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FEDERAL RESERVE BANK OF CHICAGO

# AGRICULTURAL

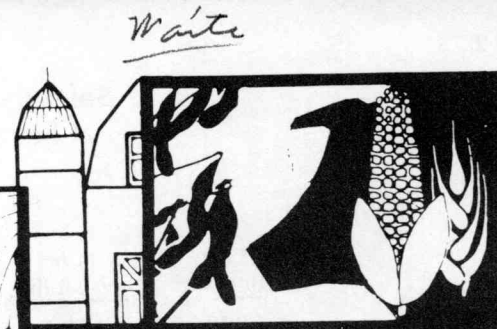
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# LETTER



**AGRICULTURAL CREDIT CONDITIONS** in the Seventh Federal Reserve District were greatly unsettled by several developments in the first quarter. In an unprecedented manner, interest rates sky-rocketed from already high levels. A new credit restraint program was announced in mid-March, causing confusion about the implications for farmers and small businesses. On top of this, earlier projections of a sharp decline in farm earnings this year were vividly reflected in a squeeze between lower farm commodity prices and sharply higher production costs.

These developments came rapidly to a head in the latter half of March. Although a number of related issues were involved, the general concerns for rural credit markets were—and to some extent, still are—the availability of farm credit and the possible impacts of the high cost of credit and a decline in farm earnings on highly leveraged farmers. In some quarters, the characterizations used to depict the situation were probably the most pessimistic since the Depression. But without minimizing some very real problems that did emerge and some real consequences that might be in store in the unlikely event that conditions do not improve, those depictions probably overstated by a wide margin the extent of the current situation.

The events that unfolded in the first quarter were evident in the results of our April 1 survey of district agricultural banks. Results show a further tightening in the available funds for farmers, a fall-off in farm loan demand, a surge in the rates banks charge on farm loans, and a slight downturn in farmland values. (A summary of first-quarter trends in farmland values will be the topic of the next issue of *Agricultural Letter*.)

**Farm loan demand** at district agricultural banks tailed off sharply in the first quarter. The measure of farm loan demand fell to 86 (see table on page 2), indicating that the proportion of bankers that reported farm loan demand was less than a year ago exceeded the proportion that reported a year-to-year gain in loan demand by 14 percentage points. That represents the first time in the 15-year history of quarterly surveys that the measure of loan demand has fallen below 100. The only exception to

the soft loan demand was in Iowa, where most bankers reported farm loan demand higher than a year ago.

The fall-off in farm loan demand at rural banks is probably due mostly to farmers' cutbacks in all but essential borrowings because of high interest rates. Also, the availability of lower-cost loans from other sources, such as production credit associations, federal land banks, and government lending agencies, probably also contributed to the softer demand at rural banks.

The soft farm loan demand is expected to continue into the current quarter, although the picture varies widely by type of loan. Demand for operating loans was expected to hold above year-earlier levels, no doubt reflecting the increased cost of fuel and fertilizer. On the other hand, a vast majority of the bankers project a decline in the demand for feeder cattle and farm machinery loans.

**Interest rates** charged on farm loans by district agricultural banks increased sharply during the first quarter. Districtwide, rates on feeder cattle loans and farm operating loans averaged more than 17 percent. Rates on farm mortgage loans averaged nearly 16¼ percent. For feeder cattle and operating loans, that marks a rise of 3½ percentage points from three months earlier and a rise of 5½ percentage points from six months earlier.

Rates varied widely both within district states and between district states. This reflected the difficulties bankers faced in pricing loans because of the unusual volatility in interest rates and cost of funds. In Iowa and Wisconsin, it also reflected the uncertainties and the constraints of usury ceilings. In Wisconsin, for instance, the usury ceiling on farm loans was 12 percent until recent legislation at the federal and state levels overrode the ceiling.

