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FEDERAL RESERVE BANK OF CHICAGO

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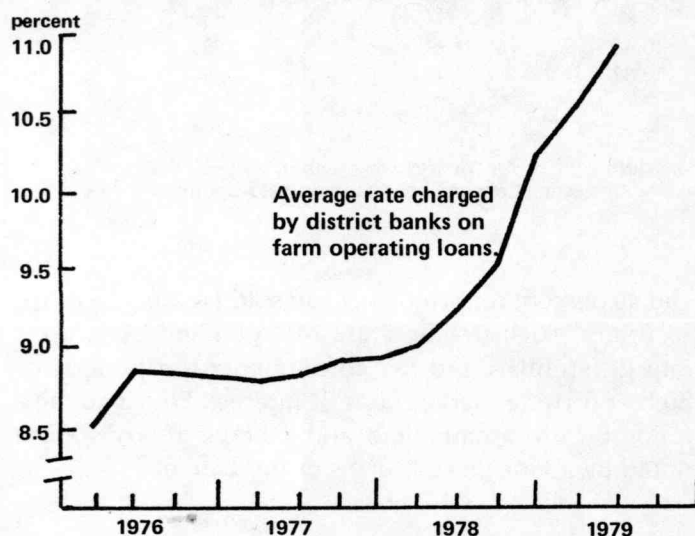
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LETTER

CREDIT CONDITIONS at district agricultural banks remained tight in the second quarter, although improvement was apparent to some extent. A survey of over 550 district agricultural banks shows some slowing in farm loan demand and some improvement in both farm loan repayments and loan renewals and extensions. Nevertheless, the measure of availability of funds, while up from the first quarter, remained low, and loan-to-deposit ratios still averaged at the record high level of the first quarter. Moreover, interest rates charged on farm loans continued to rise sharply.

Interest rates on farm loans continued on sharp uptrend in second quarter



The index of farm loan demand (see table on page 2), although down from the first quarter, still indicates a fairly strong demand in the second quarter. The underlying strength in loan demand reflects, no doubt, the uptrend in prices paid by farmers for production inputs and, in some instances, more unit purchases of inputs. The index of prices paid by farmers for production inputs in the second quarter averaged 14 percent higher than a year earlier. The increase was paced by a rise of nearly 40 percent in prices paid for feeder livestock, and a rise of

nearly 25 percent in prices paid for fuels and energy. In addition to higher prices, increases in planted crop acreage this spring and the marked uptrend in hog production suggests the volume of inputs purchased by farmers was also up from a year ago.

Evidence of the continuing liquidity pressures on rural banks is reflected in the low measure of fund availability and the high loan-to-deposit ratios. The index of funds available for lending—which reflects an overall assessment of loan demand, deposit growth, and incentives and flexibilities for restructuring asset portfolios—was up slightly in the second quarter. But it was still very low by most historical comparisons. And loan-to-deposit ratios among district agricultural banks at the end of the second quarter were virtually unchanged from the record high of .67 at the end of the first quarter. Among the five district states, average loan-to-deposit ratios ranged from a low of .64 at agricultural banks in Indiana to a high of .72 at banks in Wisconsin. Districtwide, over a fourth of the agricultural banks had loan-to-deposit ratios of .75 or higher.

The tight liquidity pressures confronting rural banks have existed for several quarters. Such conditions present a number of challenges to banks eager to maintain their share of the rapidly growing agricultural finance market. Confronted with liquidity pressures, banks must either limit their lending activities or raise additional funds by selling assets, generating additional deposits, or expanding debt or equity capital. Many of the ways of raising additional funds can be costly, however, in periods of high and rising interest rates.

The most recent quarterly survey included a number of questions designed to gauge bankers' responses to the liquidity pressures. Over three-fifths of the banks had originated loan participations in the past six months and over half had purchased fed funds or sold securities under repurchase agreements. Roughly half the bankers indicated they had tried to curtail lending activity over the past six months by encouraging borrowers to refinance

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

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.

existing loans with other lenders, by referring new loan requests to other lenders, or by denying loan requests due to a lack of funds. Only 30 percent of the bankers indicated they had sold loans during the past six months,

Rural banks react to liquidity pressures by greater utilization of a number of practices in the first half

