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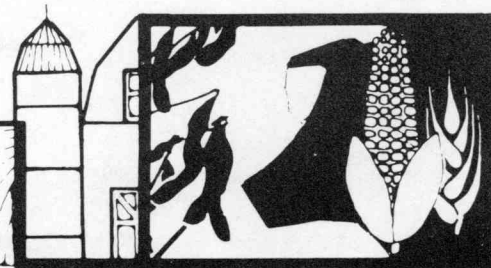
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LETTER

CREDIT CONDITIONS at Seventh District agricultural banks eased substantially in the third quarter. A recent survey of 600 District agricultural banks shows marked improvement in the availability of funds and in farm loan repayment rates. Interest rates charged on farm loans edged upward this summer, no doubt contributing to the continued softness in farm loan demand. But deposit growth picked up considerably, pushing loan/deposit ratios to nearly a three-year low. Despite some problems, particularly in areas where crops were hurt the most by adverse weather, rural bankers are somewhat optimistic that credit conditions will continue to improve.

Evidence of the easing credit conditions at District agricultural banks is most apparent in measures of funds available for farm lending and farm loan repayment rates, and in the significant decline in loan/deposit ratios. (See table on page 2.) The measure of fund availability rose sharply for the second consecutive quarter, reaching a four-year high of 131. This represents a composite of the more than two-fifths of the bankers that reported fund availability exceeded the year-earlier level, compared to only a tenth of the bankers that reported lower fund availability. The remaining proportion of the bankers indicated that fund availability was about the same as a year ago.

Farm loan repayment rates also moved sharply higher this summer. At 94, the measure of loan repayment rates was well above the levels of the first half and the highest since the spring of 1976. Even so, the proportion of bankers that noted loan repayment rates were below the relatively favorable level of a year ago still exceeded the proportion that reported a faster repayment rate.

A large contraseasonal decline in the average loan/deposit ratio provides further evidence of the easing credit conditions in the third quarter. The average ratio stood at .625 at the end of the third quarter, down from .650 at midyear and down from the year-ago peak of .676. In conjunction with the decline, banker concern has shifted from the view that loan/deposit ratios are too

high to the feeling that ratios may be too low. Only 21 percent of the bankers viewed their ratio at the end of the third quarter as being higher than desired, while 40 percent felt their ratio was below the desired level.

The decline in loan/deposit ratios reflects continued softness in farm loan demand and faster deposit growth this summer. Although the measure of farm loan demand picked up slightly this summer, the proportion of bankers reporting that loan demand was down from a year ago exceeded the proportion that reported an increase by a wide margin. This marks the fourth consecutive quarter in which the measure of farm loan demand has been unusually low.

High interest rates undoubtedly have been a factor in the soft farm loan demand. At the end of the third quarter, interest rates charged by District agricultural banks on feeder cattle and farm operating loans averaged about 14¼ percent, while rates on farm real estate loans averaged 13¾ percent. These averages are about 25 basis points higher than three months ago and 250 basis points higher than a year ago.

The sluggishness in farm loan demand the past few quarters has also been evident in other types of loan demands facing rural banks. Total loans at District banks that are members of the Federal Reserve System and heavily engaged in agricultural lending declined from March through August and have increased only nominally in the past two months. In October total loans at member agricultural banks were 1 percent below the year before. The decline is unprecedented by the standards of the 1970s when the increase in total loans during the 12 months ending in October averaged nearly 16 percent.

In the face of slow loan growth, deposit growth this summer picked up sharply from the sluggish pace of earlier quarters. At member agricultural banks, total deposits increased nearly 7 percent from June to October, sharply above the ten-year average rise of 4.6 percent for that four-month period. Time and savings deposits rose about 5 percent, which is normal for that period.

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

¹At end of period.

²Bankers 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.

Demand deposits led the rise with an increase of 13 percent, marking a pronounced recovery from the slide in demand deposits that occurred earlier this year. Because of the sharp recovery, demand deposits at District member banks are now about equal to the year-ago level. In June demand deposits were down 10 percent from a year ago.

The various measures alluding to the easing credit conditions at District agricultural banks have no doubt been influenced by the sharp rise in commodity prices this summer and the much improved farm income prospects. The overall index of farm-commodity prices rose 12.5 percent in the third quarter. The increase was led by

gains of more than a fifth in prices for hogs, corn, and soybeans, the major commodities produced in District states. The combination of high prices, large grain and soybean stocks, and the opportunity that farmers had to voluntarily withdraw from the three-year corn reserve apparently resulted in seasonally large marketings and a much improved cash flow for farmers this summer. These cash inflows to farmers were probably an important factor behind the faster deposit growth, the stepped-up loan repayment rate, and the improved availability of funds at district agricultural banks.

Activity at other commercial farm lenders has slowed considerably in recent months. Year-to-year gains in

