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CREDIT CONDITIONS AT DISTRICT AGRICULTURAL BANKS during the second quarter were characterized by a marked improvement in liquidity, an unusually soft demand for farm loans, and a "sticky" decline in interest rates charged on farm loans. These findings represent the consensus view from a recent survey of about 550 district agricultural banks.

The improved liquidity conditions at rural banks are evident in several measures. The index of available funds, for instance, rose from the unprecedented low of 49 in the first quarter to 108 in the second quarter (see table on page 2). This measure represents a composite of the nearly one-third of the banks that reported fund availability exceeded the year-earlier level compared to only a fourth that reported a decline. The remaining bankers indicated fund availability was equal to a year ago. This was the first time in three years that the proportion of bankers reporting an increase in fund availability has exceeded the proportion reporting a decline.

The improved liquidity conditions are also reflected in the contraseasonal decline in loan/deposit ratios during the second quarter. At midyear loan/deposit ratios at district agricultural banks averaged 65 percent, down from 66.4 percent at the end of the first quarter and the lowest in two years. In conjunction with the decline in loan/deposit ratios, less than a third of the banks consider their ratio to be too high, the smallest proportion of bankers to hold such a view in over three years.

The improved liquidity conditions at rural banks stem from several developments. The second-quarter slide in market rates of interest had a two-pronged impact on improving the availability of funds. Rural banks were less inclined to invest new funds in securities and other instruments following the downturn in interest rates. Moreover, the downturn in market rates of interest probably generated unrealized gains in the security portfolios of many rural banks. Banks in need of funds to meet credit demands are far more inclined to liquidate securities if the securities can be sold at a gain. U.S. Treasury securities and obligations of other U.S. government agencies account for about a sixth of the assets at agricultural banks. Obligations of states and political subdivisions account for an eighth of the assets.

The improved liquidity as reflected in the contraseasonal decline in loan/deposit ratios is the result of an abnormal decline in loans and continued—but slow—growth in deposits. At district agricultural banks that are members of the Federal Reserve, outstanding loans declined 2 percent during the second quarter, while deposits rose nearly 2 percent. Because of the recent trends, loans at member agricultural banks are only 2 percent higher than a year ago, while deposits are up a modest 6 percent.

The recent downturn in total loans apparently reflects an extremely soft demand for all types of credit at agricultural banks, including the demand for farm loans. In the most recent survey the second-quarter measure of farm loan demand dropped to 65, sharply below even the unprecedented low of the first quarter. The soft demand probably stems from the comparatively high interest rates banks are charging on farm loans. Typical bank rates on feeder cattle and farm operating loans averaged 14 percent at midyear, well below the 17 percent average at the end of March, but higher than a year earlier and above rates charged by other short-term agricultural lenders.

The sluggish decline in rates charged on bank loans can be partly traced to the earnings squeeze that gripped banks earlier this year. At the end of last year, money market certificates of deposit (MMCs) and time deposits in excess of $100,000 accounted for nearly a third of total time and savings deposits at district agricultural banks and nearly a fourth of all deposits. Unlike other types, these deposits offer interest rates more nearly in line with alternative market rates of interest. Although hard data is not yet available, numerous reports would suggest that these interest-cost sensitive deposits grew rapidly with the first-quarter surge in

Selected measures of credit conditions at Seventh District agricultural banks

	Loan demand	Fund availability	Loan repayment rates	Average rate on feeder cattle loans[1]	Average loan-to-deposit ratio[1]	Banks with loan-to-deposit ratio above desired level[1]
	(index)[2]	*(index)*[2]	*(index)*[2]	*(percent)*	*(percent)*	*(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

[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. Most of the growth was at the expense of declines in lower-cost demand and savings deposits, sharply escalating the overall cost of funds to rural banks. Although market rates of interest have since declined, the impact on the cost structure at rural banks will not become especially evident until the six-month MMCs that were opened earlier this year mature this summer.

Among individual district states, there were few exceptions to the overall evidence of sluggish loan demand and improved liquidity. Bankers in all five district states reported loan demand continued soft in the second quarter, even those in Iowa who were the exception in reporting a fairly strong loan demand in the first quarter. With the exception of Wisconsin, bankers in all district states indicated that fund availability had improved. And with the exception of Iowa, average loan/deposit ratios in all district states are below earlier peaks. The biggest declines in average loan/deposit ratios occurred among agricultural banks in Illinois and Indiana.

