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CREDIT CONDITIONS at District agricultural banks in the second quarter were little changed. Farm loan demand continued sluggish, the availability of funds for lending remained adequate, and for the second consecutive quarter, farm loan repayment rates apparently slowed. In addition to these continuing trends, interest rates on farm loans rebounded to a new high in the second quarter and loan-to-deposit ratios turned upward for the first time since the summer of 1979. These findings represent the consensus views from a recent survey of 550 agricultural banks in the Seventh Federal Reserve District.

The second-quarter rise in the average loan-to-deposit ratio was modest (see table on page 2). At 61.9 percent the average ratio at the end of the second quarter was still 4 percentage points below the year before and nearly 7 percentage points below the peak in the summer of 1979. Moreover, only a fifth of the bankers considered their loan/deposit ratio too high, while over two-fifths viewed their ratio as undesirably low. These measures support other survey findings that suggest the availability of funds for agricultural lending continues to be ample.

The upturn in the average loan/deposit ratio was apparently due to a leveling-off in deposits and a modest rise in loan portfolios. Information from agricultural banks that file weekly reports on loans and deposits shows total loans rose 2 percent from mid-March to mid-June. Although that was the largest quarterly rise since the summer of 1979, it still was only half the normal increase for the second quarter. In contrast to the rise in loans, total deposits in mid-June were unchanged from three months earlier. Although the leveling off follows several quarters of unusually rapid growth, it marks only the second time in the past 11 years that deposits have not registered a quarterly increase of some magnitude.

The leveling-off in deposits may partially reflect a loss of some depositors' funds to high-yielding nonbank investments. It may also reflect the apparent growing popularity of the so called "retail repo." This relatively new instrument allows a depositor to convert his funds temporarily to a loan to the bank collateralized by a portion of the bank's government security portfolio. In doing so, the depositor receives a higher return than the return on funds held as a deposit. To the extent retail repos have been adopted by agricultural banks, measures of total deposits would tend to be undermined while total funds available to banks would be unchanged. The use of the funds so retained by banks, however, may be more limited than if the funds were held as deposits.

Interest rates on farm loans charged by agricultural banks turned upward in the second quarter, offsetting declines of the first quarter. Rates on feeder cattle and farm operating loans averaged 17¾ percent at the end of the second quarter, up 125 basis points from three months earlier, up 40 basis points from the previous high six months earlier, and up 375 basis points from a year ago. The average rate on farm real estate loans was nearly 16½ percent, up 100 basis points from three months earlier.

Among District states, average rates on bank loans vary widely. In Wisconsin rates on feeder cattle and farm operating loans averaged less than 16½ percent. Rates on such loans averaged less than 17½ percent among Iowa banks, 18¼ percent at Illinois banks, 18½ percent at Indiana banks, and 19½ percent at Michigan banks.

The new highs on loan rates reflect pressures on banks' operating margins from the increasing share of their deposits that are interest-sensitive and the restructuring of deposits that has occurred since the introduction of interest-bearing checking (NOW) accounts in January of this year. It appears that agricultural banks have lost a fourth of their demand (interest-free) deposits since the end of 1980. The bulk of this has probably gone into NOW accounts, along with a considerable amount of funds from passbook savings accounts. The new highs in bank loan rates also reflect the uptrend in

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)
1976						
Jan-Mar	142	130	101	8.74	56.2	20
Apr-June	147	134	102	8.79	57.3	24
July-Sept	140	124	93	8.76	59.2	25
Oct-Dec	150	130	81	8.71	58.8	26
1977						
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
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

[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.

market rates of interest during the second quarter. Rising market rates of interest affect loan-pricing decisions through the alternative returns banks can earn by investing their funds in assets other than loans.

Banks may continue to experience pressure on their cost of funds. An August 1 regulatory change replaced the former fixed-rate ceiling on 30-month small saver certificates (SSCs) of deposits with a rate tied biweekly to yields on U.S. Treasury securities. Banks can presently pay up to 15.55 percent on new SSC deposits, up from the former fixed ceiling of 11¾ percent. Since depository institutions typically require only a small minimum balance on their SSC accounts, removal of the fixed ceiling could enhance the popularity of such deposits and expand the interest-sensitive portion of the overall deposit structure at agricultural banks. The popularity at banks, however, may be partially offset by regulations that permit thrift institutions to offer rates on SSCs up to 25 basis points higher than banks. At times in the past, the 25 basis point differential has had a significant impact on deposit flows in rural areas, particularly on large deposit accounts.

The outlook for credit conditions continues to reflect elements of pessimism in the eyes of agricultural bankers. Only a fourth of the bankers that responded to the recent survey expect farm loan demand to exceed year-earlier levels in the third quarter. Thirty-six percent anticipate demand will be lower, while the remainder expect demand will be about the same as the depressed level of a year ago. Only 6 percent of the bankers anticipate faster-than-normal deposit growth over the next three to six months, while 28 percent expect slower-than-normal deposit growth. Only 8 percent expect farm loan repayment rates will be faster than normal, while 35 percent look for slower-than-normal repayments. On a more positive note, a fourth of the bankers expect interest rates on their farm loans will trend lower over the next three to six months, while 10 percent anticipate further increases. Twenty-two percent of the bankers believe that their loan/deposit ratio will rise, while 13 percent expect their ratio will trend lower.

