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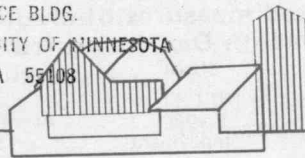
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### **Credit trends at District agricultural banks**

Credit conditions were largely unchanged from the trends of the last several quarters according to a survey of 530 agricultural banks in the Seventh Federal Reserve District. The availability of funds for extending credit to farmers remains high and interest rates charged on farm loans continue to drop. However, bankers at the surveyed institutions continue to report weak demand for loans by producers in their areas. Loan repayment rates at District agricultural banks also remain weak.

Continuing the trend that has characterized the 1980s, the measure of funds available for lending to farmers remained at a very high level. The composite measure, at 152, indicates that more than half of the agricultural banks surveyed reported an increase from a year earlier during the second quarter, while less than 4 percent reported a drop. The remaining 40 percent indicated there had been no change in fund availability for loans to farmers at their bank.

While deregulation of the banking industry in the 1980s has contributed to the ample supply of funds at agricultural banks, weak loan demand and financial stress in the agricultural sector over the last several years has also had an important role in the substantial drop in loan-to-deposit ratios. The measure of farm loan demand at District agricultural banks, at 65, represents a composite of the 16 percent of the respondents that indicated demand had increased from a year ago less the 51 percent reporting a decline. The remaining third of the bankers reported no change from a year ago in farm loan demand. While a reduction in credit worthy customers is a factor in weak loan demand, reduced production costs due to acreage cuts and lower input prices, and smaller livestock inventories have also weakened loan demand.

With loan demand remaining weak, District agricultural bankers reported a further drop in the ratio of loans to deposits. At about 51 percent, the average of the reported ratios at the end of June was down 4 percentage points from the ratio reported at the end of the second quarter of 1985. However, most bankers indicated a preference for substantially higher loan-to-deposit ratios. More than three-fourths of the survey respondents indicated that the current ratio of loans to deposits at their banks were below the pre-

ferred level, while less than 6 percent stated it was higher. The average of the preferred ratios, at almost 60 percent, was well above the reported level.

Loan repayment rates during the second quarter remained weak across all District states. The measure of loan repayment rates, although up 29 points from a year earlier at 85, represents a composite of the 11 percent of the bankers noting an improvement in repayment rates less the 26 percent reporting deterioration in repayments compared to last year. The remaining 63 percent of the respondents indicated that repayment rates on farm loans during the second quarter were unchanged from a year ago.

Bankers continue to report that a significant proportion of their farm loan portfolios are experiencing repayment difficulties. However, the bulk of the farm loan portfolios, more than 82 percent on average, are regarded as having no significant repayment problems, or only minor problems that can be remedied easily. Another 12 percent of the portfolios, on average, are characterized as having major repayment problems, requiring longer term workouts to rectify the problems. The remainder of their farm loan portfolios, averaging almost 6 percent, are considered to have severe repayment difficulties that may result in loan losses or forced sales of borrowers' assets. Although the responses indicate that a significant problem exists, they also indicate that some stabilization of the degree of financial stress in the District is occurring. Reflecting this, the average proportion of the portfolios falling into each category in the most recent survey was largely unchanged from the proportions reported in similar surveys six months and a year earlier.

In order to alleviate some of the difficulties in their portfolios, more District agricultural banks are turning to Farmers Home Administration (FmHA) loan guarantees. Among the District agricultural banks surveyed, more than half indicated that some of their farm loans carried FmHA guarantees, up from about 38 percent last year. The proportion of banks utilizing the program was highest in Iowa at 82 percent. Among the other District states the proportion ranged from 30 percent in Indiana to 57 percent in Michigan.

Participating banks indicated that about 9 percent of their farm loan portfolios were covered by FmHA guarantees, on average, well above the 6 percent av-

