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TRENDS IN LOANS AND DEPOSITS AT DISTRICT AGRICULTURAL BANKS this year have deviated markedly from the pattern of the 1970s. Among banks that are members of the Federal Reserve Bank of Chicago and heavily involved in farm lending, outstanding loans declined more than 2 percent between December and May. The downturn is unprecedented by the standards of the 1970s. During the past decade the December-to-May growth in total loans at such banks ranged from 2.7 percent to 8.6 percent and averaged 5.8 percent. Deposits at member agricultural banks have trended higher this year, but the increase has been the smallest in over a decade. The 1.5 percent increase in deposits this year compares to an average December-to-May increase of 4.5 percent in the 1970s.

Virtually all of the decline in loans at member agricultural banks has occurred since March. This suggests the decline may be related more to a fall-off in loan demand—due to high interest rates, impacts from the imposition of credit controls, and a sharp decline in farm earnings and the overall economy—rather than curtailed lending policies of banks. Evidence is not yet available as to what types of credit have led the cutback in loans at agricultural banks. But most types of credit demand have probably slackened in rural areas. Rural communities have not been immune from the sluggishness in auto sales and overall retail sales, suggesting a downturn in consumer loan demand. The soft housing market also probably extends into rural areas, with a likely downturn in mortgage lending. And evidence of a sharp decline in unit retail sales of farm equipment is probably the most vivid reflection of a softening in farm loan demand at rural banks.

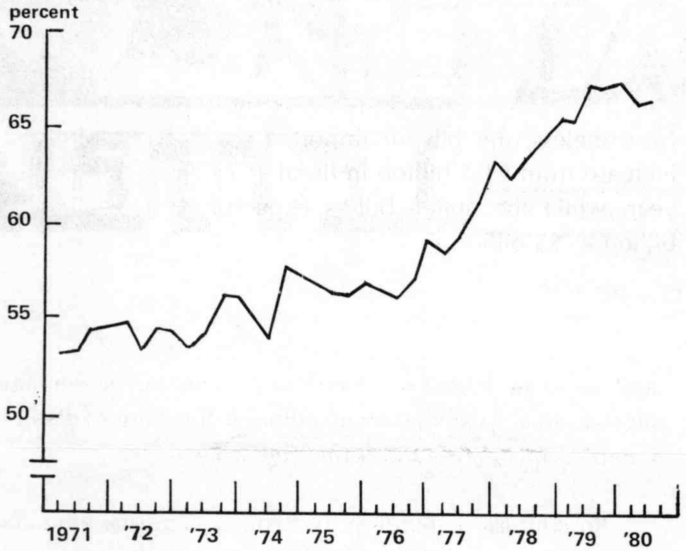
Deposits at district agricultural banks, in addition to slow overall growth, have undergone a substantial restructuring this year. Demand deposits (checking account balances) at member agricultural banks have declined nearly 13 percent since December, and in May were at the lowest level since the summer of 1975. Although an irregular downturn during the first five months of the year is fairly typical, the December-to-May decline in demand deposits this year was nearly double the largest decline recorded for that period during the 1970s.

In contrast to the drop in demand deposits, time and savings deposits at member agricultural banks have risen more than 6 percent this year. This is slightly ahead of the December-to-May rise the previous two years, but lags the average of nearly 8 percent recorded in the 1970s. Time and savings deposits typically account for about two-thirds of all deposits at agricultural banks.

The decline in demand deposits and the rise in time and savings deposits have substantially raised the cost of funds to agricultural banks. The increase in time and savings deposits was dominated by growth in the six-month money market certificates (MMCs). Unlike the fixed-interest rates applicable for most other time and savings deposits, regulations permit banks to offer interest rates on MMCs more nearly in line with general market rates of interest. As interest rates soared earlier this year, interest rates that banks could offer on MMCs—which require a minimum balance of $10,000—rose to a peak of more than 15 percent in late March. Because of the interest-sensitivity of local deposits, banks had to offer the maximum rates in order to maintain their deposit base. Indications that a large volume of funds moved from other deposits into MMCs suggest that the average cost of funds for rural banks is well above historical levels. These higher costs will have a major impact on margins at banks for the next few months, even though interest rates have subsequently dropped markedly.

