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AGRICULTURAL CREDIT CONDITIONS last year reflected high farm earnings, escalating interest rates, further large gains in farm debt, and a wide disparity in the contribution of major lenders to the increase in farm debt. USDA estimates now show that net farm income rose from the fairly high level of $27.9 billion in 1978 to $33.3 billion. Net income last year, in nominal terms, was equal to the 1973 record and, adjusted for inflation, was the third highest in 25 years. Despite favorable earnings and rising interest rates, farm debt continued on a sharp uptrend. It now appears that farm debt rose 16 percent last year, continuing the rapid increases of recent years. Because of liquidity pressures, however, the contribution of banks to last year's increase in farm debt was relatively small. Although the liquidity pressures facing district agricultural banks eased somewhat during the fourth quarter, conditions still remain quite tight.

The liquidity pressures facing district agricultural banks have been evident for the past several quarters. Liquidity problems are largely the result of strong loan demand, slow deposit growth, and the cyclical upswing in interest rates. The incentives for rural banks to make agricultural loans are typically undermined during periods of rising interest rates by the potential for higher yields on other investments and the capital losses that are likely to result from the liquidation of investment portfolios to meet loan demand.

A recent survey of more than 550 district agricultural banks shows some evidence that liquidity pressures eased in the fourth quarter. The measure of bankers' views about the availability of funds for farm loans, although still very low, edged up to the highest level in six quarters. (See table on page 2.) Likewise, average loan/deposit ratios, after holding fairly stable in the first three quarters, recorded more than the typical seasonal decline in the fourth quarter. The fourth-quarter decline in average loan/deposit ratios was evident in all district states except Iowa. Nevertheless, average ratios still equal or exceed year-earlier levels in all states except Illinois.

It appears the slight easing in liquidity pressures in the fourth quarter was related mostly to surging interest rates, which sharply lowered farm loan demand at rural banks. Changes in monetary policy procedures announced in early October led to a huge increase in rates charged on farm loans by banks. Interest rates on feeder cattle loans and farm operating loans, for instance, jumped 185 basis points in the fourth quarter. The fourth-quarter rise was more than the sharp gains posted during the first three quarters and boosted average rates for agricultural loans to more than 13½ percent. Rural bank rates on farm real estate mortgages also rose sharply, though not as much as rates for nonreal estate loans, and now average a little over 13 percent. A year ago, rates on all three types of farm loans averaged 10¼ percent or less, and two years ago the averages were a little under 9 percent.

The rise in interest rates no doubt contributed to a softer demand for farm loans at rural banks. In the latest survey, the measure of farm loan demand fell to a low unprecedented for at least the past decade. A softer loan demand was reported by banks in all district states, but the extent of the softening was most apparent in Michigan and Wisconsin and only nominally evident in Iowa.

The magnitude of the fourth-quarter downturn in the measure of farm loan demand at rural banks no doubt overstates the situation for agriculture as a whole. As evidence of this, PCAs—banks' chief competitor for nonreal estate farm loans—recorded an unusually strong performance in the fourth quarter. In district states, loans made by PCAs in the fourth quarter exceeded the year-earlier level by 28 percent. That represents an even larger year-to-year gain than had been recorded in the first three quarters and may indicate some switching of loan customers from banks to PCAs. Rates on PCA loans also increased during the latter part of 1979. But they rose only about half as much as rates charged by rural banks and retained a decided competitive edge over bank rates. If historical patterns are repeated, the competitive advantage will shift in bankers' favor when interest rates turn lower.

Total farm debt rose sharply again last year, capping a threefold increase for the decade of the 1970s. Preliminary figures show farm debt at the end of last year may have reached $159 billion. If that is correct, it marks

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

[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.

