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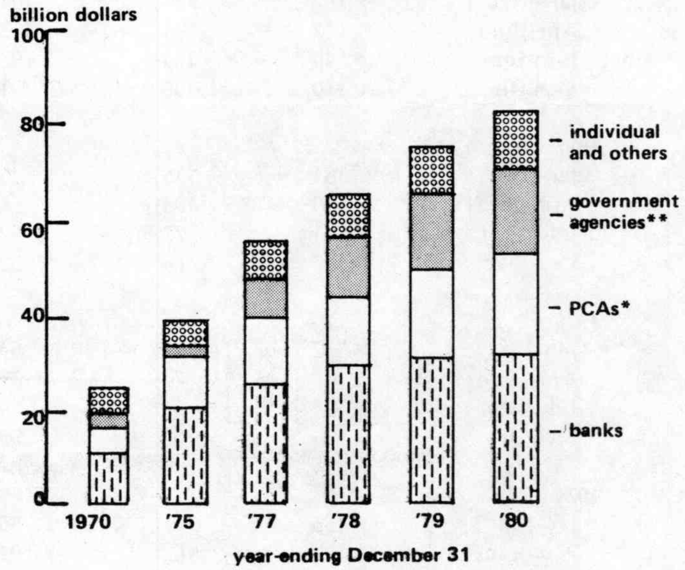
CREDIT CONDITIONS at District agricultural banks during the first quarter were characterized by a continuation of the soft demand for loans and an adequate availability of funds for lending. The April 1 survey of more than 550 agricultural banks in the Seventh Federal Reserve District also indicates that interest rates on farm loans edged lower in the first quarter, as did loan/ deposit ratios. Despite the decline in interest rates, rates on bank loans to farmers remain above rates charged by other farm lenders. Differentials in interest rates overshadowed the improved liquidity at agricultural banks, resulting in a further decline in banks' share of the farm credit market in 1980.

Improving liquidity conditions have highlighted the developments at agricultural banks for the past year. In the early part of 1980, the improvement reflected a fall-off in loan demand in response to record-high interest rates, a plunge in farm earnings, and the depressed economic conditions overall in rural areas. Since about mid-1980, an unusually rapid growth in deposits has further bolstered liquidity at agricultural banks. During the second half of 1980, total deposits at District agricultural banks that are members of the Federal Reserve System rose at a rate unprecedented in the 1970s except for the latter half of 1972. This unusually rapid growth in deposits continued in the first quarter. As a result, total deposits at these banks are now 15 percent higher than a year ago.

The much improved liquidity conditions at agricultural banks is perhaps best reflected in their assessment of the availability of funds for lending and in their loan/ deposit ratios. The latest measure of fund availability (see table on page 2) nearly equaled the unprecedented high recorded in the previous survey and contrasts strikingly with the unprecedented low recorded in the survey taken just one year ago. Similarly, the average loan/ deposit ratio—which has been declining since late 1979—edged lower again in the first quarter and is now at a four-year low. The first-quarter decline, while fairly small, represents a significant departure from the normal seasonal rise during the first three months of the

Nonreal estate farm debt outstanding by lender



*Includes small amount of OFI financing by FICBs.
**Farmers Home Administration, Commodity Credit Corporation and Small Business Administration.

year. In conjunction with the lower ratios, 47 percent of the bankers view their current loan/deposit ratio as being lower than desired, while only 17 percent consider their ratio too high. The remaining 36 percent consider their ratio is at the desired level.

The measure of farm loan demand, while up from the last quarterly survey, is still indicative of a very sluggish demand at rural banks. The sluggish loan demand reflects a number of factors. After falling sharply in 1980, farm income is expected to bounce back this year. The extent of the recovery, however, will be considerably less than had been forecast. A drought-related spurt pushed crop prices to a peak in late 1980. Since then, crop prices have drifted lower and prospective spring and summer price levels have been undermined by the huge harvest now winding up in the Southern Hemisphere, the weaker-than-anticipated foreign demand for U.S. grains, and recent evidence of a substantial fall-off in domestic utilization for feed. More importantly, farm earnings so far this year have been undermined by huge financial losses on livestock marketings. With these

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)
1975						
Jan-Mar	134	108	65	8.84	56.4	28
Apr-June	142	120	80	8.76	56.3	22
July-Sept	133	131	105	8.81	57.0	22
Oct-Dec	134	130	100	8.80	56.6	23
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

[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.