	Percent using practice	Of those using practice, percent noting recent use was	
		No more than normal	More than normal
Originate loan participations	63	47	53
Encourage borrowers to refinance loans with other lenders	49	27	73
Refer loan requests to other lenders	54	35	64
Deny loan requests due to lack of funds	45	10	90
Sell loans	29	38	62
Sell Treasury or other securities	39	29	71
Promote or sell time and savings deposits in local area	72	34	66
outside local area	17	33	67
Buy fed funds or sell securities under repurchase agreements	53	35	65
Raise bank capital by selling bonds or equity stock	5	29	71

and 40 percent reported they had sold Treasury or other securities. Such practices are often limited by interest rate differentials and tax consequences in periods of high and rising market rates of interest. Efforts to raise funds by promoting time and savings deposits were noted by about three-fourths of the bankers.

Interest rates on farm loans charged by agricultural banks continued to trend sharply upward in the second quarter. By mid-year, the average of rates reported on feeder cattle loans, farm operating loans, and farm mortgages ranged from 10¾ to 11 percent. That was about 35 basis points higher than at the end of the first quarter and 1½ to 1¾ percentage points higher than a year ago.

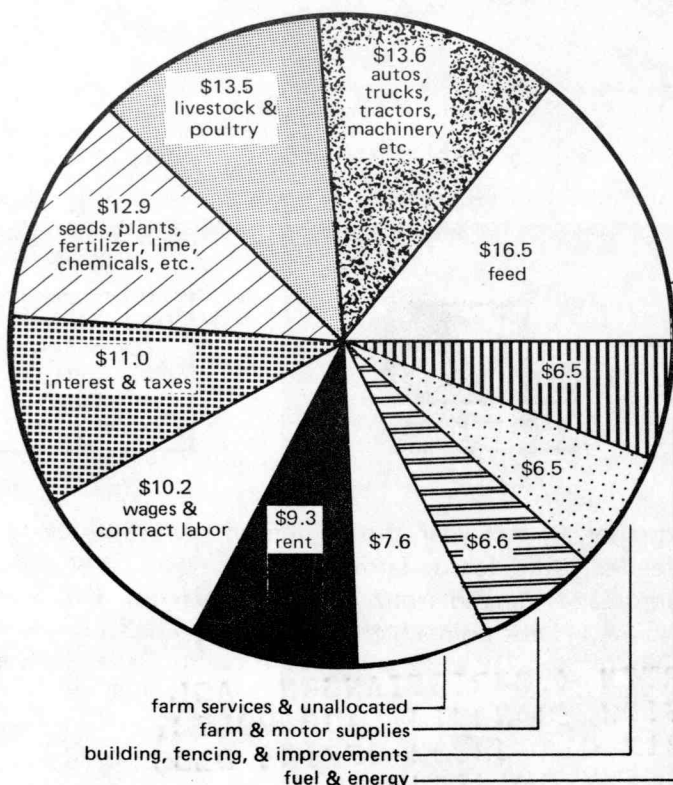
Gary L. Benjamin
Agricultural Economist

FARM PRODUCTION EXPENDITURES rose sharply in 1978. A recent survey by the U.S. Department of Agriculture shows expenditures totaled \$114 billion last year, up nearly 17 percent from a year before. Moreover, current projections suggest outlays will continue upward at a strong pace this year, perhaps rising more than 13 percent. This year's increase in expenditures will probably be paced by larger outlays for interest payments, cattle, and fuel.

Because of differences in accounting procedures, results of the recent survey do not compare directly with the figures used by the USDA in estimating net farm income. The data, therefore, cannot be used directly to adjust estimates of 1978 farm earnings. Interestingly, there appears to be a bigger discrepancy between this expenditures survey and the production expenses in the farm income accounts than in past surveys. For instance, the survey findings of a nearly 17 percent surge in production expenditures to \$114 billion compares with a 10 percent rise in expenses to \$98 billion shown in current net farm income figures. Ironically, part of this discrepancy could have resulted from a procedural change in this year's survey involving an effort to ensure that operators of large, specialized farm units were adequately represented in the sample.

Purchases of livestock—up nearly a third to \$13.5 billion—paced the rise in 1978 production expenditures.