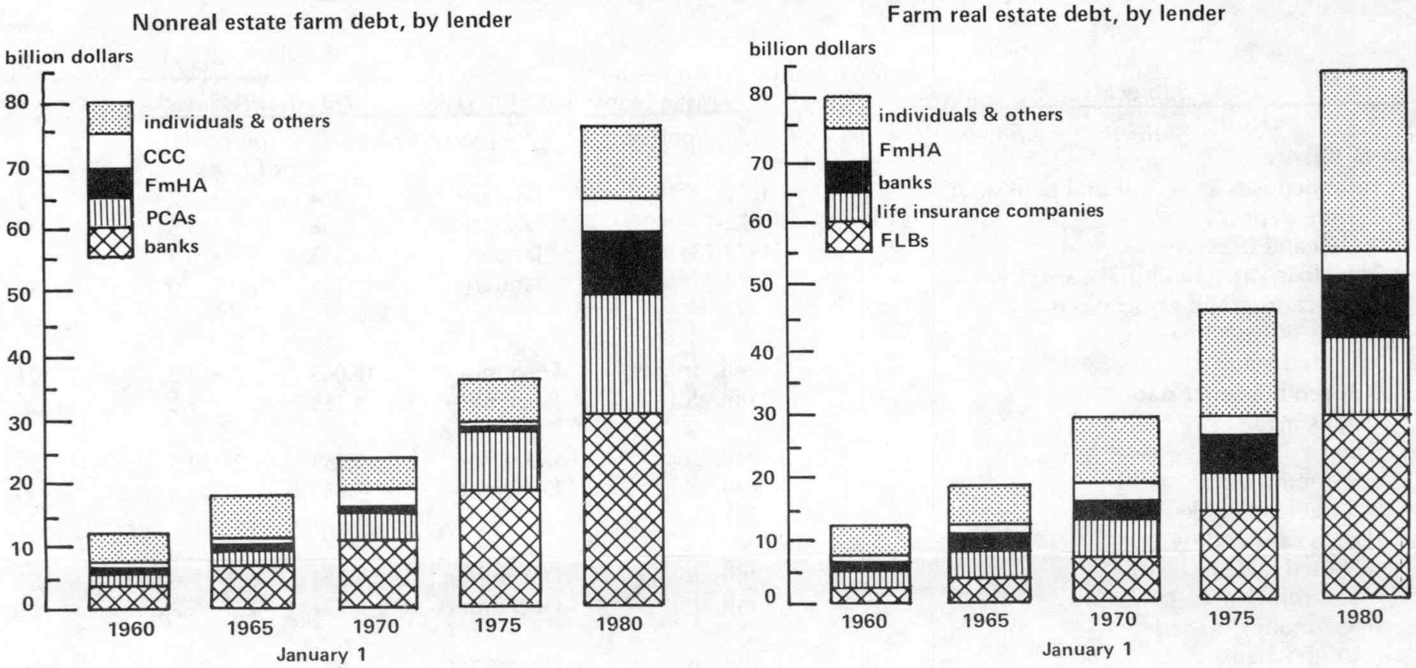
the third consecutive year that farm debt has risen 15 percent or more. Only two other years out of the past four decades have witnessed such large annual gains on farm debt.

Farm real estate debt rose about 15 percent last year, while nonreal estate farm debt, including CCC loans, rose about 16 percent. Contributions of major lenders to last year's increase in farm debt varied widely. Because of liquidity pressures, preliminary figures show farm real estate debt owed to banks rose less than 5 percent, while nonreal estate farm debt owed to banks rose only about 9 percent. The overall increase of about 8 percent was the third smallest annual increase in farm debt held by banks in the past decade. Interestingly, the other two years in which the rise in farm loans held by banks was smaller was in 1970 and 1974, also years of high interest rates and tight liquidity pressures at rural banks.

Competitors of banks in both nonreal estate and farm real estate lending scored much larger gains. For instance, farm mortgage loans held by federal land banks rose 20 percent last year, while those held by insurance companies rose 17 percent. Farm real estate loans held by individuals and others rose an estimated 14 percent. Nonreal estate farm loans held by production credit associations rose more than 20 percent. Similarly, nonreal estate loans held by the Farmers Home Administration (FmHA) soared more than 70 percent. For the FmHA, 1979 marked the fourth year out of the past five that nonreal estate farm loans held by the FmHA have risen 67 percent or more. Because of that rapid growth, the FmHA now holds 13 percent of the outstanding nonreal estate farm loans compared with only 3 percent five years ago.

