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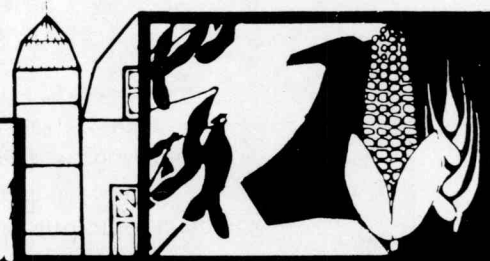
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FEDERAL RESERVE BANK OF CHICAGO

# AGRICULTURAL



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# LETTER

**AGRICULTURAL CREDIT CONDITIONS** in the Seventh District during the third quarter were characterized by a weak farm loan demand, rising interest rates, and ample fund availability. Loan-to-deposit ratios remained virtually unchanged from the previous quarter. But for the third consecutive quarter, farm loan repayment rates slowed and renewals and extensions of farm loans increased. Rural bankers are concerned about the ability of farmers to service their outstanding debt in the months ahead. Based on a recent survey, these findings represent the consensus of 550 agricultural bankers in the District.

Farm loan demand at District agricultural banks tailed off sharply in the third quarter. The measure of farm loan demand fell to 66 (see table on page 2), 19 percentage points below the level of the previous quarter. Only at one other time in the 17-year history of the quarterly survey has the measure been lower. That was in the second quarter of 1980—a period of credit controls—when the measure fell to 65. Nearly three times as many rural bankers reported farm loan demand in the third quarter was less than a year ago as reported it higher. The fall-off in farm loan demand at rural banks no doubt was influenced by the record high interest rates which caused farmers to hold borrowing down to essential needs.

Rural bankers look for the soft farm loan demand to continue in the months ahead, but the pattern will vary by type of loan. Bankers expect the demand for operating loans in the current quarter to exceed year-ago levels. However, the demand for feeder cattle loans, farm machinery loans, and farm real estate loans is expected to be down.

**Interest rates charged** on farm loans by District agricultural banks continued to rise in the third quarter. By the end of the quarter, interest rates charged on feeder cattle and farm operating loans were at record high levels, averaging more than 18½ percent. This was 75 basis points higher than three months ago and 200 basis points higher than six months ago. Interest rates on farm

real estate loans averaged 17½ percent, up 110 basis points from three months ago. Compared with a year ago, interest rates on farm loans were up about 4 percentage points.

Among District states, average rates on nonreal estate loans varied widely. In Wisconsin, rates on feeder cattle loans and farm operating loans averaged about 17¼ percent. In contrast, rates on feeder cattle loans and farm operating loans in Michigan averaged 19¾ percent. Rates on farm real estate loans varied somewhat less between states, ranging from 16½ percent in Wisconsin to 18 percent in Indiana.

The new highs on loan rates reflect rising costs of funds at rural banks and other factors. Rates on deposits at agricultural banks have become increasingly reflective of market interest rate trends in recent years as regulations establishing interest rate ceilings have become less encompassing and as new deposit-type instruments have surfaced. During recent months, the interest-sensitivity of deposit rates—and thus higher costs of funds—was heightened by the removal of ceiling interest rates on Small Saver Certificates and the sudden popularity of “retail repurchase agreements”. Retail repurchase agreements are arrangements whereby the customer purchases some of the bank’s government securities, with the bank agreeing to repurchase the securities at a later date. The transactions are in denominations of \$100,000 or less, mature in less than 90 days, and offer interest rates that are close to prevailing short-term market rates. Forty percent of the bankers indicated that they have issued “retail RPs” and 50 percent thought they would be issuing them in the future.

Evidence on liquidity at rural banks in the latest survey reflected a leveling-off relative to the previous survey. The loan-to-deposit ratio at the end of the third quarter was 60.9 percent. This was unchanged from the previous quarter, 1.5 percent below a year ago, and down considerably from the peak of two years ago. In District portions of Illinois and Indiana, average loan-to-deposit ratios were up slightly from second quarter

### 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>1977</b>						
Jan-Mar	161	115	79	8.71	59.4	28
Apr-June	169	103	66	8.74	61.2	38
July-Sept	161	77	52	8.79	63.5	46
Oct-Dec	147	86	59	8.85	62.3	41
<b>1978</b>						
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
<b>1979</b>						
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
<b>1980</b>						
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
<b>1981</b>						
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

<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.

results. Nearly half of the rural bankers responding to the survey viewed their ratios at the end of the third quarter as being lower than desired. Only a fifth indicated that their loan-to-deposit ratio was higher than desired.