The tight liquidity pressures at rural banks in the late 1970s and earlier this year are still evident. However, there are a number of encouraging signs that the pressures are starting to ease. The decline in loans so far this year and the nominal rise in deposits has pulled loan/deposit ratios at most rural banks below year-ago peaks. This marks the first time since the mid-1970s that the ratios have fallen below year-earlier levels.

Loan/deposit ratios at district agricultural banks are down from last year's peaks



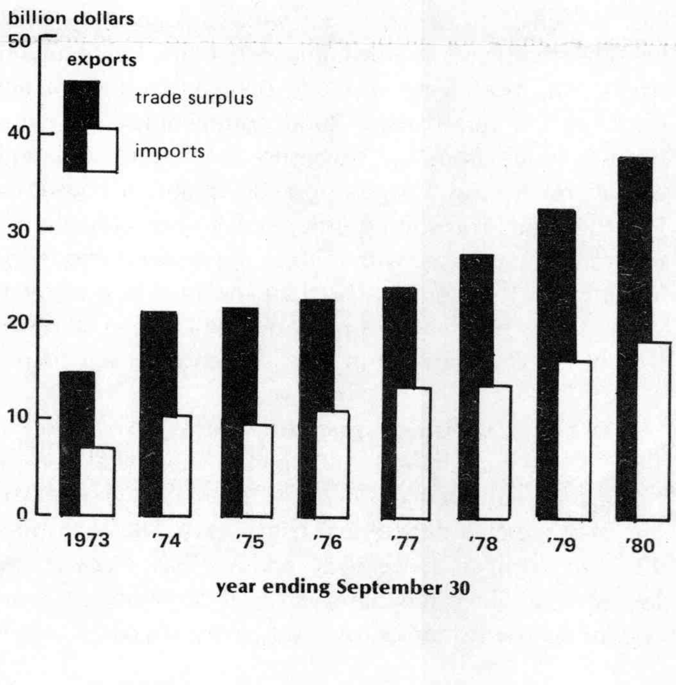
Sharp declines in market rates of interest since March may also improve rural bank liquidity, particularly as it relates to funds available for lending. Because rates on several financial instruments are presently at the lowest level in a year or two, security portfolios at most rural banks now probably show an unrealized profit. In comparison to the losses that existed earlier this year when interest rates were escalating, the unrealized profits offer banks greater flexibility for liquidating securities should loan demand strengthen in the future. Moreover, declines in interest rates on financial securities have undoubtedly outpaced declines in rates banks charge on loans. As a result, prospective returns on loans compare more favorably with returns on alternative investments for banks. The more favorable returns on loans may be particularly important in light of the higher average cost of funds that now face rural banks following the restructuring of deposits earlier this year.

New regulations defining the ceiling interest rates that banks can pay on six-month MMCs represent further evidence that the liquidity pressures at rural banks may be easing. In the past, ceiling rates that banks could pay on MMCs were set equal to the rates on new issues of six-month Treasury bills. Under new regulations that became effective last week, the ceiling for banks rises to 25 basis points above the Treasury bill rate. Moreover, when Treasury bill rates fall to 7.5 percent or lower, as was the case this week, the ceiling that banks can pay holds at a minimum of 7.75 percent under the new regulations. Although banks in all cases have the option of paying less than ceiling rates, the new regulations will enhance the ability of banks that need funds to retain local deposits at all rates of interest. This will be particularly true if Treasury bill rates hold below 7.5 percent.

U.S. AGRICULTURAL EXPORTS are expected to reach $38 billion in the year ending in September, according to recently revised estimates by the USDA. The latest estimate portends an increase of $6 billion from the record set in fiscal 1979. The increase for fiscal 1980, however, had already been achieved by April. From October to April, agricultural exports totaled $24.8 billion, a third higher than during the same months the year before. The latest estimate suggests that exports during the rest of this fiscal year may be nominally below the year-ago pace.

