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FRB CHICAGO

AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO
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District credit conditions

Credit conditions across the Seventh Federal Reserve District during the final months of 1987 mostly continued the trends that were evident earlier in the year. A survey of more than 500 agricultural banks indicates that bankers had ample funds for lending to farmers, but farm loan demand continued weak. Interest rates charged on bank loans to farmers were unchanged from three months earlier, but up slightly from year-earlier levels. Farm loan repayment rates continued strong in the fourth quarter, suggesting further improvement in the condition of banks' farm loan portfolios and an easing of the pressure on some financially stressed borrowers.

The measure of nonreal estate farm loan demand at District agricultural banks, although still relatively weak, did rise slightly during the final months of 1987. At 78, the fourth quarter measure of farm loan demand represents a composite of the 17 percent of the respondents who indicated that demand for farm loans was above the level of a year ago less the 39 percent indicating it was lower. The remaining 44 percent of the respondents reported that farm loan demand at their institutions was unchanged from a year earlier. Among the individual District states farm loan demand remained particularly weak in Michigan, while the responses of Iowa bankers pointed to a comparatively stronger farm loan demand. However, the proportion of Iowa bankers reporting weaker farm loan demand than a year ago still outnumbered those reporting an increase.

In the face of weak farm loan demand, District agricultural banks continue to report having an ample supply of funds available for lending to farmers. The measure of fund availability, after slight declines during the spring and summer, edged back up during the fourth quarter. Only 4 percent of the survey respondents indicated that funds available for farm lending were below the previous year's level, while 46 percent reported continued increases. The remaining 50 percent of the respondents reported no change in the amount of funds available for lending to farmers compared to the same period of a year ago. The measure of fund availability was high among all District states, ranging from more than 150 in Iowa and Wisconsin to 127 in Indiana.

From a low of 48.8 percent at the end of March, the average loan-to-deposit ratio at District agricultural banks recorded two consecutive quarterly increases, reaching 51.5 percent at the end of September. By the end of the year, however, the average ratio at responding banks dropped to 50.3 percent. These recent ratios are well below the averages that prevailed in the early 1980s when District agricultural banks reported loan-to-deposit ratios above 60 percent.

As had been the case throughout 1987, agricultural banks in Illinois and Iowa reported the lowest loan-to-deposit ratios, at about 45 percent. Banks in Indiana reported an average ratio of 55 percent at the end of 1987. Bankers in Michigan and Wisconsin, states that typically have the highest ratios, reported average loan-to-deposit ratios of about 60 percent.

With loan-to-deposit ratios well below historical levels and ample supplies of funds, 78 percent of the surveyed bankers indicated a preference for higher ratios while only 5 percent indicated that their current loan-to-deposit ratio was above the desired level. For the District as a whole, the average of the surveyed bankers' desired loan-to-deposit ratios, at 59.6 percent, was about 9 percentage points higher than the average of their actual ratios at year end, but still well below the historical highs. Among individual District states, the desired ratios ranged from an average of 67 percent in Michigan to 55 percent in Illinois.

After trending upward during the spring and summer months, interest rates charged on farm loans at District agricultural banks stabilized during the fourth quarter. Reported year-end rates on feeder cattle and farm operating loans averaged 11.2 and 11.3 percent, respectively, unchanged from three months earlier. The average rate charged on farm real estate loans at the end of 1987 was also unchanged, remaining at 10.7 percent. The increases that occurred earlier in the year, however, have left rates about 15 to 20 basis above the levels that were reported at the end of 1986. Rates were fairly consistent across four of the District states, with Michigan banks reporting somewhat higher average rates on the three categories of loans surveyed.

The surveyed bankers once again noted substantial improvement in farm loan repayment rates during the fourth quarter of 1987. At 145, the measure reached

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
Oct-Dec	101	153	78	13.65	53.6	8
1984						
Jan-Mar	131	135	62	13.82	54.4	12
Apr-June	138	128	64	14.32	55.7	14
July-Sept	120	122	59	14.41	57.2	17
Oct-Dec	103	124	49	13.61	55.9	19
1985						
Jan-Mar	107	120	47	13.48	56.1	17
Apr-June	105	133	56	12.93	55.1	14
July-Sept	90	127	59	12.79	55.5	14
Oct-Dec	68	144	97	12.70	52.7	10
1986						
Jan-Mar	74	149	80	12.34	50.9	8
Apr-June	65	152	86	11.81	51.1	6
July-Sept	68	146	87	11.31	51.4	6
Oct-Dec	61	153	107	11.06	49.4	3
1987						
Jan-Mar	71	149	118	10.88	48.8	5
Apr-June	75	140	118	10.98	50.5	6
July-Sept	75	136	134	11.22	51.5	7
Oct-Dex	78	142	145	11.22	50.3	5

[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.

another record high, indicating that more than half of the survey respondents cited improvement in farm loan repayment rates compared to a year earlier, while less than 6 percent reported that loan repayment rates had dropped from a year ago. The remaining 43 percent of the surveyed bankers indicated that farm loan repayment rates during the fourth quarter were unchanged from the year-earlier level.