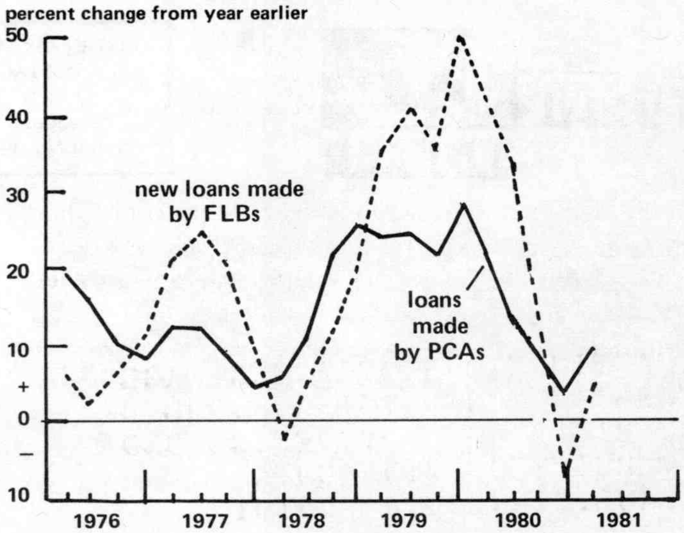
developments eroding actual and anticipated farm earnings, expenditures by farmers have been held in close check, particularly capital expenditures.

The soft loan demand at banks also reflects the comparatively high interest rates charged by banks on farm loans. At the start of the first quarter, rates charged by District agricultural banks on feeder cattle loans and farm operating loans averaged more than 17¼ percent. At the same time effective rates charged by production credit associations averaged roughly 14 percent, while the rates charged by FmHA and the CCC ranged from 11 to 13 percent. During the first quarter the gap narrowed as rates on bank loans declined, while rates charged by other farm lenders trended higher. Nevertheless, with District bank rates averaging 16½ percent by the end of March, banks are still at a competitive disadvantage to the other farm lenders whose interest rates for most nonreal estate farm loans now range from 14 to 15½ percent.

While interest rates on farm loans edged lower during the first quarter, rural banks were still faced with upward pressures on costs of funds. The introduction of NOW accounts on January 1 resulted in some restructuring of deposits at rural banks. An overall estimate of the impact of NOW accounts is not yet available. However, it appears that "interest free" demand deposits (checking accounts) at District agricultural banks declined more than a fifth during the first quarter. Undoubtedly, most if not all of these deposits were converted to NOW accounts with an interest cost of 5¼ percent. In addition, rollovers of the six-month money market certificates—which account for nearly 30 percent of total deposits at District agricultural banks—added additional pressure. Any first-quarter rollovers would have come from MMCs opened or renewed during the third quarter of 1980 when banks were permitted to pay ceiling rates averaging about 9.5 percent. In the first quarter of this year, ceiling rates on six-month money market certificates averaged nearly 14 percent, an increase of nearly 50 percent in the interest cost of such deposits for banks. Following the recent upsurge in market rates of interest, ceiling rates on six-month money market certificates have soared to more than 15¾ percent, a high exceeded only briefly in March 1980.

Lending activity at most other farm lenders has been on the upswing since the start of this year. During the first quarter loans made by production credit associations—banks' chief competitor for nonreal estate farm loans—were 10 percent above the year before. That compares to the year-to-year gain of 5 percent recorded during the latter half of 1980. Similarly, new loans made by federal land banks—the leading institutional farm mortgage lender—in the first quarter were nearly 5 percent above the year before. During the latter half of 1980, new loans made by FLBs lagged year-earlier levels by 4 percent.

