FEDERAL RESERVE BANK OF CHICAGO

AGRICULTURAL LETTER

November 3, 1978 Number 1485

AGRICULTURAL CREDIT CONDITIONS in the Seventh District during the third quarter reflected a strong farm loan demand, rising interest rates, and a further tightening in fund availability. This represents the concensus view of the 600 district agricultural banks that responded to the October 1 survey. The bankers reported a slight increase over the previous quarter in the rate of repayment on farm loans and a further slowing in renewals and extensions of existing loans, trends that have been evident for the past year. Nevertheless, there was evidence of liquidity pressures at rural banks becoming more intense. And more of the bankers expected a further tightening in their bank's liquidity position over the next three to six months than thought pressures would ease.

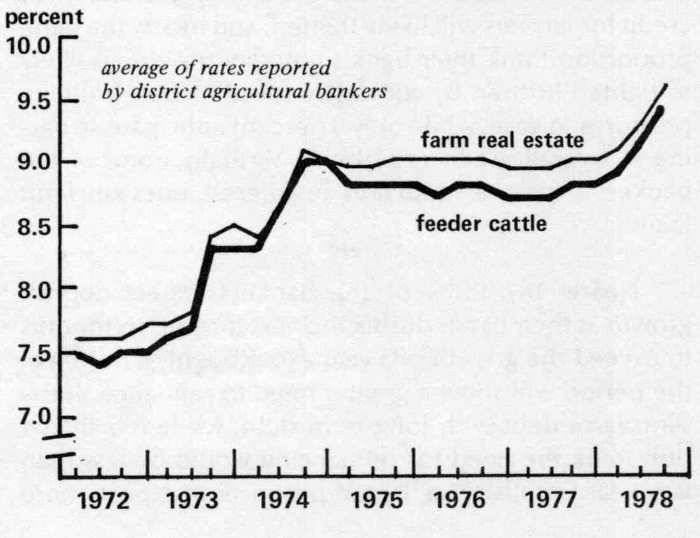
The mounting liquidity pressures at rural banks are reflected in loan-to-deposit ratios and in the index of fund availability. At the close of the third quarter, the average loan-to-deposit ratio stood at a new high of 65.8 percent, up from 64.5 percent the previous quarter and 63.5 percent a year ago. Bankers in all five states of the Seventh Federal Reserve District reported higher loan-to-deposit ratios ranging from a high of 71.4 percent in Wisconsin to a low of 62.6 percent in Illinois. But maybe even more relevant was the record 52 percent of the responding bankers that reported their current ratio was higher than they would like it to be. As recently as early last year it was considered the exception when more than 30 percent of the bankers held such a view.

Closely related to the higher-than-desired loan-to-deposit ratios is the issue of fund availability. The index of fund availability hit a new low of 64 in the third quarter (see table on next page). Evidence of tight fund availability was particularly apparent in Wisconsin, where 71 percent of the bankers reported a decline from a year ago and only 3 percent reported an increase. On the other hand, a fifth of the bankers in Iowa reported greater fund availability this year, compared with 31 percent reporting availability lower. Credit conditions in Iowa last year were adversely affected by drought.

More than three-fifths of the bankers reported farm loan demand this summer exceeded that of a year earlier. Presumably, major factors behind the strength were demands for feeder cattle and farm machinery loans. Requests for renewals and extensions of existing loans also contributed to the demand for farm loans. The index of loan renewals and extensions fell to 122, the lowest point in two years. Even so, the proportion of bankers reporting year-to-year increases in loan renewals and extensions—31 percent—was still high by historical standards.

Interest rates charged on farm loans have risen significantly in the past six months, surpassing the previous peak in 1974. The general uptrend in money market interest rates, coupled with the strong demand for loans and the tight liquidity positions of agricultural banks, were primarily responsible for the increases. Interest rates at rural banks averaged 50 basis points higher than in the first quarter. Rates charged by district banks on feeder cattle loans averaged 9.4 percent in the third quarter, while farm real estate loans averaged 9.6 percent. Among district states, interest rates charged on feeder cattle loans ranged from 9.0 percent in Illinois and Iowa to 10.4 percent in Michigan.

Interest rates on farm loans hit new high



Agricultural bankers report new high in loan/deposit ratio and further tightening in fund availability

	Loan demand	Fund availability	Loan repayment rates	Loan renewals and extensions	Average loan-to-deposit ratio	Banks with loan-to-deposit ratio above desired level
	*(index)**	*(index)**	*(index)**	*(index)**	*(percent)*	*(percent of banks)*
1974						
Jan-Mar	127	133	136	72	54.1	17
Apr-June	142	89	87	117	57.9	27
July-Sept	126	69	85	121	57.3	32
Oct-Dec	122	98	79	127	56.9	32
1975						
Jan-Mar	134	108	65	145	56.4	28
Apr-June	142	120	80	122	56.3	22
July-Sept	133	131	105	100	57.0	22
Oct-Dec	134	130	100	103	56.6	23
1976						
Jan-Mar	142	130	101	109	56.2	20
Apr-June	147	134	102	102	57.3	24
July-Sept	140	124	93	109	59.2	25
Oct-Dec	150	130	81	124	58.8	26
1977						
Jan-Mar	161	115	79	125	59.4	28
Apr-June	169	103	66	140	61.2	38
July-Sept	161	77	52	152	63.5	46
Oct-Dec	147	86	59	151	62.3	41
1978						
Jan-Mar	152	79	64	145	63.7	44
Apr-June	148	73	81	126	64.5	46
July-Sept	158	64	84	122	65.8	52
Oct-Dec						

*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.