Much of the growth in loans held by the FmHA in re-

Farm debt increased threefold during the 1970



cent years reflects various emergency lending programs designed to help farm borrowers recoup from natural disasters and periods of economic stress. The ironic feature is that last year's large growth occurred when there were few natural disasters and earnings were quite high for most farmers.

Last year's big increase in farm debt reflects a number of factors. Perhaps most important was the impact of inflation, which continued to cause large increases in prices of major inputs. Prices paid by farmers for production inputs last year averaged 14 percent higher than the year before. In addition, production expenses were rising because of expanded output. Harvested crop acreage was up 3 percent last year and large increases in pork and poultry production contributed to a slight increase in total livestock production. Last year's rise in debt also reflects the continuing uptrend in land values as well as another year of fairly strong capital expenditures by farmers.

The year ahead may present challenges for both farmers and their lenders. The USDA is projecting net farm income may decline a fourth to around $25 billion. That outlook is based on assumptions of only a nominal increase in cash receipts and another large increase in production expenditures. If that is correct and if consumer prices continue to rise at a double digit rate, real net farm income would decline almost a third next year, perhaps falling to the lowest level since the depression era. Although many analysts doubt the decline will be that much, all generally agree that the farm income picture looks much less optimistic for the start of the 1980s.

Prospects for lower farm earnings have mixed implications for farm lenders. On the one hand, low earnings and high interest rates usually result in a slowdown in capital expenditures by farmers. At the same time, however, demand for loans to finance current production will remain high. If there are no set-aside or paid diversion programs this year, crop acreage will likely remain very high. And production costs, particularly for fuel and fertilizer, are continuing to increase rapidly. Prospects for lower farm earnings suggest lenders may also receive slower repayments on farm loans, particularly if the decline in earnings is as much as the USDA expects.

The availability of credit for farmers will likely tighten somewhat this year. Rural banks will likely still face liquidity pressures for the next few months or at least until interest rates turn significantly lower and deposit inflows to rural banks pick up. The availability of mortgage funds from life insurance companies could be undermined by high policy loan demands and other investments. To help discourage new growth, most federal land banks have recently adopted loan fees ranging up to about 3 percent of the loan.

The availability of credit from government lending agencies is somewhat mixed. Farmers eligible for the grain reserve program will probably find the first-year waiver of interest charges on loans covering corn enrolled in the reserve to be appealing. On the other hand, the FmHA economic emergency lending authorization is scheduled to expire in May. Although Congress may extend this program in a modified form, it is doubtful that the agency will provide the massive credit to farmers it has in recent years.

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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	January	204	+ 1.2	+ 8
Time deposits	1972-73=100	January	246	+ 1.5	+12
Demand deposits	1972-73=100	January	133	+ 0.3	- 3
Total loans at agricultural banks†	1972-73=100	January	258	0	+10
Production credit associations					
Loans outstanding					
United States	mil. dol.	December	18,045	+ 3.0	+21
Seventh District states	mil. dol.	December	3,765	+ 2.9	+25
Loans made					
United States	mil. dol.	December	3,259	+29.5	+25
Seventh District states	mil. dol.	December	681	+43.4	+30
Federal land banks					
Loans outstanding					
United States	mil. dol.	December	29,725	+ 1.6	+20
Seventh District states	mil. dol.	December	6,724	+ 1.7	+27
New money loaned					
United States	mil. dol.	December	642	+20.6	+66
Seventh District states	mil. dol.	December	142	+22.2	+56
Interest rates					
Feeder cattle loans††	percent	4th Quarter	12.60	+12.0	+29
Farm real estate loans††	percent	4th Quarter	12.22	+ 9.8	+23
Three-month Treasury bills	percent	1/17-1/23	12.08	+ 0.6	+29
Federal funds rate	percent	1/17-1/23	13.77	+ 2.2	+37
Government bonds *(long-term)*	percent	1/10-1/16	10.37	+ 2.4	+17
Agricultural trade					
Agricultural exports	mil. dol.	November	3,784	+ 7.9	+35
Agricultural imports	mil. dol.	November	1,525	+19.7	+19
Farm machinery sales					
Farm tractors	units	November	5,567	−68.4	−22
Combines	units	November	1,670	−80.8	+14
Balers	units	November	268	−84.5	−32

†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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