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AGRICULTURAL LETTER

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Credit trends at District agricultural banks

Survey responses from 550 agricultural banks in the Seventh Federal Reserve District suggest that credit conditions during the first quarter of this year were little changed from the trends of the previous quarter. Farm loan demand at District agricultural banks remained weak, leaving a majority of the reporting lenders with a higher level of funds available for making loans to farmers than was the case the previous year. The measure of loan repayment rates, although down from the fourth quarter level, remained substantially above the levels of the last several years. In addition, interest rates charged on loans to farmers continued to trend lower, returning to 1979 levels.

The measure of farm loan demand at District agricultural banks remained low during the early months of 1986 but was little changed from the final months of 1985. At 74, the measure represents a composite of the 20 percent of the bankers who noted an increase in demand compared to a year earlier less the 46 percent reporting a decline. About a third of the respondents indicated no change in the level of farm loan demand. Loan demand at banks appears to be weakest in Illinois and Iowa, where more than half of the surveyed bankers reported a drop from a year ago. In the other District states the proportion of the bankers noting an increase in demand about equalled the proportion noting a decline, suggesting relative stability in farm loan demand at agricultural banks in those states.

Weaker farm loan demand undoubtedly reflects the heavy use of Commodity Credit Corporation crop support loans in the latter part of 1985 and the first few weeks of 1986. These loans not only provide a source of much needed liquidity in rural areas, they also provide a substitute for commercial lending. At the end of March, more than 2.8 billion bushels of corn and 445 million bushels of soybeans were under loan with the CCC, representing a very substantial pool of funds available to farmers. Moreover, anticipation of advance deficiency payments for 1986 crops and final deficiency payments on 1985 crops also contributed to weaker loan demand. In addition, lower operating expenses, less crop acreage this year, and reduced livestock numbers have lowered farmers' demand for credit and will likely continue to do so in the months ahead.

While funds for lending to farmers were sometimes in short supply at agricultural banks during the late 1970s, the deregulation of banks in the 1980s and sharply lower loan-to-deposit ratios have increased fund availability at District agricultural banks. Continuing the trend of the last six years, the measure of funds available for lending at District banks edged still higher during the early months of 1986. More than half of the bankers responding to the survey indicated that funds available for lending to farmers were above a year earlier, while only 5 percent reported a drop. More than 40 percent indicated that fund availability was unchanged. As a result, the measure of fund availability in the first quarter edged up to 149. Across the five District states, the fund availability measure ranged from 169 in Iowa to 105 in Michigan.

District agricultural bankers reported a further decline in loan-to-deposit ratios during the first quarter. At less than 51 percent, the average of the reported ratios as of the end of March was down almost 2 percentage points from the ending 1985 level and more than 5 percentage points lower than a year ago. The sharp drop of the past year furthered the downtrend that has been evident since the 1979 high when the average of loan-to-deposit ratios at District agricultural banks exceeded 67 percent.

Although the majority of surveyed bankers indicated a desire for higher loan-to-deposit ratios, their preferred levels are well below the highs of the late 1970s. The average for the survey group was about 59 percent, about 8 percentage points above the actual loan-to-deposit ratios. More than 71 percent of the surveyed bankers indicated they were operating below their desired loan-to-deposit ratios, while only 8 percent indicated they were above the desired level. The remaining 20 percent of the respondents noted that their loan-to-deposit ratio was at a satisfactory level at the end of the first quarter of 1986.

The measure of loan repayment rates, after a sharp jump in the months following harvest late last year, receded during the first three months of 1986. The measure, at 80, was down 17 points from the previous quarter and represents a composite of the 16 percent of bankers that noted a rise from a year earlier in repayments on nonreal estate loans to farmers less the 36 percent that noted a decline. The remaining 48

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	86	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

[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.

percent of the survey respondents indicated that repayment rates were unchanged from the year-ago level.

As was the case in the previous quarter, loan repayment rates appear weakest in Michigan and Wisconsin. In those states, the measure of loan repayment rates dropped below 60, indicating that the number of bankers noting a decline from a year ago in repayments on nonreal estate farm loans far outweighed those noting an increase. Responses of Indiana and Iowa bankers also indicated some weakening, but their responses were closer to the District average. Bankers in Illinois, on the other hand, reported the strongest repayment situation, with the proportion reporting an improvement slightly larger than the proportion reporting a drop.

The repayment difficulties of the last several years and falling asset values in the agricultural sector have coincided with more stringent collateral requirements on loans to farmers. About two-thirds of the survey respondents indicated that collateral requirements had been raised during the first quarter, while virtually none of the bankers reported that collateral requirements had been relaxed from year-ago levels during the period. The remaining one-third of the respondents stated that collateral requirements on loans to farmers were unchanged compared to last year.

Interest rates on farm loans at District agricultural banks, which have been trending down from the 1981 highs, declined for the sixth consecutive quarter this winter. The average interest rate charged by the surveyed banks at the end of the first quarter on feeder cattle and farm operating loans was about 12.3 percent, down about 36 basis points from the previous quarter and 114 basis points from a year earlier.