U.S. farm production expenditures, 1978
(\$114.2 billion)



Feeder cattle and calf purchases totaled \$6.4 billion. That was only 15 percent more than in 1977, when purchases had marked a doubling over the 1976 level. Last year's outlays for dairy cattle more than doubled to \$1.4 billion, and beef cattle purchases rose 56 percent to \$2.2 billion. Outlays for hogs added another \$1.1 billion, and poultry purchases added \$1.2 billion. Feed purchases, the largest of the major categories of farm production expenditures, totaled \$16.5 billion last year, up 14 percent. Roughly two-thirds of this spending went for purchases of mixed or formula feeds. Another fifth of the feed expenditures was for grains. The value of formula feed purchases was more than 13 percent above the 1977 level, while expenditures for grains were up 38 percent.

Larger outlays were also reported among major crop inputs. Fertilizer, lime, chemical, and seed expenditures totaled \$12.9 billion, up from \$11.7 billion in each of the past two years. Farmland rentals—both cash rent and share rent—totaled \$9.3 billion last year compared with \$8.1 billion totals in both 1977 and 1976. The value of share rentals, which accounted for about two-thirds of the total compensation for rented land, was up a tenth. Cash rent payments were almost a fourth higher. Operating costs for machinery and motor vehicles rose 14 percent to \$4.9 billion, while fuel and energy payments rose 15 percent to \$6.5 billion.

Although accounting for only 15 percent of all farms in the United States, farms with annual sales exceeding \$100,000 accounted for nearly 63 percent of total farm expenditures in 1978. A year earlier, 8 percent of the farms were in this class and made 52 percent of the total purchases. Farms with sales of \$40,000 to \$99,999 accounted for 19 percent of all farms and 21 percent of the production expenditures. At the other extreme, 26 percent of all farms had sales under \$5,000 last year and accounted for less than 3 percent of the purchases. These farms represented 43 percent of all farms in 1976 and made almost 8 percent of the purchases. On average, expenditures exceeded receipts last year on farms with less than \$5,000 annual sales.

Farm production expenditures in 1979 continue to trend upward, but the pace will likely fall short of the 17 percent rate reported in the survey. The July index of prices paid by farmers for production inputs was 12 percent higher than the year-ending mark and 15 percent above the year-earlier level. Most of the increase in 1979 expenditures is expected to result from higher prices, although expanded plantings and larger pork and poultry production will augment quantities purchased. The largest year-to-year increases are expected to stem from higher livestock and fuel prices and interest rates.

Don A. Langford
Agricultural Economist

Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from	
				Prior period	Year ago
Index of prices received by farmers	1967=100	July	246	+ 0.8	+14
Crops	1967=100	July	243	+ 4.3	+14
Livestock	1967=100	July	250	- 2.0	+15
Index of prices paid by farmers	1967=100	July	251	+ 0.8	+14
Production items	1967=100	July	251	+ 1.2	+15
Producer price index* (finished goods)	1967=100	July	216	+ 1.1	+10
Foods	1967=100	July	225	+ 0.4	+ 7
Processed foods and feeds	1967=100	July	223	+ 1.0	+ 9
Agricultural chemicals	1967=100	July	210	+ 0.6	+ 4
Agricultural machinery and equipment	1967=100	July	230	+ 0.7	+ 8
Consumer price index** (all items)	1967=100	June	217	+ 1.2	+11
Food at home	1967=100	June	234	+ 0.3	+ 9
Cash prices received by farmers					
Corn	dol. per bu.	July	2.73	+ 9.6	+26
Soybeans	dol. per bu.	July	7.38	+ 0.3	+15
Wheat	dol. per bu.	July	3.95	+ 6.2	+41
Sorghum	dol. per cwt.	July	4.69	+ 9.1	+34
Oats	dol. per bu.	July	1.38	+ 2.2	+28
Steers and heifers	dol. per cwt.	July	69.40	- 2.0	+30
Hogs	dol. per cwt.	July	37.90	- 4.5	-17
Milk, all sold to plants	dol. per cwt.	July	11.60	+ 0.9	+15
Broilers	cents per lb.	July	25.5	- 3.4	-19
Eggs	cents per doz.	July	53.4	- 4.0	+ 8
Income (seasonally adjusted annual rate)					
Cash receipts from farm marketings	bil. dol.	2nd Quarter	130	+ 2.4	+18
Net realized farm income	bil. dol.	2nd Quarter	33	- 0.6	+20
Nonagricultural personal income	bil. dol.	June	1,852	+ 0.6	+12

*Formerly called wholesale price index.

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