FRB CHICAGO

AGRICULTURAL LETTER

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Credit conditions at District ag banks

First quarter trends at agricultural banks in the Seventh Federal Reserve District were characterized by a slight decline in interest rates, continued stepped-up farm loan repayment rates, ample funds for lending, and a weak, but perhaps firming, farm loan demand. These findings reflect the consensus view of the nearly 525 bankers that responded to a recent survey by the Federal Reserve Bank of Chicago.

Farm loan demand continued weak at District agricultural banks during the early part of this year, a trend that has persisted for several quarters. The weakness has reflected several factors, including large government farm program payments, curtailed crop plantings, and, until recently, declines in farm production expenses and cuts in capital expenditures by farmers. Although still weak, there is some evidence that loan demand is starting to strengthen. The overall measure of farm loan demand for the first quarter stood at 102 (see table on page 2). This measure is derived from the 28 percent of the bankers that noted first quarter loan demand was up from a year ago, less the 26 percent that reported a lower loan demand. While up from past surveys, the latest reading is based on the relatively weak loan demand conditions of a year ago and hence may only indicate the start of a firming in what previously had been a weakening trend.

In looking ahead, it appears that bankers are anticipating some additional firming in farm loan demand. Some 29 percent of the bankers expect second quarter farm lending to exceed that of a year earlier, somewhat greater than the 19 percent of the bankers who projected a decline. Expectations for a second quarter rise in new lending were particularly apparent for farm operating loans and for farm machinery loans. In terms of farm real estate lending, which has shown steady growth at banks in recent years, 34 percent of the banks look for further growth in the second quarter while less than 10 percent anticipate declines compared to a year ago.

Expectations for some renewed strength in farm lending are consistent with several emerging trends in the farm sector this year. Crop acreage, after declining in recent years, is likely to hold steady in 1988. Government payments to farmers are trending down. And farm sector cash production expenses, after declining 15 percent over the last 3 years, may edge up in 1988 due to higher input prices. In April, the index of prices paid by farmers for production items was up 2 percent from 3 months earlier and up nearly 5.5 percent from a year ago. Prices paid for feed, fertilizer, and feeder livestock have recorded the largest gains relative to a year ago, 11 to 12 percent.

Interest rates charged on farm loans by District agricultural banks edged lower in the first quarter. The rates reported for feeder cattle and for farm operating loans as of the end of March averaged just over 11 percent, while the rates reported for farm real estate loans averaged just under 10.5 percent. For all three types of loans, the latest averages are down 20 to 25 basis points from three months earlier but up 13 to 21 basis points from the average rates reported a year ago. Among the five District states, average rates for feeder cattle and farm operating loans ranged narrowly from a low of 10.9 percent in Illinois to a high of nearly 11.3 percent in Iowa. The range in average farm real estate loan rates was slightly wider, from a low of 10.3 percent in Iowa to a high of 11.0 percent in Michigan.

Farm loan repayment rates continued at an unusually high level during the first quarter. Overall, some 46 percent of the bankers noted that farm loan repayment rates in the first quarter exceeded the year earlier pace, substantially exceeding the 2 percent that noted slower loan repayments. Faster loan repayments were noted by bankers from all District states, particularly those from Iowa, Illinois, and Indiana.

With faster paydowns on existing farm loans and sluggish new loan demand, agricultural bankers continue to have ample funds for lending and relatively low loan-to-deposit ratios. About 42 percent of the bankers reported that the availability of funds for farm loans in the first quarter exceeded the year-earlier level while less than 5 percent reported a decline. In a similar vein, the average of the reported loan-to-deposit ratios as of the end of March held at just over .5, virtually unchanged from three months earlier and only marginally above the low year-earlier level. Among the five District states, the average loan-to-deposit ratios ranged from a low of .45 in Iowa to a high of nearly .63 in Michigan. The rather wide range in loan-to-deposit ratios is heavily influenced by the

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)
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-Dec	78	142	145	11.22	50.3	5
1988						
Jan-Mar	102	137	143	11.02	50.2	4

[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.

differing bank structures in District states. Ratios historically have been lowest in Illinois and Iowa where the banking structure is characterized by a large number of small banks with few, or no branch offices. In the other three District states, branching is more prevalent and more of the bank loans to farmers in those states are made by large banks that typically have a more diversified loan portfolio, both geographically and by type of loans.

In conjunction with the stepped-up farm loan repayment rates, the stress in farm loan portfolios at banks has abated considerably. Recently released year-end 1987 reports for banks, for example, show that net charge-offs on bad farm loans by commercial banks nationwide dropped to about $530 million last year. That compares to about $1.2 billion in 1986, $1.3 billion in 1985, and $0.9 billion in 1984 when such information first became available. Net charge-offs of farm production loans by banks in Seventh District states last year dropped to about $110 million, down from $350 million the year before, nearly $400 million in 1985, and about $200 million in 1984.

