDA projections as of September 12.
**Excludes intra-EC trade.

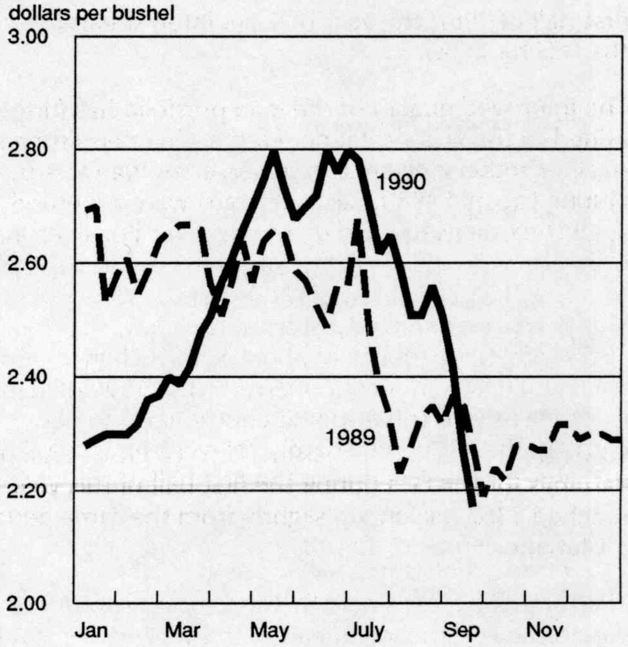
stressed crop. The corn production forecast was raised to 8.12 billion bushels, up nearly 3.5 percent from the previous forecast and nearly 8 percent above last year's harvest. Improved yield prospects in Seventh District states accounted for a large share of the upward revision in the U.S. corn production estimate.

The expanded world grain harvest foreshadows increased consumption and some rebuilding of what had been relatively low carryover stocks of wheat. But due to the widespread nature of the expanded harvest among major importing and exporting countries, as well as forecasts showing increased use of wheat as livestock feed, prospects for world trade and U.S. exports are disappointing. World consumption of wheat in 1990/91 is now projected to be up about 4.5 percent from last year, paced by a huge rise in the amount of wheat fed to livestock. With more wheat fed to livestock, world consumption of both corn and total coarse grains is projected to decline nominally in 1990/91.

In line with the USDA's production and consumption forecasts, world trade in wheat and flour during the year ending in June 1991 is expected to hold near the reduced levels of the past two years and about 7.5 percent below the 1987/88 peak. Even more discouraging, U.S. wheat and flour exports this year are now expected to register the third consecutive annual decline of about 10 percent. World trade in coarse grains for the year ending in October 1991 is now forecast to decline more than a tenth from the 9-year high reached over the past 12 months. A slightly larger cut is projected for U.S. coarse grain exports.

U.S. grain prices have retreated considerably as prospects for a bumper world harvest foreshadow smaller world import needs and cuts in U.S. exports. In August, U.S. farm prices for wheat were at a 3-year low of $2.60 a bushel, down 25 percent from April and down 31 percent from a year ago. The erosion in grain prices has been particularly apparent for corn in recent weeks. Cash prices for corn in central Illinois fell to less than $2.20 a bushel earlier this week, the lowest since the onset of the 1988 drought and down more than 20 percent from the two-year highs in late June. With the harvest season at hand, current prices are probably close to a seasonal low. But until export

Weekly average corn prices



prospects pickup, the post-harvest recovery in grain prices may be comparatively modest. At the same time, the continuing low level of world carryover stocks, especially for corn and coarse grains, suggest that export prospects could recover quickly if crop conditions in any major area of the world next year were to be threatened by weather or other developments.

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Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from: Prior period	Year ago	Two years ago
Prices received by farmers *(1977=100)*	August	150	-1.3	3	3
Crops *(1977=100)*	August	126	-3.1	-2	-9
Corn *($ per bu.)*	August	2.46	-6.1	8	-7
Oats *($ per bu.)*	August	1.09	-5.2	-26	-57
Soybeans *($ per bu.)*	August	6.00	0.5	1	-28
Wheat *($ per bu.)*	August	2.59	-7.2	-31	-28
Livestock and products *(1977=100)*	August	174	0.6	8	14
Barrows and gilts *($ per cwt.)*	August	56.90	-8.5	21	23
Steers and heifers *($ per cwt.)*	August	78.80	2.9	7	13
Milk *($ per cwt.)*	August	14.40	2.1	9	22
Eggs *(¢ per doz.)*	August	65.6	18.0	-8	13
Prices paid by farmers *(1977=100)*	July	184	0.5†	3	7
Production items	July	170	0.6†	2	7
Feed	July	130	1.6†	-2	-10
Feeder livestock	July	214	0.5†	11	19
Fuels and energy	July	185	-1.1†	-1	9
Producer Prices *(1982=100)*	August	119	1.0	5	10
Agricultural machinery and equipment	August	121	0.6	2	7
Fertilizer materials	August	93	1.9	0	-5
Agricultural chemicals	August	119	-0.8	3	12
Consumer prices *(1982-84=100)*	August	132	0.9	6	11
Food	August	133	0.2	6	11
Production or stocks					
Corn stocks *(mil. bu.)*	June 1	2,839	N.A.	-17	-51
Soybean stocks *(mil. bu.)*	June 1	596	N.A.	28	-9
Beef production *(bil. lbs.)*	July	1.94	-2.0	3	-2
Pork production *(bil. lbs.)*	July	1.10	-3.5	-1	-3
Milk production *(bil. lbs.)*††	August	10.5	-1.8	4	3

N.A. Not applicable.
†Prior period is three months earlier.
††21 selected states.

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