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FRB CHICAGO

AGRICULTURAL LETTER
FEDERAL RESERVE BANK OF CHICAGO
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District credit conditions

Credit conditions across the District remain largely unchanged according to a recent survey of 540 agricultural bankers. The responses indicate that ample funds are available for lending to farmers but the demand for bank loans by farmers remains weak. Interest rates charged on farm loans continued to drift lower, recording a ninth consecutive quarterly drop. Farm loan repayment rates at District banks showed some signs of improvement, suggesting some easing of the pressure on financially strapped borrowers. However, the bankers' responses indicate that a small proportion of farmer borrowers are still experiencing significant financial difficulties, requiring substantial restructuring of their balance sheets.

The measure of nonreal estate farm loan demand at District agricultural banks, which has pointed to weakening loan demand since mid 1985, showed further deterioration during the final months of 1986. At 61, the fourth quarter measure of farm loan demand represents a composite of the 12 percent of the respondents noting a pickup in farm loan demand less the 51 percent noting a drop from the same months of a year earlier. The remaining 37 percent of the bankers indicated the loan demand at their institutions was unchanged from a year ago. Farm loan demand was down across all of the District states, but showed particular weakness in Illinois and Iowa.

Fund availability has not been a contributing factor to the reduction in farm loans. As has been the case for the last several years, District agricultural banks had an ample supply of funds available for lending to farmers. The fourth quarter measure of fund availability remained at a very high level. Only 4 percent of the survey respondents indicated a reduction in fund availability compared to a year ago, while 56 percent reported continued gains. The remaining 40 percent of the bankers noted that fund availability was unchanged from the previous year's high level during the final months of 1986. The measure of fund availability was at a high level in all the District states, ranging from 162 in Iowa to 125 in Michigan.

The prolonged weakness in farm loan demand and ample funds for lending are reflected in the decline in loan-to-deposit ratios at agricultural banks within the District. As of the end of 1986, loan-to-deposit ratios among the responding banks averaged 49.4 percent, down from 51.4 percent three months earlier and the lowest level since 1971 when the ratios were first reported on the quarterly survey. The most recent decline extends a downtrend that has continued since 1979 when loan-to-deposit ratios at District agricultural banks averaged more than 67 percent. As has been the case for the last few surveys, Illinois and Iowa bankers reported the lowest ratios, about 44 percent, with Indiana bankers reporting a somewhat higher 52 percent. Michigan and Wisconsin bankers reported significantly higher loan-to-deposit ratios of about 60 percent.

With loan-to-deposit ratios significantly below historical levels, more than 80 percent of the agricultural bankers indicated a preference for higher ratios while only 3 percent felt their current ratio was above the desired level. For the District as a whole, the average of the bankers' desired ratios, at 59 percent, was substantially higher than the actual ratios. Among the five District states, the desired loan-to-deposit ratios ranged from almost 67 percent in Michigan to 55 percent in Illinois.

Interest rates on farm loans at District agricultural banks declined again during the final three months of 1986, registering a ninth consecutive quarterly drop. However, the most recent decline was somewhat smaller than the quarterly drops recorded earlier in the year. Average rates on feeder cattle and farm operating loans at the end of 1986, at about 11.1 percent, were 20 basis points lower than three months earlier and almost 160 basis points below a year ago. Rates on farm real estate loans dropped to 10.5 percent at the end of December, 25 basis points lower than in September and 250 points below the year-earlier level.

While rates on farm real estate loans varied within a narrow range across the five District states, Iowa bankers continued to report somewhat higher rates on short term farm operating loans. At 11.6 percent, the average rate charged by Iowa banks was 75 basis points higher than the average for the other District states, which all reported average rates below 11 percent.

Following two quarters of stabilization in farm loan repayment rates, District agricultural bankers noted some improvement during the final months of 1986.

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

[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.

The fourth quarter measure of farm loan repayment rates stood at 107, an unusually high level within the context of the 20 year history of these quarterly surveys. The measure indicates that for the first time since 1980 a greater proportion of bankers noted repayments were ahead of a year earlier than noted they were behind. The composite measure represents the 29 percent of respondents citing higher repayment rates during the period less the 21 percent citing a drop from a year earlier. The remaining half of the survey respondents reported no change in the rate of loan repayment compared to the last three months of 1985.

Much of the strength in farm loan repayment rates was accounted for by significant improvement among Illinois and Iowa banks. Responses from these states showed about 30 percent and 49 percent of the bankers reporting year-to-year improvement in repayment rates during the fourth quarter. While the proportions of bankers in Indiana and Wisconsin reporting further deterioration were larger than the proportions reporting improvement, a majority of bankers indicated that repayment rates on farm loans had stabilized during the fourth quarter. Michigan bankers, however, reported significant deterioration in repayment rates, most likely due to the widespread flood damage in the state last fall. Only 9 percent of the reporting bankers in Michigan noted improvement, while almost half reported that loan repayment rates were below year-earlier levels.