Roughly three-fifths of the responding agricultural bankers expect an increase over the next three to six months in interest rates on farm loans charged by their banks. More than a third feel the overall availability of credit for farmers will likely tighten, and nearly the same proportion think their bank's liquidity position is likely to tighten further. By contrast, a fourth expect liquidity pressures to ease, while only 8 percent anticipate an easing in overall credit availability. Virtually none of the bankers expect a reduction in interest rates on farm loans.

Nearly two-fifths of the bankers expect deposit growth at their banks during the next three to six months to exceed the growth of a year ago. Roughly a third feel the period will show a greater need to refinance short-term farm debt with long-term debt, while less than a fifth think the need for refinancing would be less than last year. Similarly, a larger proportion expect more renewals and extensions of farm loans in the period than expect a reduction. Over 40 percent of the respondents think capital expenditures by farmers in the period from October to March will exceed the year-earlier pace.

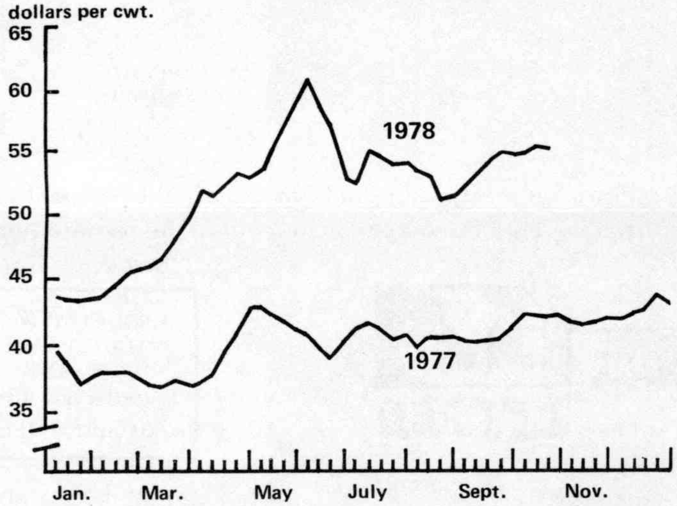
Overall, the latest quarterly survey findings suggest farm loan demand will remain quite strong in the months ahead. Loan repayment rates and renewals and extensions of existing farm loans may register further slow improvement. Despite a high proportion of banks anticipating faster growth in deposits, pressures on fund availability may be accentuated in the short run by the continuing rise in money market interest rates. Even though more than half the bankers reported credit availability will likely remain about the same for the next three to six months, farm credit conditions, overall, will still be of concern in the months ahead.

Don A. Langford
Agricultural Economist

CATTLE PRICE PROSPECTS for the short term dimmed slightly with the USDA's recent release of the *Cattle on Feed* report. That report indicated a record number of cattle moved into feedlots this summer. Although the heavy volume of placements on feed was partially offset by a 6 percent rise in fat cattle marketings, feedlot inventories on October 1 were still 16 percent higher than a year earlier. As a result, some of the near-term strength that was expected for cattle prices has evaporated. Prospects for basically strong cattle markets over the next three or four years, however, have been heightened by the delay in rebuilding breeding herds.

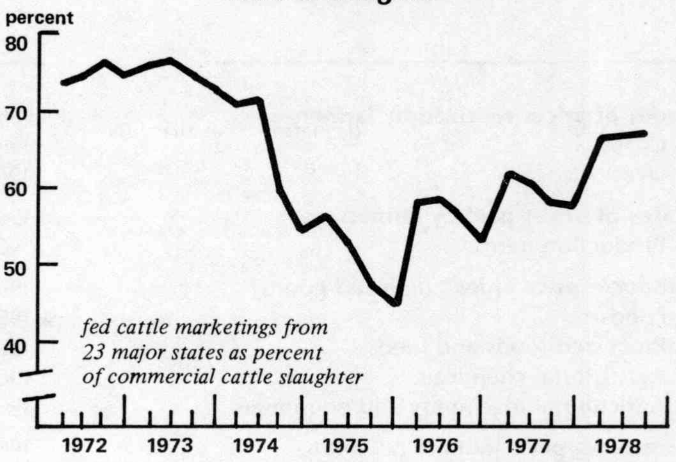
Net placements of cattle on feed during the third quarter exceeded the year-earlier level by 12 percent, marking the fifth consecutive quarter of rapidly expanding feedlot activity. Most of the expansion has been in the seven major cattle feeding states, where inventories were up 23 percent on October 1. In the other 16 states covered by the USDA report, the combined inventory of cattle on feed was down 1 percent. Inventory numbers in Iowa—which has slipped to fourth place in national ranking—were up 9 percent from a year before. Wisconsin farmers had 2 percent more cattle on feed. But inventories in the other three states of the Seventh Federal Reserve District were below year-ago levels. The declines ranged from 7 percent in Indiana to 11 percent in Illinois.