As has been the case for the last several quarterly surveys, Iowa bankers continued to report the most substantial improvement in farm loan repayment during the final months of 1987. Almost three-fourths of the surveyed bankers in Iowa cited higher than year ago repayment rates on their farm loan portfolios, while only 3 percent indicated that the rate of farm loan repayment during the fourth quarter was below a year earlier. In contrast, the responses of Michigan agricultural banks point to little change in the rate of loan repayment compared to a year earlier. More than 56 percent of the respondents from Michigan indicated farm loan repayments were unchanged, with 21 percent citing improvement compared to a year earlier and 23 percent citing declines.

The condition of farm loan portfolios at banks has been strengthened by the improvement in loan repayment rates that has been evident in the quarterly surveys since the latter part of 1986. At the end of the fourth quarter, the average proportion of District agricultural bank farm loan portfolios experiencing no significant or only minor repayment problems that could be remedied fairly easily jumped to almost 92 percent. That compares to 87 percent a year ago and 83 percent two years ago.

Despite the improvement, the bankers indicated that financial difficulties continue to pressure some farmer borrowers. Across the District an average of 6 percent of the bankers' portfolios were characterized as experiencing major repayment problems that will require more collateral and longer term workouts. The average proportion of portfolios in this category is down from more than 9 percent a year ago and the 11 percent level of two years ago. Similarly, a declining proportion of the bankers' farm loan portfolios have been characterized as having severe repayment problems that will likely result in loan losses or require forced sales of borrowers' assets. At an average of about 2 percent of the portfolios across the District states, farm loans with severe repayment difficulties are about half the level reported at the same time last year and down from more than 6 percent two years ago.

The improvement evident in the condition of farm loan portfolios at District agricultural banks is attributable to the stronger income over the last several years. Returns to livestock producers have been unusually high over the last two years. In addition, the cash flows of crop farmers have been buoyed by widespread participation in commodity price support programs and associated deficiency and diversion payments. Over the same period, production expenses have declined sharply as a result of lower input prices and more streamlined operations. These factors, along with the Dairy Termination Program and the Conservation Reserve Program, have served to improve farmers' cash flows and to facilitate the reduction of outstanding debt, enabling farm operations to regain financial stability.

During the first quarter of this year, credit demand at District agricultural banks is expected to remain weak. Only 17 percent of the respondents expect the volume of nonreal estate farm lending to be above a year ago, while 29 percent expect a decline. However, more than half of the respondents expect no change from a year ago in the volume of farm lending during the first three months of 1988. Demand for feeder cattle, dairy, and crop storage loans is expected to be particularly weak, with the volume of farm operating loans expected to be down only slightly from a year ago. Farm machinery lending, however, may show an increase in volume during the period, with more than a third of the bankers expecting an increase and only about a fifth expecting further declines. The responses of the bankers point to continued increases in the volume of farm real estate lending in early 1988. More than 29 percent of the bankers foresee an increased volume of farm mortgage lending while 54 percent feel the volume will match the year-ago level. Less than 17 percent of the survey respondents expect the volume of farm real estate lending at their institutions to register year-to-year declines during the first quarter.

Peter J. Heffernan

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Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from: Prior period	Year ago	Two years ago
Receipts from farm marketings *($ millions)*	September	12,146	21.2	-2	1
Crops*	September	5,406	63.6	11	-13
Livestock	September	6,533	3.1	4	19
Government payments	September	207	-46.2	-84	-30
Real estate farm debt outstanding *($ billions)*					
Commercial banks	September 30	14.1	2.1†	14	28
Federal Land Banks	September 30	35.1	1.7†	-12	-24
Life insurance companies	October 31	10.0	-0.7†	-11	-17
Farmers Home Administration	September 30	10.1	-1.2†	-3	-3
Nonreal estate farm debt outstanding *($ billions)*					
Commercial banks	September 30	30.6	0.7†	-9	-22
Production Credit Associations	September 30	10.0	1.3†	-17	-37
Farmers Home Administration	September 30	16.2	-2.2†	-8	-10
Commodity Credit Corporation	June 30	14.3	-23.9†	-20	62
Interest rates on farm loans *(percent)*					
7th District agricultural banks					
Operating loans	January 1	11.29	0.0†	2	-11
Real estate loans	January 1	10.70	0.1†	2	-13
Commodity Credit Corporation	February	7.12	0.0	21	-8
Agricultural exports *($ millions)*	November	2,825	5.6	12	1
Corn *(mil. bu.)*	November	123	-11.3	7	-42
Soybeans *(mil. bu.)*	November	98	0.2	2	23
Wheat *(mil. bu.)*	November	79	-25.3	16	-9
Farm machinery sales[p] *(units)*					
Tractors, over 40 HP	January	4,341	-9.1	36	0
40 to 139 HP	January	2,906	-18.5	20	1
140 HP or more	January	1,435	18.4	87	-2
Combines	January	606	-24.7	265	-3

*Includes net CCC loans.
†Prior period is three months earlier.
[p]Preliminary

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FEDERAL RESERVE BANK OF CHICAGO
Public Information Center
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