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AGRICULTURAL LETTER

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Credit trends at District agricultural banks

The measures of fourth quarter credit conditions obtained from a survey of 500 agricultural banks in the Seventh Federal Reserve District showed major departures from past trends in some critical areas. The response to the January 1 survey suggests that farm loan demand at District agricultural banks fell sharply from the year-earlier level, leaving most banks with a surplus of funds available for lending to farmers. At the same time the measure of loan repayment rates at these institutions, although still reflecting a significant amount of financial difficulty within the sector, jumped to its highest level since 1980. These departures from past trends apparently stem from the record movement of grain under price support loans with the Commodity Credit Corporation (CCC).

Although trending down throughout 1985, the measure of farm loan demand at banks during the final three months of the year registered a substantial decline (see table on page 2). At 68, the fourth quarter measure of farm loan demand represents a composite of the 15 percent of the respondents noting a year-to-year rise in farm loan demand, less the 47 percent noting a decline. The remaining 36 percent of the survey respondents reported that farm loan demand was unchanged from a year earlier. The measure of farm loan demand varied across the District states. Composite measures in Illinois and Iowa, at 61 and 53, respectively, were well below the District average, while the responses of Indiana and Wisconsin bankers put the measure at 80 in those states. The measure of farm loan demand of Michigan agricultural banks, at 96, indicates an almost equal proportion of bankers noting an increase in demand as those reporting a decline.

As has been the case each quarter for the past six years, District agricultural banks reported an ample supply of funds for lending to farmers during the fourth quarter. The measure of fund availability at banks across the District, at 144, was up sharply from the third quarter. Almost half of the survey respondents reported a year-to-year increase in the amount of funds available for lending to farmers, while only 5 percent reported a drop. The remaining 46 percent of the surveyed bankers indicated that fund availability during the last three months of 1985 was unchanged from a year earlier. The measure of fund availability remained high across the District, ranging from 109 in Michigan to 160 in Iowa.

Loan-to-deposit ratios at District agricultural banks declined during the fourth quarter, pushing the ratios further below historical levels. At 52.5 percent, the average loan-to-deposit ratio was down about 3 percentage points from the previous quarter and a year earlier. Among the five District states, agricultural bankers reported average loan-to-deposit ratios ranging from 47 percent in Illinois to 60 percent in Michigan and Wisconsin. In comparison, average loan-to-deposit ratios ranged from 60 to 70 percent in the late 1970s.

Many of the surveyed bankers reported that a substantially higher loan-to-deposit ratio would be desirable, providing further indication of an ample supply of funds for lending. The average of the desired ratios reported by the bankers, at about 59 percent, was almost 7 percentage points above the reported ratios and near the level of actual ratios reported during the fourth quarter of 1980. About two-thirds of the survey respondents reported that their current loan-to-deposit ratio was below the desired level, while less than 11 percent indicated it was above the desired level. The remaining 22 percent of the bankers reported they were satisfied with the level of their loan-to-deposit ratio at the end of the fourth quarter.

While financial stress among farmer borrowers remains evident in the bankers' responses, repayment rates during the fourth quarter appear to have registered a marked improvement. Following a gradual uptrend during the first nine months of the year, the fourth quarter measure of repayment rates on nonreal estate farm loans at District agricultural banks jumped sharply. The measure, at 97, was well above the previous quarter's 60 and at a five-year high. With the measure of loan repayment rates approaching 100, it indicates that an almost equal proportion of respondents noted an increase in repayments from a year earlier as noted a decline. The remaining surveyed bankers, about 36 percent of the total, reported no change in their farm customers' repayment rates from a year earlier.

The noticeable improvement in the measure of repayment rates, as well as the indications of a decline in loan demand and increased fund availability, un-

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

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.

doubtedly reflect the large harvests that were recorded across the District and heavy use of CCC loans. Record and near record yields combined with a relatively high level of participation in government programs have provided substantial price and income protection. The huge movement of 1985 crops under loan with the Commodity Credit Corporation—2.3 billion bushels of corn and 430 million bushels of soybeans through mid January—began to firm prices late last year. More importantly, the tremendous volume of corn and soybeans going under loan at $2.55 and $5.02 per bushel, respectively, provided a substantial amount of liquidity to farmers. As these funds became available, many farmers cutback on their new borrowings from conventional lenders, stepped up their repayments on outstanding debts, or both.

Despite the apparent improvement in repayments, the condition of the surveyed bankers' farm loan portfolios continues to reflect a significant amount of financial stress among farmer borrowers. The respondents indicated that the bulk of their portfolios, on average about 83 percent, are having no significant repayment problems, unchanged from the year-ago level. However, there is some variability across states, with Illinois, Indiana, and Iowa all showing a larger proportion of loans than a year earlier with no significant problems, while Michigan and Wisconsin bankers reported some decline in this category.