Choice steer prices at Omaha



Fed cattle slaughter has risen substantially this year, and further gains are likely through at least mid-1979. For the first three quarters, fed cattle slaughter exceeded the year-earlier level by 6 percent and came within 1 percent of equaling the record pace set in 1972. Total cattle slaughter, however, was down nearly 5 percent, reflecting a pronounced decline in nonfed steer and heifer slaughter and a moderate decline in cow slaughter.

Fed cattle accounts for larger share of slaughter



For the current quarter, marketing intentions reported by cattle feeders point to an 8.5 percent year-to-year rise in fed cattle slaughter. The inventory of heavyweight cattle, however, is large enough to support expectations of a 10 to 12 percent rise if marketings are kept current. Prospects for the first half of next year suggest fed cattle slaughter will exceed the year-earlier level by 5 percent or more and set new record highs. With prospects for widening declines in cow and nonfed steer and heifer slaughter, however, total beef supplies will likely lag year-earlier levels, maybe by 3 to 5 percent.

Long-term prospects for cattle markets continue to point toward declining supplies. Slaughter of she-stock has been high this year, extending the downturn in the cattle cycle. Federally inspected cow slaughter so far this year is down only 8 percent from a year ago, although the decline did widen considerably this summer. Heifer slaughter year-to-date has slightly exceeded that of 1977. The increase stemmed from a surge in the movement of heifers into feedlots during the first half as opposed to being retained for breeding herds. The rapid movement of heifers into feedlots apparently slowed in the third quarter, although the October 1 inventory of heifers on feed was still 11 percent higher than a year ago.

The indications that cattlemen have been reluctant to rebuild herds increases the likelihood that next year's calf crop will decline for the fifth consecutive year. Implications for cow-calf operators are especially favorable. A smaller calf crop implies tighter supplies, and high prices, for feeder cattle. Feedlot operators, however, will have to be cautious in bidding for feeder cattle. The profit margins from high fat cattle prices can be quickly absorbed by aggressive bidding on feeder cattle.

Gary L. Benjamin
Agricultural Economist

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	October	217	+ 0.9	+23
Crops	1967=100	October	201	− 1.0	+13
Livestock	1967=100	October	232	+ 2.7	+32
Index of prices paid by farmers	1967=100	October	224	+ 0.4	+11
Production items	1967=100	October	222	+ 0.9	+12
Producer price index* *(finished goods)*	1967=100	September	197	+ 0.8	+ 8
Foods	1967=100	September	209	+ 1.7	+10
Processed foods and feeds	1967=100	September	206	+ 1.8	+11
Agricultural chemicals	1967=100	September	202	+ 0.2	+ 7
Agricultural machinery and equipment	1967=100	September	217	+ 1.3	+ 8
Consumer price index** *(all items)*	1967=100	September	199	+ 0.8	+ 8
Food at home	1967=100	September	214	− 0.2	+11
Cash prices received by farmers					
Corn	dol. per bu.	October	1.97	− 0.5	+18
Soybeans	dol. per bu.	October	6.41	+ 3.6	+21
Wheat	dol. per bu.	October	3.04	+ 4.1	+32
Sorghum	dol. per cwt.	October	3.30	+ 2.2	+18
Oats	dol. per bu.	October	1.14	+ 5.6	+12
Steers and heifers	dol. per cwt.	October	56.60	+ 2.5	+48
Hogs	dol. per cwt.	October	51.10	+ 7.4	+28
Milk, all sold to plants	dol. per cwt.	October	11.20	+ 2.8	+11
Broilers	cents per lb.	October	24.8	− 7.1	+ 9
Eggs	cents per doz.	October	52.3	− 2.6	+ 9
Income *(seasonally adjusted annual rate)*					
Cash receipts from farm marketings	bil. dol.	3rd Quarter	108	− 0.9	+18
Net realized farm income	bil. dol.	3rd Quarter	25	− 5.7	+50
Nonagricultural personal income	bil. dol.	September	1,696	+ 0.5	+11

*Formerly called wholesale price index.

**For all urban consumers.

FEDERAL RESERVE BANK OF CHICAGO
Public Information Center
P. O. Box 834
Chicago, Illinois 60690
(312) 322-5112

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INSTITUTE OF AGRICULTURE,
UNIVERSITY OF MINN.
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