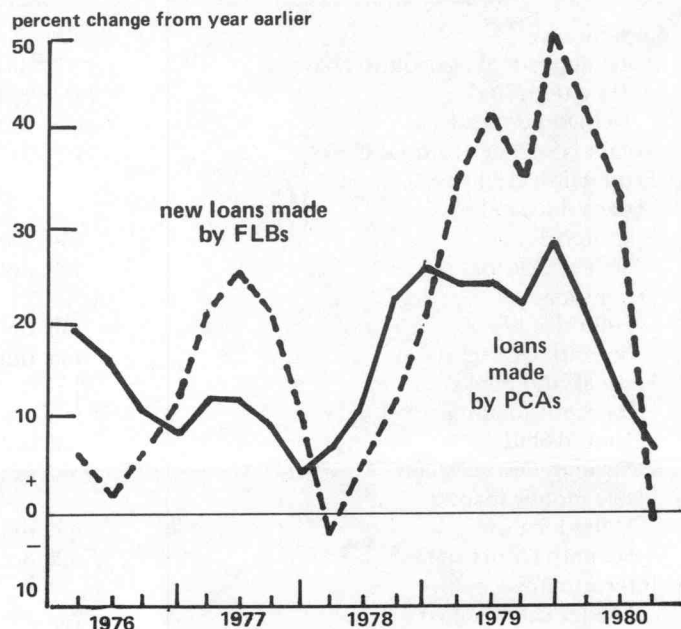
loans made by production credit associations—banks' chief competitor for nonreal estate farm loans—narrowed from 12 percent in the second quarter to 7 percent in the third quarter. These smaller increases follow seven consecutive quarters when year-to-year increases in loans made by PCAs averaged 24 percent. Because of the slowing, loans outstanding at PCAs have risen only 10 percent since the end of last year. The increase in outstandings is well below the PCAs' average December-to-September increase of 15 percent.

In the farm mortgage market, new money loaned by federal land banks slowed abruptly this summer, while the volume of farm mortgages acquired by life insurance companies fell sharply. New money loaned by FLBs in the third quarter dipped below the year-earlier level, a marked departure from the average year-to-year gain of 37 percent in the preceding seven quarters. Farm mortgages acquired by life insurance companies in July were down 60 percent from the year before, a considerably bigger decline than had occurred in the second quarter. Because of a sharp decline in new commitments made earlier in the year, acquisitions by life insurance companies probably held at a very depressed level throughout the third quarter.

Farm lending by the FmHA has shown substantial increases in recent months, and the trend will continue in the months ahead. Because of the widespread drought and the financial pressures facing many farmers, loans provided through the Farmers Home Administration's two emergency loan programs will be substantial in the months ahead. Based on a recent survey of FmHA offices, the USDA projects that new obligations for the FmHA's Emergency (disaster) Loan Program may reach \$5.2 billion in fiscal 1981. If that level materializes, it will be more than double the \$2.3 billion in obligations assumed in fiscal 1980. In addition, outstanding loans under the FmHA's Economic Emergency Loan Program are expected to reach the statutory ceiling of \$6 billion in fiscal 1981. Between the unobligated funds still remaining and the recycling of principle payments, new obligations for that program are projected to total \$1.2 billion in fiscal 1981. In fiscal 1979 and 1980—the only two years this program has existed—obligations were \$3.1 billion and \$2.2 billion, respectively. Lending levels for the other FmHA farmer loan programs in fiscal 1981 will probably be about the same as the slightly expanded levels of fiscal 1980.

The outlook includes a number of caveats, but bankers are expecting some aspects of the overall credit situation will show further improvement in the months ahead. By a substantial margin, bankers in all District

Lending activity at PCAs and FLBs slowed this summer



states expect farm loan repayment rates this fall and winter will exceed the declining levels of the year before. More than a fifth of the bankers believe that the frequency of defaults on farm loans in the next few months will be less than a year ago, while only a tenth are expecting an increase. On a less optimistic note, however, bankers in all District states except Iowa expect that the need to refinance short-term debt with long-term debt may be higher in the months ahead.

Other potential developments for the near-term are mixed. High commodity prices and prospects for further improvement in farm earnings suggest that deposit growth at rural banks may continue to be fairly strong. Strong deposit growth and faster loan repayments could result in further improvement in fund availability at rural banks.

Bankers will probably try to expand their loan portfolios as a result of the improved fund availability. Although high farm earnings usually generate stronger loan demand—particularly to finance capital expenditures—farm loan demand may be held in check a few more months by high interest rates. The uptrend in market rates of interest that has continued through mid-November has resulted in higher costs of funds at rural banks. While future trends in market rates of interest are uncertain, it is clear that the high cost of funds to rural banks will hold loan rates at a high level for the next few months.

Gary L. Benjamin

Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from	
				Prior period	Year ago
Farm finance					
Total deposits at agricultural banks†	1972-73=100	October	221	+ 3.1	+ 9
Time deposits	1972-73=100	October	272	+ 2.4	+12
Demand deposits	1972-73=100	October	136	+ 5.7	+ 1
Total loans at agricultural banks†	1972-73=100	October	254	+ 0.5	- 1
Production credit associations					
Loans outstanding					
United States	mil. dol.	September	19,911	- 0.9	+14
Seventh District states	mil. dol.	September	4,116	- 0.1	+16
Loans made					
United States	mil. dol.	September	2,087	+ 9.3	+11
Seventh District states	mil. dol.	September	425	+12.0	+ 9
Federal land banks					
Loans outstanding					
United States	mil. dol.	September	34,852	+ 1.0	+23
Seventh District states	mil. dol.	September	8,182	+ 0.9	+28
New money loaned					
United States	mil. dol.	September	453	+ 7.0	+10
Seventh District states	mil. dol.	September	96	- 0.7	- 9
Interest rates					
Feeder cattle loans††	percent	3rd Quarter	14.12	- 9.2	+26
Farm real estate loans††	percent	3rd Quarter	13.59	- 8.3	+22
Three-month Treasury bills	percent	10/30-11/5	12.95	+14.2	+ 6
Federal funds rate	percent	10/30-11/5	13.99	+11.1	+ 2
Government bonds (<i>long-term</i>)	percent	10/30-11/5	12.27	+ 7.7	+18
Agricultural trade					
Agricultural exports	mil. dol.	September	3,236	- 0.2	+18
Agricultural imports	mil. dol.	September	1,242	- 6.2	- 2
Farm machinery sales^P					
Farm tractors	units	September	10,999	+45.5	+ 3
Combines	units	September	4,114	+95.8	-26
Balers	units	September	1,184	-32.3	-35

†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.

^PPreliminary.

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