Recent developments among other agricultural lenders paint a somewhat different picture with respect to agricultural loan demand. Lending by the Cooperative Farm Credit System has been very strong this year, although the pace slowed somewhat during the second quarter. Loans made by production credit associations during the first half exceeded year-earlier levels by 17 percent and exceeded the level of two years ago by 45 percent. New loans made by federal land banks during the first half were up 37 percent from a year ago and up 90 percent from two years ago. This rapid pace pushed outstanding loans at PCAs 12 percent above the ending 1979 level and 21 percent above the year before. At FLBs midyear outstandings were 13 percent higher than at the end of last year and 24 percent higher than the year before. At PCAs and FLBs located in district states, the year-to-year gains in loans outstanding were even larger than the increases recorded nationwide.

Lending by the Farmers Home Administration has continued very strong over the past year and the trend will continue in the months ahead. Farm loans held by the FmHA as of the end of June were up 30 percent from the year before. Of the roughly $18 billion in total outstandings, the Emergency (disaster) Loan program accounted for $7.5 billion and the Economic Emergency loan program accounted for $4.1 billion. Both of these programs will register substantial growth in the months ahead because of the extensive drought damage throughout much of the United States. The midyear outstandings in the Economic Emergency loan program included only a nominal amount of the recent surge in new lending that has occurred because of legislation this spring that raised the ceiling on total obligations for this program from $4 billion to $6 billion. Since March, nearly $1.2 billion in new funding has been allocated for this program. The remaining $850 million will become available this fall, along with a reallocation of principal repayments on previously extended Economic Emergency loans. The Emergency (disaster) Loan program, which has no statutory ceiling, is available to farmers who suffer a loss of 20 percent or more as a result of a natural disaster. Under this program loans to cover losses (up to a maximum of $500,000) are available at 5 percent interest. Over 800 counties—including all of Alabama, Arkansas, Missouri, North Dakota, and Tennessee—have already been declared disaster areas because of drought and the total is growing rapidly.

For the rest of this year, rural bankers remain fairly pessimistic about rural credit conditions. Nearly half expect deposit growth will be slower than normal and only 5 percent expect faster growth. About half of the bankers expect farm loan repayment rates will be normal. But of the remainder, those expecting slower than normal loan repayments exceed those expecting faster repayments by a margin of more than 6 to 1. Bankers generally expect their improved liquidity positions to hold, but the net proportion of bankers anticipating an increase in their loan/deposit ratios is fairly small. Two-thirds of the banks, however, expect interest rates they charge on farm loans will trend lower during the second half.

Some of these views may be altered by the recently improved prospects for farm earnings. The sharp uptrend in commodity prices since early June portends substantially larger receipts from farm marketings. The increased earnings may strengthen deposit growth, and—if rates on farm loans trend lower and become competitive with other agricultural lenders—foreshadow a rebound in capital expenditures and farm loan demand at agricultural banks. Whatever the impact of the better earnings picture, the improved liquidity positions and the prospects for lower interest rates suggest rural banks are approaching their best position in recent years to finance rural credit demands.

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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	July	244	+ 5.2	0
Crops	1967=100	July	236	+ 4.4	- 1
Livestock	1967=100	July	251	+ 5.9	+ 1
Index of prices paid by farmers	1967=100	July	280	+ 0.7	+11
Production items	1967=100	July	273	+ 1.1	+ 9
Producer price index* *(finished goods)*	1967=100	June	243	+ 0.7	+14
Foods	1967=100	June	231	+ 0.4	+ 3
Processed foods and feeds	1967=100	June	234	+ 0.3	+ 6
Agricultural chemicals	1967=100	June	258	− 0.2	+23
Agricultural machinery and equipment	1967=100	June	256	+ 0.3	+12
Consumer price index** *(all items)*	1967=100	June	248	+ 1.1	+14
Food at home	1967=100	June	248	+ 0.6	+ 6
Cash prices received by farmers					
Corn	dol. per bu.	July	2.73	+ 9.6	+ 3
Soybeans	dol. per bu.	July	6.97	+17.9	- 5
Wheat	dol. per bu.	July	3.82	+ 3.5	- 2
Sorghum	dol. per cwt.	July	4.92	+ 7.4	+10
Oats	dol. per bu.	July	1.59	+ 7.4	+20
Steers and heifers	dol. per cwt.	July	67.10	+ 3.1	- 3
Hogs	dol. per cwt.	July	41.00	+23.9	+ 8
Milk, all sold to plants	dol. per cwt.	July	12.50	0	+ 8
Broilers	cents per lb.	July	31.7	+29.9	+28
Eggs	cents per doz.	July	50.7	+ 4.8	- 6
Income *(seasonally adjusted annual rate)*					
Cash receipts from farm marketings	bil. dol.	2nd Quarter	128	- 3.2	0
Net farm income	bil. dol.	2nd Quarter	20	-26.8	-41
Nonagricultural personal income	bil. dol.	June	2,044	+ 0.4	+10

*Formerly called wholesale price index.

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