The latest estimate for fiscal 1980 is identical to the projection made prior to the imposition of the Soviet embargo in January and is $1 billion above the USDA's previous post-embargo estimate. A similar pattern exists for the revisions in projected export tonnage. More than 158 million metric tons of agricultural commodities are now expected to be exported this year, virtually unchanged from the pre-embargo estimate and up 4 percent from the post-embargo estimate.

Big increase in exports will lead to record agricultural trade surplus in fiscal 1980



The tonnage estimate for fiscal 1980 is impressive, particularly in light of the embargo, various internal transportation bottlenecks, and earlier doubts by some analysts as to whether capacity constraints would permit such large shipments. The revised tonnage estimate portends an increase of 16 percent from fiscal 1979 and an increase of 60 percent from the mid-1970s. Mild weather this winter contributed to the large shipments, helping to hold the average monthly volume of exports at 14 million metric tons during October–April. Continuation of that pace during the remainder of fiscal 1980 would result in an even bigger volume of shipments than the USDA is presently forecasting.

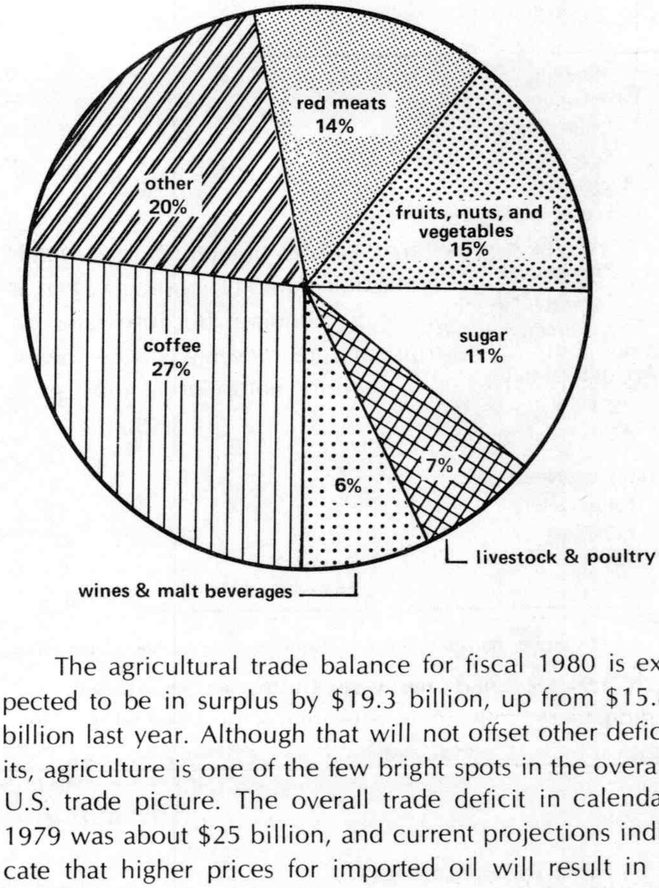
Grains and soybeans account for about 90 percent of the export tonnage projected for this fiscal year. More than 35 million metric tons of wheat and flour are expected to be exported, up from 32.2 million tons in fiscal 1979. Feed grain exports are expected to reach 71 million metric tons compared with 59.5 million last year. Shipments of soybeans are estimated at 22.5 million metric tons, while shipments of soybean meal and oil are expected to reach 7.8 million tons. In fiscal 1979, soybean exports totaled 20.2 million tons and meal and oil exports totaled 7.1 million.

The projected increase in wheat and feed grain shipments had already been achieved by April 1. Therefore, shipments of wheat and flour between May and September could fall 9 percent below last year's pace without jeopardizing the tonnage estimate for all of fiscal 1980. Similarly, feed grain exports during May–September could be down 4 percent from the year before and the record 71 million metric tons projected for all of fiscal 1980 could still be achieved. In contrast, soybean shipments will have to hold nearly 16 percent higher than last year if the tonnage estimate for all of fiscal 1980 is to be realized.