**Selected measures of credit conditions  
at Seventh District agricultural banks**

	Loan demand (index) <sup>2</sup>	Fund availability (index) <sup>2</sup>	Loan repayment rates (index) <sup>2</sup>	Average rate on feeder cattle loans <sup>1</sup> (percent)	Average loan-to-deposit ratio <sup>1</sup> (percent)	Banks with loan-to-deposit ratio above desired level <sup>1</sup> (percent of banks)
<b>1978</b>						
Jan-Mar	152	79	64	8.90	63.7	
Apr-June	148	73	81	9.12	64.5	44
July-Sept	158	64	84	9.40	65.8	46
Oct-Dec	135	62	93	10.14	65.4	52
<b>1979</b>						
Jan-Mar	156	51	85	10.46	67.3	
Apr-June	147	62	91	10.82	67.1	58
July-Sept	141	61	89	11.67	67.6	55
Oct-Dec	111	67	79	13.52	66.3	52
<b>1980</b>						
Jan-Mar	85	49	51	17.12	66.4	
Apr-June	65	108	68	13.98	65.0	51
July-Sept	73	131	94	14.26	62.5	31
Oct-Dec	50	143	114	17.34	60.6	21
<b>1981</b>						
Jan-Mar	70	141	90	16.53	60.1	
Apr-June	85	121	70	17.74	60.9	17
July-Sept	66	123	54	18.56	60.9	20
Oct-Dec	66	135	49	16.94	58.1	21
<b>1982</b>						
Jan-Mar	76	134	36	17.30	57.8	
Apr-June	85	136	41	17.19	57.3	18
July-Sept	87	136	36	15.56	57.8	14
Oct-Dec	74	151	47	14.34	55.1	15
<b>1983</b>						
Jan-Mar	69	158	66	13.66	53.3	
Apr-June	85	157	78	13.49	54.0	6
July-Sept	81	156	78	13.70	54.8	6
Oct-Dec	101	153	78	13.65	53.6	8
<b>1984</b>						
Jan-Mar	131	135	62	13.82	54.4	
Apr-June	138	128	64	14.32	55.7	12
July-Sept	120	122	59	14.41	57.2	14
Oct-Dec	103	124	49	13.61	55.9	17
<b>1985</b>						
Jan-Mar	107	120	47	13.48	56.1	
Apr-June	105	133	56	12.93	55.1	17
July-Sept	90	127	59	12.79	55.5	14
Oct-Dec	68	144	97	12.70	52.7	14
<b>1986</b>						
Jan-Mar	74	149	80	12.34	50.9	
Apr-June	65	152	86	11.81	51.1	8

<sup>1</sup> At end of period.

<sup>2</sup> 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.

erage for participants a year ago. The proportion of farm loans carrying guarantees at participating banks in Illinois and Indiana averaged less than 5 percent, while Iowa and Michigan banks using the program had 11.5 and 13.8 of their portfolios carrying guarantees. The proportion of the portfolio covered by participating banks in Wisconsin averaged 9 percent. These averages were above the year-earlier levels at participating banks in each of the District states.

Continued declines in interest rates during the second quarter will likely further stabilize some of the repayment problems. Rates on feeder cattle and operating loans at the end of the second quarter averaged 11.8 percent at the surveyed banks, down more than half a percentage point from three months earlier. Farm real estate loans at District agricultural banks showed a similar drop, averaging 11.25 percent rate at mid-



year. In addition, improved returns to livestock producers and the recent announcement that another 10 percent of estimated deficiency payments will be made in advance could provide some boost to repayment rates. However, these payments, along with the new program provision that 1986 crops will not have to be stored in approved facilities in order to be eligible for CCC crop support loans, will also dampen demand for loans at agricultural banks.

### **Cattle herd continues to decline**

The inventory of cattle on U.S. farms has continued to decline. According to USDA estimates, the number of cattle and calves as of July 1 was about 3.5 percent below a year earlier. While reductions in the dairy herd due to the dairy herd termination program have contributed to the overall drop, most of the inventory reduction is accounted for by declines in the numbers of beef cows and replacement heifers. While these trends have contributed to maintaining beef production at high levels, they also portend future sharp cuts in output as the underlying productive capacity of the U.S. beef herd is cut.

The July 1 estimate of all cattle and calves in the U.S., at 112.2 million head, was the lowest reading since the mid-year estimate was first published in 1973. Declines were registered across all groups. Heifers not held for herd replacement along with steers over 500 pounds registered a year-to-year decline of almost 4 percent. After adjusting for the number of cattle in feedlots, this suggests a tightening supply of cattle available for placement, perhaps 1 to 2 percent less than a year ago. A 4 percent drop in the inventory of calves under 500 pounds was also reported. The number of beef cows that have calved was down 3 percent from last year and the inventory of heifers held for beef cow replacement dropped 2 percent. These declines further reduced the productive capacity of the industry, contributing to a 1986 calf crop that is expected to total only 40.1 million head, more than 2 percent less than last year's small crop.