The pessimism in bankers' expectations reflects the sluggish economy overall and the impact of low farm income and high interest rates on discretionary expenditures by farmers. Their expectations for a continuing soft farm loan demand may also reflect the interest rate differential on farm loans between banks and other lenders. Rates charged by PCAs, the CCC, and the FmHA have risen significantly this year and further increases are no doubt in store. Nevertheless, the gaps remain to the competitive disadvantage of banks.

Gary L. Benjamin

FARM INCOME PROSPECTS are expected to improve somewhat in the months ahead, owing mainly to a recovery in the livestock sector. Weakness in most farm commodity prices throughout the first half of 1981 held farm income to an estimated $21 billion (seasonally adjusted to an annual basis). In the second half of 1981, net farm income may rise above $24 billion. Net farm income for all of 1981 may only rise nominally above last year's dismal $22 billion level.

The farm income picture varies accordingly among sectors of the agricultural economy. Because of expanded marketings and higher milk prices, cash receipts to dairy farmers during the past 6 months were up 12 percent over the same period a year ago and may rise similarly in the second half. The impact on dairy farmers' earnings, however, has been cushioned somewhat by higher feed costs. As of midyear, dairy ration costs were up a fifth from last year. Since another adjustment in dairy support prices is due in October, dairy farmers' earnings may improve in the fourth quarter.

A long-awaited upturn in cattle and hog prices has improved the prospects for livestock producer earnings in the second half of 1981. Barrow and gilt prices at major markets have recently averaged $50 per hundredweight, up from $40 in late March and $40 a year ago. Prices of choice steers at Omaha at $69 per hundredweight are up from $61 in late March but are comparable to a year ago. Prior to the midyear strengthening in prices, livestock producers had sustained a rather prolonged period of financial losses. Although further large gains in livestock prices are not anticipated, livestock producers' earnings may be further augmented if feed costs continue to ease as they have recently.

Earnings prospects for crop farmers are shaded. Corn and soybean prices fell during the second quarter, briefly rallied in July, and have trailed off again. Major crop prices that held well above year-ago prices throughout the first half of 1981 now have dipped below the rapidly rising levels of a year ago. Progress reports indicate that developing crops are in good shape and that the fall harvest may be larger than previously anticipated. Recent export developments have been a depressant on crop prices, but prospects could improve if negotiations with the Soviet Union and others prove eventful. On balance, however, receipts to crop farmers may not rise above year-ago levels in the second half of this year.

Farm production costs will continue to rise substantially. Last year the per acre cost of producing 11 major U.S. crops rose an average of 15 percent (excluding land costs) over the previous year. This year, the USDA estimates the increase might be 17 percent. Fuel and energy costs rose 38 percent in 1980 from the previous year and are expected to rise 22 to 26 percent this year. Relatively large cost increases are also foreseen this year for seed, equipment, and wages. If yields return to trend this year, the impact will be lessened as per bushel costs of production rise more slowly than was the case in 1980. The USDA estimates that nonland production costs for corn and soybeans will reach $246 and $150, respectively, per planted acre. For corn that translates into a per bushel cost of $2.46 if yields average 100 bushels and for soybeans a cost of $5 per bushel if yields average 30 bushels per acre.

Overall estimates of various farm income measures point to a modest increase in 1981, considerably below what had been forecast earlier. Net farm income for the year may range from $22 billion to $24 billion. Earlier estimates had placed net farm income near $30 billion based primarily on expectations of sharper price gains in the livestock sector. Last year net farm income was $22 billion. As a result, farmers may not see any gain in real terms when inflation is factored into the income calculation.

Jeffrey Miller

Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from Prior period	Percent change from Year ago
Index of prices received by farmers	1977=100	July	141	- 0.7	+ 4
Crops	1977=100	July	136	- 0.7	+ 9
Livestock	1977=100	July	145	- 0.7	+ 1
Index of prices paid by farmers	1977=100	July	151	0	+ 9
Production items	1977=100	July	149	- 0.7	+ 9
Producer price index* *(finished goods)*	1967=100	June	270	+ 0.4	+10
Foods	1967=100	June	253	+ 0.4	+ 9
Processed foods and feeds	1967=100	June	250	+ 0.7	+ 7
Agricultural chemicals	1967=100	June	289	+ 3.7	+12
Agricultural machinery and equipment	1967=100	June	286	+ 0.5	+11
Consumer price index** *(all items)*	1967=100	June	271	+ 0.9	+10
Food at home	1967=100	June	268	+ 0.4	+ 8
Cash prices received by farmers					
Corn	dol. per bu.	July	3.17	0	+16
Soybeans	dol. per bu.	July	7.11	+ 0.1	+ 5
Wheat	dol. per bu.	July	3.55	- 4.1	- 7
Sorghum	dol. per cwt.	July	4.98	+ 0.6	+ 1
Oats	dol. per bu.	July	1.89	- 5.0	+26
Steers and heifers	dol. per cwt.	July	62.30	- 3.6	- 9
Hogs	dol. per cwt.	July	49.60	+ 4.6	+20
Milk, all sold to plants	dol. per cwt.	July	13.40	0	+ 6
Broilers	cents per lb.	July	30.4	+ 4.1	- 5
Eggs	cents per doz.	July	58.4	+ 2.3	+14
Income *(seasonally adjusted annual rate)*					
Cash receipts from farm marketings	bil. dol.	2nd Quarter	146	+ 2.1	+10
Net farm income	bil. dol.	2nd Quarter	23	+18.8	+43
Nonagricultural personal income	bil. dol.	June	2,331	+ 0.6	+12

*Formerly called wholesale price index.

**For all urban consumers.

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