With the exception of the Soviet Union, agricultural exports to most areas of the world are expected to be higher in fiscal 1980. Because of the embargo, the value of shipments to the Soviet Union will likely decline from $2.2 billion last year to $1.5 billion. In contrast, exports to Western Europe are projected to rise from $9.7 billion last year to $11.8 billion, while exports to Eastern Europe are likely to increase from $1.5 billion a year ago to $2.5 billion. Exports to Asian countries are projected to reach $14 billion this year, up from $11.7 billion in fiscal 1979. The Asian estimate includes $5.6 billion to Japan—the leading importer of U.S. agricultural commodities—and $1.5 billion to China. Shipments to Latin American countries are projected to rise from $3.4 billion in fiscal 1979 to $4.6 billion this year.

Agricultural imports are expected to total $18.7 billion this fiscal year, up from $16.2 last year. The bulk of the increase reflects higher prices for sugar and coffee, which together account for about 37 percent of all imported agricultural commodities. The volume of sugar and coffee imports is projected to decline slightly this year. Nevertheless, the bill for imported sugar is projected to increase from $1.1 billion in fiscal 1979 to $2 billion this year, while the coffee bill is expected to rise from $4 billion to $5 billion.

Agricultural imports
($18.7 billion)



The agricultural trade balance for fiscal 1980 is expected to be in surplus by $19.3 billion, up from $15.8 billion last year. Although that will not offset other deficits, agriculture is one of the few bright spots in the overall U.S. trade picture. The overall trade deficit in calendar 1979 was about $25 billion, and current projections indicate that higher prices for imported oil will result in a much larger deficit this year.

Consistent surpluses in agricultural trade have a short history of less than 25 years. Prior to the late 1950s, except during World War II, agricultural imports consistently exceeded exports. During the 1960s and early 1970s, the annual agricultural trade surplus ranged from $500 million to $2.3 billion (in 1967). Since the commencement of large grain sales to the Soviet Union in 1973, the agricultural trade surpluses have escalated rapidly.

Gary L. Benjamin

Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from: Prior period	Percent change from: Year ago
Farm finance					
Total deposits at agricultural banks†	1972-73=100	May	205	− 0.5	+ 7
Time deposits	1972-73=100	May	258	+ 0.2	+12
Demand deposits	1972-73=100	May	116	− 3.2	−10
Total loans at agricultural banks†	1972-73=100	May	253	− 1.1	+ 3
Production credit associations					
Loans outstanding					
United States	mil. dol.	April	19,498	+ 2.9	+23
Seventh District states	mil. dol.	April	4,035	+ 0.5	+27
Loans made					
United States	mil. dol.	April	2,977	− 7.1	+14
Seventh District states	mil. dol.	April	669	−14.6	+13
Federal land banks					
Loans outstanding					
United States	mil. dol.	April	32,425	+ 2.6	+23
Seventh District states	mil. dol.	April	7,569	+ 3.3	+30
New money loaned					
United States	mil. dol.	April	935	+ 3.4	+61
Seventh District states	mil. dol.	April	266	−21.2	+85
Interest rates					
Feeder cattle loans††	percent	1st Quarter	15.32	+21.6	+49
Farm real estate loans††	percent	1st Quarter	14.60	+19.5	+41
Three-month Treasury bills	percent	5/29-6/4	7.71	−20.3	−19
Federal funds rate	percent	5/29-6/4	10.74	−17.1	+ 5
Government bonds *(long-term)*	percent	5/22-5/28	10.19	− 7.3	+13
Agricultural trade					
Agricultural exports	mil. dol.	April	3,468	− 5.9	+31
Agricultural imports	mil. dol.	April	1,432	− 6.1	− 3
Farm machinery sales ᴾ					
Farm tractors	units	April	10,627	+ 2.2	−47
Combines	units	April	1,012	−17.2	−45
Balers	units	April	821	+38.4	− 3

†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.

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