Performance measures for agricultural banks—banks with an agricultural loan-to-total loan ratio that exceeds the average of such ratios for all banks—also recorded marked improvements in 1987. For instance, nonperforming loans accounted for 2.9 percent of all loans at agricultural banks nationwide as of the end of 1987, down from a seasonal high of 5.1 percent in March 1986 and the lowest since the end of 1983. Nonperforming loans are loans that no longer accrue interest and loans that are delinquent 90 days or more. With fewer problem loans pressuring the need for building a reserve for possible write-offs, earnings at agricultural banks improved considerably last year. Net after tax earnings of agricultural banks nationwide in 1987 provided a 7.7 percent return to equity capital, up from a 5.0 percent return the year before. At agricultural banks in District states, the return to equity rose from 5.2 percent in 1986 to 9.1 percent in 1987.

Stepped-up farm loan repayments and the curtailed demand for new farm loans contributed to a further decline in outstanding farm debt last year. Preliminary USDA estimates suggest that outstanding farm debt (excluding CCC crop loans and farm operator household debt) declined to about $141 billion as of the end of 1987. Based on recent year-end reports for major lenders, however, it appears the ending 1987 level might have been slightly higher, perhaps about $143 billion. Regardless of which preliminary estimate proves more accurate, it is clear that the ending 1987 level of farm debt was down considerably from $155 billion the year before and more than a fourth below the ending 1983 peak of almost $193 billion.

The preliminary estimates based on lender reports show that banks moved ahead of the Farm Credit System last year to become the leading lender serving farmers. Nationwide, banks held nearly $40.7 billion of outstanding farm debt as of the end of 1987, slightly exceeding the approximately $39.4 billion held by the farmer lending institutions, mostly FLBs and PCAs, within the Farm Credit System. During the 25 years leading up to the 1982 peak of $64.5 billion in farm debt owed to the FCS, the portfolio of farm loans held by that entity rose at a compound annual rate of nearly 14 percent. In 1975, the FCS moved ahead of banks as the leading institutional lender serving farmers and in the early 1980s accounted for slightly over a third of all farm debt. Proportionately sharp declines since the early 1980s have reduced the FCS's share of all farm debt slightly below the 28 percent share now held by banks.

Gary L. Benjamin

Farm debt* held by banks now exceeds that of the Farm Credit System

	Banks	Farm Credit System	Farmers Home Adm.	Life insurance companies	Individuals and others	Total
	(billion dollars)					
Dec. 31:						
1965	9.6	6.4	2.0	4.3	13.6	35.8
1970	13.8	11.7	2.9	5.1	15.2	48.8
1975	24.7	25.2	4.6	6.2	24.3	85.0
1980	37.7	53.0	17.6	12.0	46.6	166.8
1983	45.6	64.4	21.6	11.8	49.3	192.7
1984	46.9	63.4	22.9	11.6	45.9	190.8
1985	44.2	55.2	24.3	11.0	40.5	175.2
1986	41.0	45.4	23.9	10.2	34.5	155.0
1987**	40.7	39.4	23.4	9.2	30.5	143.1

*Excludes CCC price support loans and farm operator household debt.
**Preliminary estimates, based partially on USDA projections and partially on adjusted year-end lender reports.

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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)*	April	130	0.0	4	7
Crops *(1977=100)*	April	111	0.9	10	-3
Corn *($per bu.)*	April	1.85	-0.5	22	-20
Oats *($per bu.)*	April	1.66	-6.7	11	47
Soybeans *($per bu.)*	April	6.36	5.0	30	22
Wheat *($per bu.)*	April	2.81	2.6	7	-17
Livestock and products *(1977=100)*	April	148	0.0	1	17
Barrows and gilts *($per cwt.)*	April	42.40	-1.2	-17	6
Steers and heifers *($per cwt.)*	April	73.10	0.8	10	36
Milk *($per cwt.)*	April	11.70	-1.7	-4	-3
Eggs *(¢per doz.)*	April	45.5	-10.4	-17	-20
Prices paid by farmers *(1977=100)*	April	168	1.8†	4	6
Production items	April	155	2.0†	5	7
Feed	April	112	0.0†	11	-1
Feeder livestock	April	198	2.6†	11	35
Fuels and energy	April	163	1.2†	3	4
Producer Prices *(1982=100)*	March	106	0.3	2	4
Agricultural machinery and equipment	March	111	0.5	1	1
Fertilizer materials	March	98	2.5	14	9
Agricultural chemicals	March	107	0.5	5	4
Consumer prices *(1982-84=100)*	March	117	0.4	4	9
Food	March	116	0.2	3	8
Production or stocks					
Corn stocks *(mil. bu.)*	March 1	7,631	N.A.	-7	16
Soybean stocks *(mil. bu.)*	March 1	1,146	N.A.	-14	-42
Beef production *(bil. lbs.)*	March	1.93	5.3	1	3
Pork production *(bil. lbs.)*	March	1.36	15.0	11	14
Milk production *(bil. lbs.)*††	March	10.6	9.3	3	0

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

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