**Deposit growth** at District agricultural banks during the third quarter was modest by historical standards. According to information compiled from weekly reports of loans and deposits at agricultural banks, total deposits rose 1.7 percent from mid-June to mid-September. Historically, deposits have risen an average of 2.8 percent in the third quarter. But in the wake of a soft farm loan demand, the growth in deposits was ample. Two-fifths of the bankers reported fund availability in the third quarter exceeded year-ago levels while one-sixth of the bankers reported lower fund availability. The overall measure of fund availability—at 123—was below the level reported a year ago but still at a fairly high level.

**Farm loan repayments** slowed considerably this summer. At 54, the measure of loan repayment rates was well below levels of the first half of this year and comparable with the lowest levels ever reported in the 17-year history of the quarterly surveys. Slightly over 50 percent of the bankers indicated that loan repayments were down from a year ago compared with only 6 percent of the bankers who indicated repayments were up. The other two-fifths of the bankers reported that repayments were about the same. In addition, renewals and extensions of farm loans were up for the third consecutive quarter. The measure of renewals and extensions in the third quarter, at 155, repeated the high established in 1980.

No doubt the slowing in farm loan repayment rates and the rise in renewals and extensions are tied to recent developments in the overall farm sector. Crop and livestock prices have declined sharply in recent months,

lowering cash receipts. According to the USDA, the index of crop prices received by farmers fell 13 percent from July to October and dropped below year-ago levels. The index of livestock prices received fell 7 percent during the same period. For livestock producers, this is especially significant since most producers have sustained low or negative returns over the last few years. For the year as a whole, net farm income after inventory adjustment is expected to improve somewhat over the depressed 1980 level, but remain a third below the level reached in 1979.

**Activity at other commercial farm lenders** was varied in recent months. Year-to-year gains in loans made by production credit associations narrowed in the past two months as farmers, in step with curtailed borrowing at banks, reduced their borrowing of short-term funds from PCAs—the banks' major competitor. Year-to-year gains in August and September averaged 6 percent, down from gains averaging 12 percent in the first seven months of this year. Loans outstanding at PCAs, nevertheless, are up 14 percent since the end of the year in line with December-to-September increases of past years.

In contrast, lending activity in the farm mortgage market seems to have picked up as compared with a year ago. New money loaned by federal land banks increased sharply during the third quarter over the year before—although lending activity in the second half of 1980 was slowed. Though modest year-to-year gains were posted in the first six months of 1981, new loan amounts in dollars exceeded recent levels. In addition, farm mortgages acquired by life insurance companies in July and August also picked up and were well in excess of depressed year-earlier levels. Third-quarter acquisitions are likely to exceed the year-ago level, breaking a two-year trend of quarterly acquisitions lagging year-earlier levels. But despite the rise in acquisitions by life insurance companies during the third quarter, acquisitions for the first eight months of this year trail last year's level by a fourth. On balance, the waning activity at short-term lenders in the face of continued strength in farm mortgage lending may reflect efforts of farmers to restructure their debt by refinancing short-term debt with lower cost mortgage debt.

