FRB CHICAGO

AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO
October 25, 1985 Number 1667

Credit trends at District agricultural banks

Measures of credit conditions at agricultural banks in the Seventh Federal Reserve District reflect the financial adjustments taking place in the agricultural sector. The responses of 570 District agricultural bankers to an October 1 survey suggest that farm loan demand during the third quarter may have weakened slightly from a year earlier. However, the funds available for lending to farmers during the period remained in ample supply and almost two-thirds of the respondents expressed a desire to increase loan-to- deposit ratios. Reflecting the financial stress being experienced by many highly leveraged farmer borrowers, nearly half of the agricultural bankers surveyed reported a decline in farm loan repayment rates from year-ago levels and 72 percent reported a tightening of collateral requirements.

After registering large year-to-year gains in 1984, the measure of nonreal estate farm loan demand has trended down during the first nine months of 1985, dropping below 100 during the third quarter. At 91, the third quarter measure of farm loan demand represents a composite of the 24 percent of the respondents noting a year-to-year rise in farm loan demand, less the 33 percent noting a decline. The remaining 43 percent of the survey respondents reported that farm loan demand was unchanged from a year earlier. The responses mark the first time in two years that the proportion of bankers reporting a year-to-year drop in farm loan demand exceeded the proportion reporting an increase.

The measure of farm loan demand varied across the District states. Two of the states, Iowa and Wisconsin, recorded measures well below the District average, while the composite measure derived from the responses of Illinois bankers was slightly above the District average. Indiana and Michigan, both with a somewhat larger proportion of respondents noting an increase in demand than noting a decline, recorded measures of farm loan demand above 100, suggesting some strengthening in those areas from year-ago levels.

As has been the case through most of the 1980s, District agricultural banks had an adequate supply of funds for lending to farmers. The third quarter measure of fund availability remained at a high level, with the proportion of bankers reporting an increase from a year earlier in the amount of funds available for lending to farmers far exceeding the proportion reporting a decline. Bankers indicating a year-to-year gain in loan fund availability accounted for 36 percent of the survey respondents, with only 9 percent indicating a decline. The remaining 55 percent of the surveyed bankers reported that funds available for lending to farmers during the third quarter continued at the previous year's high level. The measure of fund availability was high across all District states, ranging from 133 in Illinois to 116 in Michigan.

Loan-to-deposit ratios at District agricultural banks during the third quarter remained well below historical levels, providing further indication of an ample supply of funds for lending. At 55.5 percent, the average loan-to-deposit ratio was slightly higher from three months earlier, but was well below the 57.2 percent level of a year ago. Among the five District states, average loan-to-deposit ratios ranged from 50 percent in Illinois to 62 percent in Wisconsin. In comparison, average loan-to-deposit ratios typically ranged from 60 to 70 percent in the late 1970s and early 1980s.

With loan-to-deposit ratios well below historical norms, many of the bankers expressed a desire for a substantially higher ratio. The average of the desired ratios, at about 61 percent, was 5.5 percentage points higher than the average of the actual ratios, but slightly below the desired third quarter loan-to-deposit ratios reported in the last few years. In addition, almost 62 percent of the respondents indicated that their current ratio of loans to deposits was below the desired level, while only about 14 percent desired a lower ratio than they reported. The remaining 25 percent of the bankers indicated that they were satisfied with the level of their loan-to-deposit ratio at the end of the third quarter.

Interest rates on farm loans at District agricultural banks during the third quarter continued the downtrend that has been evident since last fall. The average interest rate charged at the end of the third quarter on feeder cattle loans and farm operating loans was 12.8 percent, down thirteen basis points from the previous quarter and 1.6 percentage points lower than a year ago. Interest rates charged on farm real estate loans by surveyed banks at the end of the third quarter averaged slightly less than 12.5 percent, down only 4 basis points from three months earlier. When combined with drops that were registered in earlier quarters, however, the latest decline places farm real estate loan rates more than 1.5 percentage points below the year-ago peak. The rate declines over the past year have dropped charges on loans to farmers from District agricultural banks to their lowest levels since 1979. Interest rates on loans to farmers at Michigan and Illinois banks were lower than at surveyed agricultural banks in other District states, while Iowa banks again exhibited the highest loan charges.