Interest rates charged for farm real estate loans at District agricultural banks averaged less than 11.7 percent, down about 60 basis points from three months earlier and 155 basis points from April 1985. The downtrend of the last several years has dropped rates significantly from the 17 to 18 percent highs recorded in the early 1980s, and has returned average rates to 1979 levels.

Although interest rates on bank loans to farmers have declined in all District states, the extent of the declines have varied, leaving an unusually wide spread in average rates among the five states. At agricultural banks in Iowa, feeder cattle and farm operating loan rates, averaging about 13.1 percent, are 120 basis points higher than the average of the other four District states. The large difference in rates between agricultural banks in Iowa and those elsewhere in the District undoubtedly reflects the more extensive problems facing Iowa banks. Indicative of this, net charge-offs of farm loans reached 6.1 percent of all farm loans among Iowa banks in 1985. That was more than double the year-earlier level and it compares to farm loan charge-off rates for the other District states that ranged from 2.3 percent in Wisconsin to 3.9 percent in Michigan.

The deterioration of loan portfolios at many Iowa agricultural banks has maintained upward pressure on loan rates in that state as affected institutions attempt to overcome losses. In addition, problems in the loan portfolios of the Omaha Farm Credit System banks, which serve Iowa, have limited competitive pressures on farm loan rates. However, the relatively high interest rates on farm loans have been insufficient to stem the slide in bank earnings. In 1985, net income as a percent of equity at Iowa agricultural banks dropped to 1 percent, down from 8 percent a year earlier, with many of the agricultural banks in the state reporting negative earnings. However, very strong earnings in the 1970s allowed agricultural banks in Iowa and elsewhere in the District to build a large capital base, providing a cushion against loan losses that stood at more than 9 percent of assets at the end of 1985. While this cushion is not evenly distributed among banks in Iowa or the other District states, it does indicate that a substantial amount of resources are available within the agricultural banking system to allow many institutions to overcome their current difficulties and to facilitate some redistribution of resources within the industry.

The bankers' expectations concerning the volume of lending to farmers this spring point to declines from year-earlier levels. About 45 percent of the surveyed bankers expect nonreal estate farm loan volume to be down from a year ago during the second quarter, while only 13 percent foresee an increase. The remaining 42 percent of the respondents expect no change from last year in the volume of nonreal estate farm loans. In contrast, almost 31 percent of the respondents expect farm real estate loan volume to be up from last spring, nearly matching the 34 percent expecting a decline. The remainder, 35 percent, expect no change in the volume of farm real estate lending at their banks from the comparable period of last year.

Peter J. Heffernan

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Public Information Center
Federal Reserve Bank of Chicago
P.O. Box 834
Chicago,IL 60690
Tel.no. (312) 322-5111

Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from: Prior period	Year ago	Two years ago
Prices received by farmers *(1977=100)*					
Crops *(1977=100)*	April	120	-1.6	-9	-17
Corn *($per bu.)*	April	112	0.9	-11	-20
Oats *($per bu.)*	April	2.25	-1.7	-17	-32
Soybeans *($per bu.)*	April	1.07	-6.1	-37	-41
Wheat *($per bu.)*	April	5.13	-1.9	-13	-35
	April	3.16	-3.7	-8	-13
Livestock and products *(1977=100)*	April	128	-3.0	-6	-15
Barrows and gilts *($per cwt.)*	April	39.60	-2.9	-4	-17
Steers and heifers *($per cwt.)*	April	55.00	-1.1	-8	-15
Milk *($per cwt.)*	April	12.00	-1.6	-7	-8
Eggs *(¢per doz.)*	April	57.8	-15.4	9	-37
Prices paid by farmers *(1977=100)*	April	160	-1.8†	-2	-3
Production items	April	145	-2.7†	-5	-8
Feed	April	112	-0.9†	-7	-22
Feeder livestock	April	147	-2.6†	-9	-7
Fuels and energy	April	160	-14.9†	-20	-21
Producer Prices *(1967=100)*					
Agricultural machinery and equipment	March	288	-1.4	-1	-1
Fertilizer materials	March	339	0.2	0	2
Agricultural chemicals	March	219	0.3	-5	-10
	March	460	0.0	1	1
Consumer prices *(1967=100)*	March	326	-0.5	2	6
Food	March	315	0.0	2	4
Production or stocks					
Corn stocks *(mil. bu.)*	April 1	5,945	N.A.	50	83
Soybean stocks *(mil. bu.)*	April 1	1,176	N.A.	31	49
Beef production *(bil. lbs.)*	March	1.86	5.2	0	-4
Pork production *(bil. lbs.)*	March	1.20	8.8	-3	-11
Milk production *(bil. lbs.)*	March	12.7	12.6	7	9

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

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Public Information Center
P.O. Box 834
Chicago, Illinois 60690
(312) 322-5112

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