The improvement in the farm loan repayment situation across much of the District is attributable to a number of factors. Returns to livestock producers, particularly important industries in Illinois and Iowa, have been relatively strong over the last two or three quarters. The Whole Herd Dairy Buyout Program and the Conservation Acreage Reserve have improved the cash flow situation of participants, allowing a reduction in outstanding debts. In addition, heavy use of the Commodity Credit Corporation loan programs and the accelerated schedule of deficiency payments, paid in cash and in kind, have provided a large injection of funds for farmers. These funds have permitted pay-down on existing indebtedness and supplanted some of the need for new financing from banks and other lenders.

Despite these positive developments, the bankers indicated that significant financial stress continues to pressure some farmer borrowers. Across the District an average of about 4 percent of the bankers' farm loan portfolios were characterized as experiencing severe repayment difficulties. These loans are expected to result in some losses to the bank and may require the forced sale of borrowers' assets. However, the proportion of the farm loan portfolios falling into the severe problem category is down considerably from the year-ago level of almost 6 percent. Declines were registered in four of the District states, with Iowa bankers reporting the greatest improvement, a 3 percentage point drop from a year ago to 4.4 percent. The average proportion of the farm loan portfolios with severe repayment problems among Michigan agricultural banks, however, rose slightly from last year to about 6.3 percent, the highest of any District state.

In addition to the improvement shown in the most stressed proportion of the farm loan portfolios, a drop in the average of the respondents' portfolios experiencing less severe but still major problems was recorded as well. Bankers across the District reported that farm loans requiring additional collateral or long-term workouts, on average, accounted for 9.2 percent of all their farm loans, down from 11 percent a year ago. Again, Iowa banks reported the most substantial improvement as the average proportion of farm loan portfolios with major repayment problems declined from 15.1 percent a year ago to 10.6 percent at the end of 1986.

As a result of these trends, the proportion of farm loans at agricultural banks with no significant or only minor repayment problems, increased across all District states, averaging almost 87. The average proportion of farm loans falling into this category ranged from 82.5 percent in Michigan to almost 91 percent in Wisconsin.

During the first quarter of the year, credit demand at District agricultural banks is expected to remain weak. Only 12 percent of the respondents expect the volume of non-real estate lending to be above a year ago, while 46 percent expect a reduction. Drops in the volume of dairy, crop storage, operating, and farm machinery loans are expected to be particularly large, while feeder cattle loans may show only a slight decline from the early months of last year. Farm real estate lending, on the other hand, is expected to show some strength. Reflecting this, about a third of the respondents expect farm real estate lending to be up from a year ago and another 38 percent expect no change. The remaining 29 percent of the bankers expect to see year-to-year declines in farm real estate lending at their institutions during the first three months of 1987.

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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	11,737	18.6	-2	1
Crops*	September	5,257	48.3	-15	-10
Livestock	September	6,040	-2.1	10	6
Government payments	September	440	145.8	50	327
Real estate farm debt outstanding *($ billions)*					
Commercial banks	September 30	12.4	2.7†	13	22
Federal Land Banks	September 30	39.6	-4.3†	-15	-20
Life insurance companies	October 31	11.3	-0.7†	-6	-10
Farmers Home Administration	September 30	10.9	-0.1†	1	7
Nonreal estate farm debt outstanding *($ billions)*					
Commercial banks	September 30	33.6	-1.5†	-14	-19
Production Credit Associations	September 30	12.1	-4.4†	-24	-38
Farmers Home Administration	September 30	18.7	-0.3†	0	11
Commodity Credit Corporation	September 30	15.4	-14.3†	57	138
Farm loans made *($ millions)*					
Life insurance companies	October	43	-18.6	-73	1
Interest rates on farm loans *(percent)*					
7th District agricultural banks					
Operating loans	January 1	11.11	-2.0†	-13	-18
Real estate loans	January 1	10.49	-2.5†	-15	-21
Commodity Credit Corporation	February	5.88	0.0	-24	-36
Agricultural exports *($ millions)*	December	2,566	2.2	-3	-28
Corn *(mil. bu.)*	December	111	-3.7	-38	-47
Soybeans *(mil. bu.)*	December	88	-8.8	-6	1
Wheat *(mil. bu.)*	December	58	-14.7	-19	-57
Farm machinery salesP *(units)*					
Tractors, over 40 HP	January	3,168	-9.5	-27	-37
40 to 139 HP	January	2,399	-15.2	-16	-34
140 HP or more	January	769	14.3	-47	-44
Combines	January	168	-66.1	-73	-77

*Includes net CCC loans.
†Prior period is three months earlier.
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