As has been the case for the last several quarters, the range in average rates among the five District states has been widening, reflected by third quarter farm operating loan charges that averaged 12.2 percent in Michigan and 13.3 percent in Iowa. The range in farm operating loan rates a year ago was only about half the current spread. The widening range is largely attributable to the relatively small decline in rates charged by Iowa agricultural banks. With earnings pressured by nonperforming loans, these institutions have been reluctant to lower rates in an attempt to maintain revenues.

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	91	127	60	12.79	55.5	14

[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.

Moreover, relatively high rates on loans from Farm Credit System lenders in the troubled Omaha district have lessened the competitive pressure for banks in Iowa to lower rates.

The financial stress being experienced by many of the District's farmer borrowers remains evident in the responses of the bankers. Repayment rates on farm loans continued to falter at many District agricultural banks. The third quarter measure of repayment rates on nonreal estate farm loans at District agricultural banks, at 60, represents a composite of the 5 percent of bankers noting an improvement in loan repayment rates relative to a year ago, less the 45 percent noting slower loan repayments. The remaining 50 percent of the respondents noted no change in their farm customers' third quarter repayment rates from a year earlier.

The measures of loan repayment rates on farm loans indicate that bankers across the District have been affected by the financial stress being experienced by some of their highly leveraged farm customers. As has been the case for sometime, a majority of surveyed bankers in Iowa, where financial stress appears to be most severe in the District, reported a worsening in loan repayment rates compared to last year. In addition, a majority of the bankers in Wisconsin reported a deteriorating farm loan repayment situation. Agricultural bankers in the other District states are experiencing the pressure from the slump in the agricultural sector as well, but to a somewhat smaller degree. Although a majority of the bankers in these states reported stable repayment rates during the third quarter, more than a third reported further deterioration compared to a year ago.

The deteriorating repayment situation of the last several years has been accompanied by rising collateral requirements, which continued to increase this summer. Almost three-fourths of the surveyed bankers indicated that collateral requirements during the third quarter had become more stringent than they were a year earlier. None of the survey respondents reported that collateral requirements on loans to farmers had been relaxed from year-ago levels. The higher collateral requirements reported by the bankers are a response to the fall in farm asset values of the last several years that has undermined the value of collateral securing loans and eroded the equity cushions of farm borrowers.

The growing repayment difficulties of agricultural banks across the District as well as the nation are apparent in the figures on nonperforming loans and net charge-offs of loans during the first half of the year. An analysis by the Board of Governors of the Federal Reserve System shows that nonperforming loans at agricultural banks nationwide reached 4.4 percent of all outstanding loans as of midyear, up from 3.4 percent a year earlier. After about equaling the nationwide level in the previous two years, nonperforming loans at Iowa agricultural banks had moved significantly higher at mid-1985. Nonperforming loans were equivalent to 5.3 percent of outstandings, up sharply from the mid-1984 level of 3.6 percent recorded by Iowa agricultural banks. In addition, net charge-offs of all loans at agricultural banks nationwide totaled .7 percent of outstandings during the first half of 1985, marking a 75 percent increase from the previous year's level. Net charge-offs at Iowa agricultural banks, however, were much higher than for the overall United States, reaching 1.3 percent of all outstanding loans .

Deteriorating conditions are also apparent in the performance measures of the Cooperative Farm Credit system (CFCS). During the first nine months of the year, net loan charge-offs among the 37 banks in the CFCS totaled $318 million, more than two and a half times the total net charge-offs recorded for all of last year, and equal to .45 percent of the $70.7 billion in loans outstanding on September 30.

During the same nine-month period the banks in the CFCS reported a net loss of $426 million compared to a net profit of $363 million during the first three quarters of 1984. The nearly $800 million swing in net earnings is accounted for by measures the CFCS took to address its deteriorating financial position. The charge against earnings for the provision for loan losses rose to $676 million in the first three quarters of this year, marking a nine-fold increase from the first three quarters of 1984. In addition, about $163 million of the financial assistance to local associations—mostly in the troubled Omaha district—was expensed during the period. There was also a $100 million provision for losses on acquired property that was charged against earnings this year as the banks in the CFCS build a reserve to offset future write-offs on farm real estate acquired through foreclosure. Due largely to the net loss recorded through the first nine months of 1985, the equity capital of the CFCS slipped to $8.5 billion from $9.2 billion at the end of last year.

