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INTEREST RATES ON FARM LOANS have begun to decline, reflecting easier credit conditions in national money markets. Short-term rates in major credit markets have dropped sharply in recent months. The most publicized decline has been the rapid succession of cuts in the "prime rate"—down from 8 percent to 6 percent within the past four months. Rates on three-month Treasury bills dropped from nearly 8 percent just over a year ago to less than 4 percent for the week ending February 10. The federal funds rate, the rate at which commercial banks borrow and lend to each other, fell from about 9 percent to less than 4 percent in the same period. Long-term rates—declining since mid-1970—are following the drop in short-term rates. New issues of top-rated corporate bonds sold during the week ending February 10 yielded less than 7 percent, compared to a peak of about 8.5 percent last June.

Changes in rural credit markets tend to lag behind changes in the more volatile national money markets. For example, interest rates in rural areas were still rising in 1970 when rates in metropolitan areas were falling. Surveys of rural banks in the Seventh District indicated that the proportion of banks charging 8 percent or more on feeder cattle loans rose from 37 percent at the beginning of 1970 to 65 percent by the end of the third quarter. During the fourth quarter, however, cattle loan rates stabilized and even edged downward at some banks.

Changes in national money market conditions are probably translated most directly to the farming sector via the cooperative farm credit agencies—Production Credit Associations (PCAs) and Federal Land Banks (FLBs). These associations obtain funds through the sale of debentures and bonds in competition with other money market offerings. Falling rates at money centers, therefore, reduce the associations' cost of obtaining funds. This means lower rates on new loans to farmers. Cost of money to PCAs in the Seventh Federal Reserve District has fallen from a high of nearly 9 percent early in 1970 to a current rate of around 7 percent. Local PCA lending rates to farmers have been reduced by amounts varying from one-half to more than a full percentage point. Rates on new farm mortgages at many FLBs have dropped by similar amounts, reflecting lower interest rates on new bond issues.

Lower money market rates indirectly affect farm loan rates at rural commercial banks. As alternative investments, such as government securities and federal funds, become less attractive relative to farm loans, more bank funds become available for farm lending. Eventually rates decline. Declining rates at PCAs and FLBs will also exert downward pressure on rates at agricultural banks.

Several changes in agricultural finance evolved from the recent period of high interest rates. The import of some of these changes will diminish as interest rates recede. Others are likely to remain permanent features of the farm credit market.

The PCAs and FLBs took over an increasing proportion of the farm loan business during the recent period of stringent credit conditions. Usury ceilings, in many states below the going market rate of interest, discouraged many commercial lenders from supplying funds to the farm market. As these commercial lenders withdrew from the farm loan market the role of the farm credit associations naturally expanded. Because PCAs and FLBs are exempt from usury rate restrictions, they were able to lend at rates well above those their competitors were allowed to charge.

Now that interest rates are declining, other commercial lenders are likely to become more active in farm lending. Commercial lenders' concern that PCAs and FLBs are "taking over" the farm credit market will likely wane as loanable funds become more plentiful and interest rates recede. Although the PCAs' and FLBs' loan volume will continue to grow, their future gains in market shares will be less striking than in the recent past.

Similarly, concern over the potential threat to rural bank deposits posed by the Farm Credit Investment Bond, (a five-year investment bond offered in multiples of $1,000 by PCAs and FLBs to member borrowers) is likely to diminish as rates decline. The latest issue of the bond bears an annual rate of 5 percent—a rate below that which banks are permitted to pay on time deposits—thus becoming less attractive relative to bank time deposits with one year or more maturities.

Some of the developments during the recent period of tight credit may have long-term significance for farm finance. Interest rate restrictions were liberalized. Usury ceilings in some states were raised. In the Seventh District, for example, usury ceilings were raised from 7 to 8 percent in Illinois, and from 7 to 9 percent in Iowa. Rates payable on bank deposits were raised for all classes of time deposits. PCAs and FLBs introduced variable rate procedures which allow rates to fluctuate during the term of the loan to reflect changes in credit conditions. An open-end mortgage developed by the Federal Land Banks guarantees borrowers additional intermediate and long-term funds without refinancing their mortgage. These developments are likely to have a lasting positive effect on farm credit markets.

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