Lending activity at the Farmers Home Administration slowed during the third quarter. However, obligations under the Emergency (Disaster) Loan Program were up. For the fiscal year which ended September 30, the dollar volume of loans made through the Emergency (Disaster) Loan Program, at \$5.1 billion, was more than twice as large as in the preceding year. Lending through other FmHA farm programs trailed year-ago levels during the July-September period and for the fiscal year as a

whole. Obligations under the Farm Ownership Loan Program in fiscal 1981 were a seventh below the previous year while obligations under the Farm Operating Loan Program trailed last year by only 3 percent. In fiscal 1982, lending under the Farm Ownership Loan Program is expected to be comparable with last year's level but the Farm Operating Loan Program will be stepped up considerably. Though final budget approval has not been given, proposals have, for the most part, set the program at \$1.3 billion, well in excess of this past year's \$800 million level. Part of the increase is expected to offset the curtailment of other programs. The Emergency (Disaster) Loan Program is expected to require about \$1.6 billion in fiscal 1982 since part of this program has been replaced by the Federal Crop Insurance Program. The Economic Emergency Loan Program expired in September and is not likely to be revived under new legislation. With funding curtailed in several of the programs, eligibility criteria for FmHA loans are likely to be more stringent.

**The outlook for credit conditions** reflects pessimism on the part of many bankers. Bankers generally expect continued softness in farm loan demand in the months ahead. Many indicated their concern over the ability of farmers to service their debts in the next few months. Half of the bankers anticipated that farm loan repayment rates would slow relative to year-earlier levels, while only 10 percent thought repayment rates would increase. Three-fifths of the bankers expect renewals and extensions of farm loans this fall and winter to rise above year-ago levels. Less than a tenth expect renewals and extensions to decline. Three-fifths of the bankers also indicated that farmers were likely to refinance short-term debt with long-term debt. Evidence of this already is suggested by the increase in third-quarter lending activity of FLBs and life insurance companies. Farmers may be restructuring their outstanding debts to obtain longer-term amortization and more favorable interest rates. About a third of the bankers believe that the rate of default on farm loans in the next few months will be higher than a year ago. Most of this pessimism stems from the outlook for farming in the months ahead. Net farm income is expected to decline again in 1982, making it the third straight year of dismal earnings for farmers.

Bankers reflected one bit of optimism. Slightly more than a third of them believed deposits would grow faster in the months ahead than a year ago. This compares with a fifth of the bankers who thought that deposit growth would trail a year ago. Also, short-term market rates of interest have declined in recent weeks, portending a break from record high interest rates on farm loans.

Jeffrey Miller



## Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from	
				Prior period	Year ago
<b>Farm finance</b>					
Total deposits at agricultural banks†	1972-73=100	October	240	+ 1.8	+ 8
Total loans at agricultural banks†	1972-73=100	October	271	+ 0.5	+ 7
Production credit associations					
Loans outstanding					
United States	mil. dol.	September	22,315	- 0.6	+12
Seventh District states	mil. dol.	September	4,642	+ 0.8	+13
Loans made					
United States	mil. dol.	September	2,188	+ 5.7	+ 5
Seventh District states	mil. dol.	September	449	+ 3.1	+ 6
Federal land banks					
Loans outstanding					
United States	mil. dol.	September	42,103	+ 1.4	+21
Seventh District states	mil. dol.	September	10,063	+ 1.4	+23
New money loaned					
United States	mil. dol.	September	676	+ 7.9	+49
Seventh District states	mil. dol.	September	167	+ 9.6	+73
Interest rates					
Feeder cattle loans††	percent	3rd Quarter	18.15	+ 5.9	+29
Farm real estate loans††	percent	3rd Quarter	16.93	+ 6.5	+25
Three-month Treasury bills	percent	11/5-11/11	11.55	-14.1	-13
Federal funds rate	percent	11/5-11/11	14.01	- 6.2	- 4
Government bonds ( <i>long-term</i> )	percent	11/5-11/11	13.76	- 4.4	+10
<b>Agricultural trade</b>					
Agricultural exports	mil. dol.	September	3,203	+ 9.5	- 1
Agricultural imports	mil. dol.	September	1,279	- 2.3	+ 3
<b>Farm machinery sales<sup>P</sup></b>					
Farm tractors	units	October	11,607	+57.7	-25
Combines	units	October	5,593	+101.8	- 4
Balers	units	October	1,041	+ 2.4	- 8

†Member banks in Seventh District having a large proportion of agricultural loans in towns of less than 15,000 population.

††Average of rates reported by District agricultural banks at beginning and end of quarter.

<sup>P</sup>Preliminary.

AGRICULTURAL LETTER  
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