With the extent of the problems in its loan portfolio becoming more apparent, officials of the CFCS recently requested assistance from the federal government. System officials requested a $6 billion line of credit from the U.S. Treasury that would accommodate annual borrowing of up to $2 billion. The amount requested, which was considerably less than earlier reports had hinted, was said to be needed to rebuild investor confidence in CFCS securities and to sustain that confidence in the months ahead. In recent weeks these securities have been trading at more than 100 basis points above Treasury issues of comparable maturity, well above the historical spread of about 20 basis points.

Prior to the CFCS recent request for assistance, a majority of the surveyed bankers in District states indicated that they were in favor of federal assistance to the system to help overcome the problems it faces. More than 62 percent of the respondents favored such assistance, while 19 percent indicated they did not. However, 70 percent of the bankers felt that any federal assistance that might be forthcoming should be made available to all commercial lenders, even though it might entail restrictions on operations.

The bankers' expectations concerning the volume of farm loans at their banks during the fourth quarter point to declines from year-ago levels. About 40 percent of the bankers expect nonreal estate farm loan volume to be lower than a year ago as farmers place crops under loan with the Commodity Credit Corporation, while only 14 percent expect an increase. The remaining 46 percent of the respondents indicated they expect no change in nonreal estate farm loan volume from last year. About 27 percent of the bankers expect farm real estate loan volume to be up from a year ago during the fourth quarter. However, much of this lending is likely attributable to refinancing of existing loans and some movement of Federal Land Bank borrowers to District agricultural banks. Of the remaining bankers, 38 percent expect their bank's volume of farm real estate lending to be lower than a year ago and 35 percent expect no change.

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AGRICULTURAL LETTER (ISSN 0002-1512) is published bi-weekly by the Research Department of the Federal Reserve Bank of Chicago. It is prepared by Gary L. Benjamin, economic adviser and vice-president, Peter J. Heffernan, economist, and members of the Bank's Research Department, and is distributed free of charge by the Bank's Public Information Center. The information used in the preparation of this publication is obtained from sources considered reliable, but its use does not constitute an endorsement of its accuracy or intent by the Federal Reserve Bank of Chicago.

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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)*	October	123	1.7	-11	-8
Crops *(1977=100)*	October	111	-0.9	-19	-17
Corn *($per bu.)*	October	2.16	-5.3	-19	-31
Oats *($per bu.)*	October	1.08	-1.8	-38	-33
Soybeans *($per bu.)*	October	4.83	-3.2	-20	-39
Wheat *($per bu.)*	October	3.00	0	-13	-17
Livestock and products *(1977=100)*	October	134	4.7	-3	-1
Barrows and gilts *($per cwt.)*	October	44.40	9.2	-1	7
Steers and heifers *($per cwt.)*	October	56.90	9.0	-4	1
Milk *($per cwt.)*	October	12.50	1.6	-11	-9
Eggs *(¢per doz.)*	October	63.5	2.1	14	-7
Prices paid by farmers *(1977=100)*	October	162	0	-1	1
Production items	October	148	0	-3	-3
Feed	October	108	-1.8	-14	-23
Feeder livestock	October	146	2.1	-3	0
Fuels and energy	October	202	-0.5	0	-2
Producer Prices *(1967=100)*	September	290	-1.1	0	2
Agricultural machinery and equipment	September	337	-0.3	0	3
Fertilizer materials	September	229	0.3	-2	4
Agricultural chemicals	September	458	-0.1	0	0
Consumer prices *(1967=100)*	September	325	0.3	3	8
Food	September	310	0.1	2	6
Production or stocks					
Corn stocks *(mil. bu.)*	June 1	2,832	N.A.	32	-43
Soybean stocks *(mil. bu.)*	September 1	318	N.A.	81	-8
Beef production *(bil. lbs.)*	September	1.99	-6.5	4	-5
Pork production *(bil. lbs.)*	September	1.20	-1.2	5	-6
Milk production *(bil. lbs.)*	September	12.0	-2.7	11	7

N.A. Not applicable

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