A similar pattern among the District states is exhibited by the proportions of farm loan portfolios experiencing major repayment problems that will require more collateral or longer-term workouts to rectify the problems. Bankers in Michigan and Wisconsin reported some deterioration from a year ago with a larger proportion of their portfolios falling into this category, while the other District states showed some improvement as the proportions dropped. Overall, loans with major repayment problems averaged about 11 percent of respondents' portfolios, down slightly from January 1985.

However, that drop occurred as some bankers reported more loans slipping into the severe repayment problem category. These are loans that will likely result in losses or forced sales of borrowers' assets. Once again an increase for Michigan and Wisconsin banks—from 4 to 6 percent of their portfolios on average—accounted for the deterioration. Farm loans with severe repayment difficulties in the other District states had stabilized at year-earlier levels. For the entire District, the proportion of banks' farm loan portfolios falling into the severe repayment problem category averaged 6 percent.

Interest rates on farm loans at District agricultural banks continued to trend down during the final three months of 1985. The average interest rate charged by surveyed banks at the end of the fourth quarter on feeder cattle loans and farm operating loans was 12.7 percent, marking declines of a tenth of a percentage point from the previous quarter and about 1.75 percentage points from the cyclical high of a year ago. Interest rates charged on farm real estate loans at District agricultural banks dropped to 12.28 percent, about 20 basis points lower than three months earlier and well below the year-ago level of 14 percent. These latest reported declines have pushed interest rates on farm loans from District agricultural banks to their lowest levels in six years, well below the high rates of the early 1980s that contributed to the financial stress that is evident in the agricultural sector.

After widening over several previous quarters, the range in average rates charged by banks across the five District states narrowed somewhat during the fourth quarter. Reflecting this, average fourth quarter farm operating loan charges ranged from 12.34 percent in Michigan to 13.14 in Iowa. This range in operating loan rates is about three-fourths of the differential exhibited three months previously. At that time, the larger difference was attributed to greater earnings pressures on Iowa banks and lessened competitive pressures from Farm Credit System lenders. Together, these factors held loan rates in Iowa at a relatively high level. During the fourth quarter, some improvement in loan repayment rates in Iowa and increased competitive pressures as FCS rates have receded contributed to a somewhat larger than average drop in rates at Iowa banks. In addition, rates charged on farm operating loans by surveyed banks in Michigan, which had been well below the levels in other District states, edged upward during the final months of 1985.

The bankers' expectations concerning the volume of lending to farmers during the first three months of 1986 point to declines from year-earlier levels. More than 40 percent of the respondents expect nonreal estate farm loan volume to be lower than the year-ago period, while only 14 percent expect an increase. The remainder expect nonreal estate loan volume at their banks to be unchanged. The only significant departures from that distribution were for operating loans, with two-thirds of the respondents about evenly split between expecting an increase or a decline, and farm machinery loan volume, with almost 60 percent expecting a lower volume of lending and only 7 percent expecting a year-to-year increase. Regarding farm real estate lending, the bankers' responses indicated that 26 percent expect an increase in lending during the first quarter, while 35 percent expect a decline from the year-earlier level. The remaining 38 percent of the bankers expect no change in the volume of real estate lending from the comparable period of the previous year.

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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)*	January	124	-3.1	-9	-15
Crops *(1977=100)*	January	114	-3.4	-10	-18
Corn *($per bu.)*	January	2.33	1.7	-12	-26
Oats *($per bu.)*	January	1.20	0.0	-31	-34
Soybeans *($per bu.)*	January	5.12	2.4	-13	-35
Wheat *($per bu.)*	January	3.10	-4.6	-8	-11
Livestock and products *(1977=100)*	January	134	-2.2	-8	-11
Barrows and gilts *($per cwt.)*	January	45.20	-2.6	-7	-8
Steers and heifers *($per cwt.)*	January	57.50	-3.8	-9	-10
Milk *($per cwt.)*	January	12.60	0.0	-10	-7
Eggs *(¢per doz.)*	January	65.1	-1.7	26	-30
Prices paid by farmers *(1977=100)*	January	163	0.6	-1	0
Production items	January	150	0.7	-3	-3
Feed	January	114	1.8	-7	-21
Feeder livestock	January	147	1.4	-10	-6
Fuels and energy	January	203	-1.5	4	0
Producer Prices *(1967=100)*	December	297	0.2	2	4
Agricultural machinery and equipment	December	338	0.0	0	2
Fertilizer materials	December	226	-0.7	-2	-1
Agricultural chemicals	December	460	0.0	1	0
Consumer prices *(1967=100)*	December	327	0.2	4	8
Food	December	313	0.7	3	7
Production or stocks					
Corn stocks *(mil. bu.)*	October 1	1,379	N.A.	91	-56
Soybean stocks *(mil. bu.)*	September 1	318	N.A.	81	-8
Beef production *(bil. lbs.)*	December	18.5	2.3	1	-6
Pork production *(bil. lbs.)*	December	12.2	-1.8	0	-10
Milk production *(bil. lbs.)*	December	12.0	3.5	9	6

N.A. Not applicable

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