The surge in rates on bank loans to farmers reflects the much higher cost of funds at rural banks. Local depositors have become far more aware of returns on alternative uses of deposits. Reports indicate the recent surge in short-term market rates of interest resulted in a

## Selected measures of credit conditions at Seventh District agricultural banks

	<u>Loan demand</u> (index) <sup>2</sup>	<u>Fund availability</u> (index) <sup>2</sup>	<u>Loan repayment rates</u> (index) <sup>2</sup>	<u>Average rate on feeder cattle loans<sup>1</sup></u> (percent)	<u>Average loan-to-deposit ratio<sup>1</sup></u> (percent)	<u>Banks with loan-to-deposit ratio above desired level<sup>1</sup></u> (percent of banks)
<b>1975</b>						
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
<b>1976</b>						
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
<b>1977</b>						
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
<b>1978</b>						
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
<b>1979</b>						
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
<b>1980</b>						
Jan-Mar	86	49	51	17.09	66.2	51

<sup>1</sup>At end of period.

<sup>2</sup>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.

substantial restructuring of deposits at rural banks. Demand deposits, passbook savings deposits, and premature rollovers of lower-yielding time deposits were converted into "money market certificates of deposits" (MMCs), which permit banks to pay interest more nearly equivalent to market rates.

Nearly all the banks that responded to the latest survey indicated that they were offering six-month MMCs and paying the maximum rate permitted on such accounts. Moreover, eight out of 10 of the banks were allowing customers to prematurely roll over existing time deposits—at a penalty to the depositor—in order to take advantage of the higher yields on new MMC ac-

counts. These actions resulted in a much higher cost of funds to rural banks and, no doubt, prevented a substantial decline in deposits.

**Evidence of liquidity pressures** at rural banks was somewhat mixed in the latest survey. On the one hand, loan-to-deposit ratios at the end of the first quarter were little changed from the ending 1979 level and down 1 percentage point from the high year-earlier level. That marked the first year-to-year decline in the average loan/deposit ratio since March 31, 1976. The average ratios were equal to or below a year ago in all district states. They were down most at banks in the district portion of Illinois.

Alternatively, the measure of fund availability—which also relates to bank liquidity—fell below the previous low set one year ago. The low measure of fund availability reflects numerous factors. As a year ago, abnormally slow deposit growth over the previous six months was probably the major factor. In addition, escalating market rates of interest greatly strengthened short-run profit prospects from alternative investments for banks, particularly in Iowa and Wisconsin, where usury ceilings held prospective returns on loans to farmers at a competitive disadvantage. The measure of fund availability was especially low in those two states.

Rural banks are imposing more stringent collateral requirements on farm borrowers this year, and—when necessary—denying or scaling down the loan requests from more than the usual number of farm borrowers. The more restrictive stance in accommodating farm loan requests is most apparent for requests to finance capital expenditures and real estate purchases or improvements. The increased restrictiveness is much less apparent for requests to finance operating expenses or to refinance or restructure existing farm loans.

The greater restrictiveness in rural credit markets also extends to the credit policies of merchants and dealers serving farmers. A huge majority of the responding bankers indicate the credit policies of local suppliers of feed, fuel, fertilizer, and farm machinery are tighter than a year ago. This suggests that local dealers and suppliers are probably raising interest charges on accounts receivable, requesting quicker payments, or maybe in some cases requiring “cash on the barrel-head.” Despite these tighter policies, a number of reports indicate that farm equipment manufacturers are financing a much larger proportion of their farm equipment sales.

**Recent developments** promise at least some relief from conditions in rural credit markets. Market rates of interest have turned down, substantially in some cases. The recent opening of the corn reserve to farmers that did not comply with acreage set-aside requirements last year and new funding for the FmHA's Economic Emergency Loan Program also promise some relief. The reserve opening could provide up to \$700 million to farmers through CCC loans and storage payments. Half of the \$2 billion increase in obligations authorized for the Economic Emergency Loan Program were recently allocated for the remainder of fiscal 1980. District states have received nearly \$200 million of this, including an \$11 million supplemental allocation this week in Iowa. Iowa's initial \$42 million allocation was exhausted by mid-April.