Lending activity at PCAs and FLBs was on the upswing in the first quarter



New loans made by the Farmers Home Administration escalated rapidly during the early months of this year. During the fourth quarter of 1980, loans extended by the FmHA through the farm operating, farm ownership, emergency (disaster), and the economic emergency loan programs totaled less than $1 billion. During the first four months of this year, however, loans extended through these four programs soared to more than $5 billion. The bulk of the extensions were through the emergency (disaster) loan program in response to the widespread drought losses of last year.

In contrast to other nonbank farm lenders, activity at life insurance companies continued at a suppressed level. Farm mortgages acquired by life insurance companies—which fell nearly 40 percent in 1980—were 27 percent below the year before in January and February. Moreover, new farm mortgage commitments made by life insurance companies in the first two months of this year were more than a third below the year before and 70 percent less than in the same months two years ago.

The outlook for agricultural credit conditions is clouded by many uncertantities, including interest rate trends, future commodity prices, and the income and spending patterns of farmers. The latest spurt in market rates of interest will add more pressure on the cost of funds at agricultural banks. If the uptrend continues, or if rates hold at current levels, the pressures will likely be reflected in higher rates on bank loans to farmers. This may well extend the competitive interest rate disadvantage facing banks with respect to the rates charged by other farm lenders.

While commodity prices may remain quite volatile, the forecasts of many analysts now reflect a degree of pessimism that is more widespread than a couple of months ago. Factors behind the pessimism include recent rains that have diminished drought concerns, prospects for a record winter wheat crop in the United States, continued softness in livestock prices, and the good condition of winter grains in most producing countries in the Northern Hemisphere. With interest rates high and farm income prospects diminished, capital spending—and hence borrowings—may remain soft for the near term. However, borrowings to finance operating capital will be seasonally high during the current quarter, reflecting expanded plantings, higher-priced inputs, and indications of a pickup in the movement of cattle into feedlots.

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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	1967=100	April	261	− 0.4	+16
Crops	1967=100	April	275	− 2.1	+26
Livestock	1967=100	April	250	+ 1.6	+ 8
Index of prices paid by farmers	1967=100	April	305	+ 1.0	+11
Production items	1967=100	April	300	+ 1.0	+11
Producer price index* *(finished goods)*	1967=100	April	268	+ 0.9	+11
Foods	1967=100	April	252	− 0.1	+ 9
Processed foods and feeds	1967=100	April	247	− 0.3	+ 8
Agricultural chemicals	1967=100	April	277	+ 0.9	+ 7
Agricultural machinery and equipment	1967=100	April	281	+ 0.9	+11
Consumer price index** *(all items)*	1967=100	March	265	+ 0.7	+11
Food at home	1967=100	March	269	+ 0.5	+10
Cash prices received by farmers					
Corn	dol. per bu.	April	3.20	− 1.5	+36
Soybeans	dol. per bu.	April	7.33	− 3.4	+30
Wheat	dol. per bu.	April	3.99	− 2.4	+11
Sorghum	dol. per cwt.	April	5.21	+ 0.8	+32
Oats	dol. per bu.	April	2.04	− 1.9	+48
Steers and heifers	dol. per cwt.	April	63.90	+ 4.1	0
Hogs	dol. per cwt.	April	39.10	+ 0.8	+40
Milk, all sold to plants	dol. per cwt.	April	13.70	− 0.7	+ 8
Broilers	cents per lb.	April	26.8	− 9.8	+19
Eggs	cents per doz.	April	64.4	+ 5.9	+23
Income *(seasonally adjusted annual rate)*					
Cash receipts from farm marketings	bil. dol.	4th Quarter	146	+ 2.0	+ 8
Net farm income	bil. dol.	4th Quarter	22	+ 1.4	−26
Nonagricultural personal income	bil. dol.	March	2,290	+ 0.8	+12

*Formerly called wholesale price index.

**For all urban consumers.

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