Additional reductions in the cattle herd are attributable to the dairy herd termination program that began in April. The number of milk cows on U.S. farms on July 1, at 10.9 million head, was down 2 percent from a year ago, but slightly above 1984. Because the termination program requires the liquidation of all dairy cattle on participants' farms, it has also significantly affected the inventory of heifers held for dairy cow replacement. The inventory of these animals dropped 6 percent from last year's level.

The number of cattle on feed in the thirteen states that report quarterly was down 8 percent on July 1, and at the lowest level for that date since 1975. With these

states typically accounting for 85 percent of all cattle on feed, the sharp downturn points toward improving prospects for cattle prices. Heavy-weight cattle on feed, those likely to be marketed during the third quarter, numbered almost 7 percent fewer than last year, while the inventory of lighter-weight animals was down more than 10 percent.

The net movement of cattle into feedlots during the second quarter as well as marketings from feedlots were down only slightly from a year ago. However, commercial cattle slaughter jumped 6 percent during the second quarter, primarily due to a sharp rise in the slaughter of dairy cows and heifers under the dairy herd termination program. From the start of the program in April through the end of June, cow slaughter jumped more than 23 percent from the comparable period of a year ago. Total beef production during the second quarter rose about 5.5 percent as lower slaughter weights offset part of the increase in commercial cattle slaughter.

Cattle feeders in the 13 major states intend to market 5 percent fewer animals than a year ago during the third quarter, consistent with the decrease in heavy-weight animals on feed at the beginning of July. Marketings of cows will likely continue above year-ago levels during the third quarter but by a somewhat smaller margin. The heaviest rate of slaughter of dairy cows and heifers under the dairy herd termination program has already occurred. Moreover, shifting some of the disposal originally scheduled for the first five months of the program into later periods will likely slow the pace of slaughter during the summer. However, federally inspected cattle slaughter registered a 7 percent year-to-year gain during the first seven weeks of the third quarter. Continued large slaughter of cows and range fed cattle may offset the expected decline in fed cattle marketings, leaving total cattle slaughter and beef production during the third quarter near last year's level.

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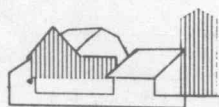
## Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from		
			Prior period	Year ago	Two years ago
<b>Receipts from farm marketings (\$ millions)</b>					
Crops*	April	11,267	22.3	-13	18
Livestock	April	3,987	-4.6	-15	22
Government payments	April	5,354	7.2	-8	-8
	April	1,926	4,597.6	-23	336
<b>Real estate farm debt outstanding (\$ billions)</b>					
Commercial banks	March 31	11.8	3.8 <sup>†</sup>	14	22
Federal Land Banks	March 31	43.4	-2.9 <sup>†</sup>	-11	-11
Life insurance companies	April 30	11.6	-0.3 <sup>†</sup>	-4	-8
Farmers Home Administration	March 31	10.8	0.2 <sup>†</sup>	3	9
<b>Nonreal estate farm debt outstanding (\$ billions)</b>					
Commercial banks	March 31	33.9	-4.5 <sup>†</sup>	-11	-13
Production Credit Associations	March 31	13.0	-7.5 <sup>†</sup>	-22	-31
Farmers Home Administration	March 31	17.8	-1.3 <sup>†</sup>	7	15
Commodity Credit Corporation	March 31	19.8	14.1 <sup>†</sup>	98	125
<b>Farm loans made (\$ millions)</b>					
Life insurance companies	April	58	-61.8	35	-52
<b>Interest rates on farm loans (percent)</b>					
7th District agricultural banks					
Operating loans	July 1	11.82	-4.4 <sup>†</sup>	-9	-18
Real estate loans	July 1	11.25	-3.8 <sup>†</sup>	-11	-19
Commodity Credit Corporation	August	6.38	-5.6	-18	-47
<b>Agricultural exports (\$ millions)</b>					
Corn (mil. bu.)	June	1,683	-9.5	-18	-34
Soybeans (mil. bu.)	June	57	18.9	-47	-49
Wheat (mil. bu.)	June	29	-49.8	58	-30
	June	86	68.9	-5	-24
<b>Farm machinery sales<sup>P</sup> (units)</b>					
Tractors, over 40 HP	July	3,028	-54.5	-28	-27
40 to 139 HP	July	2,539	-48.8	-25	-26
140 HP or more	July	489	-71.1	-40	-29
Combines	July	691	48.9	23	-15

\*Includes net CCC loans.

<sup>†</sup>Prior period is three months earlier.

<sup>P</sup>Preliminary



### AGRICULTURAL LETTER

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