**Actions by the Federal Reserve System** also promise some relief for the tight rural credit markets. On April 17,

the Fed clarified the intent of the Credit Restraint Program for small banks and announced a temporary program to help small banks meet priority credit needs of their communities. Despite guidelines that annual loan growth at individual banks should not generally exceed 9 percent, it is the intent of the Credit Restraint Program that banks meet the ordinary continuing or seasonal credit needs of farmers and small businesses. In other words, it is the intent of the program that the constraint on total loan growth fall on less urgent forms of lending—such as unsecured personal loans, loans to finance speculative activities or postponable capital acquisitions—and on customers who have access to non-bank sources of financing. In clarifying the applicability of the program, the Fed announced that banks which are essentially confining their loan expansion to the ordinary or seasonal production needs of farmers and small businesses are justified in exceeding the 9 percent loan growth guideline.

To help small banks meet local credit needs, the Federal Reserve announced a temporary, more streamlined, seasonal borrowing privilege for banks with less than \$100,000 million in deposits and a loan-to-deposit ratio of 68 percent or higher. In accordance with legislation extending borrowing privileges from the Fed to all depository institutions, the program is available for the first time to banks that are not members of the Federal Reserve System. Eligible member banks, which have had access to seasonal borrowing privileges for several years, may also use the more streamlined program.

The new program essentially offers eligible banks a line of credit. The maximum line that a bank can obtain is equal to 5 percent of its loans. The bank can draw on the line to finance up to 70 cents out of every dollar of increase in its total loans. Terms on such borrowings extend up to six months, and—under special circumstances—nine months, although banks would be expected to repay a proportionate share of any borrowings if loans subsequently decline or if loan-to-deposit ratios turn lower. The interest rate on such borrowings is the Fed's basic discount rate (not including any surcharges), currently 13 percent.

It is up to the initiative of individual banks to avail themselves of the new seasonal borrowing program. Small member banks have historically borrowed sparingly from the Fed. Preliminary figures indicate, however, that about half the 2,800 banks in the Seventh Federal Reserve District meet the size and loan/deposit ratio criteria of the new program.

Gary L. Benjamin



# Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from	
				Prior period	Year ago
<b>Farm finance</b>					
Total deposits at agricultural bankst	1972-73=100	April	206	+ 1.3	+ 7
Time deposits	1972-73=100	April	257	+ 2.1	+13
Demand deposits	1972-73=100	April	120	- 1.4	-10
Total loans at agricultural bankst	1972-73=100	April	256	- 1.1	+ 6
Production credit associations					
Loans outstanding					
United States	mil. dol.	March	18,953	+ 2.9	+23
Seventh District states	mil. dol.	March	4,014	+ 4.3	+29
Loans made					
United States	mil. dol.	March	3,205	+ 7.5	+11
Seventh District states	mil. dol.	March	784	+ 5.5	+12
Federal land banks					
Loans outstanding					
United States	mil. dol.	March	31,603	+ 2.5	+22
Seventh District states	mil. dol.	March	7,330	+ 4.2	+28
New money loaned					
United States	mil. dol.	March	904	+28.8	+39
Seventh District states	mil. dol.	March	338	+98.8	+39
Interest rates					
Feeder cattle loanst†	percent	1st Quarter	15.30	+21.5	+49
Farm real estate loanst†	percent	1st Quarter	14.59	+19.4	+41
Three-month Treasury bills	percent	4/17-4/23	12.78	-18.1	+39
Federal funds rate	percent	4/17-4/23	17.56	- 1.2	+74
Government bonds (long-term)	percent	4/10-4/16	11.43	- 5.6	+26
<b>Agricultural trade</b>					
Agricultural exports	mil. dol.	February	3,355	+ 2.4	+42
Agricultural imports	mil. dol.	February	1,350	-19.1	+ 9
<b>Farm machinery sales P</b>					
Farm tractors	units	March	10,399	+34.4	-29
Combines	units	March	1,222	+23.3	+45
Balers	units	March	593	+83.6	+44

†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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