# Why the Fed's Seasonal Credit Program Is Important to Rural America



by:
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The Federal Reserve's Seasonal Credit Program is "available to help relatively small depository institutions to meet regular seasonal needs for funds that arise from a clear pattern of intra-yearly movements in their deposits and loans and cannot be met through special industry lenders."[1]

In the spring of 2002, the Board of Governors of the Federal Reserve questioned whether the seasonal credit program should be eliminated or modified. Speaking before the Tennessee Bankers Association, Federal Reserve Governor Susan Bies stated that "the seasonal credit program was established in 1973 to address the difficulties that relatively small banks with substantial intra-yearly swings in funding needs faced because of a lack of access to the national money markets. However, funding opportunities for smaller depository institutions have expanded significantly during the past few decades as a result of deposit deregulation and the general development of financial markets, calling into question the continued need for the seasonal program."

While the Gramm-Leach-Bliley Act did expand community financial institutions' access to the Federal Home Loan Banks, funding and liquidity issues remain a long-term concern for community banks, especially rural and agricultural banks. This article explores recent trends associated with the Fed's seasonal credit program and rural banks' utilization of the program to meet liquidity and loanable funds needs.

For many community banks, funding and liquidity issues remain an ongoing concern.

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[1] Footnote 2, Table I.14, Federal Reserve Bulletin.

According to the *ABA Farm Credit Survey Report*, only 70 percent of farm banks in 2001 reported deposit growth was sufficient to meet loan demand – up from 42.5 percent in 2000.

For farm banks with heavy farm loan concentrations (at least 50 percent of their loan portfolio in farm loans), these banks had a greater likelihood of seeing loan demand outpace deposit growth in 2001. For example, deposit growth was only 3.9 percent for farm banks with 50 percent or more of loan portfolio in agriculture during the 12-month period ending June 2001 vs. 7.6 percent of the other farm bank lenders.

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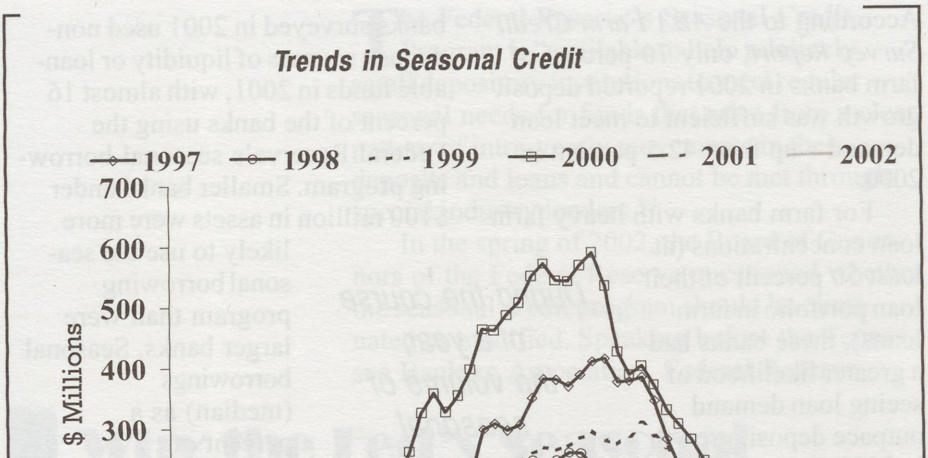
Moreover, farm banks that reported deposits had not kept up with loan demand were more likely to turn away creditworthy customers. While overall only 2.3 percent of banks reported rejecting applications from creditworthy customers due to lack of funds, the number jumps to 5.6 percent for those banks with loans growing faster than deposits. For banks under $50 million with loan concentrations in excess of 50 percent, the percent of banks turning away creditworthy applicants is 8.1 percent.

Because loan demand has outpaced deposit growth for many rural and farm banks, these institutions have had to seek alternative sources of funding. According to the *ABA Farm Credit Survey Report*, nearly six out of 10 rural and farm banks surveyed in 2001 used non-deposit sources of liquidity or loanable funds in 2001, with almost 16 percent of the banks using the Federal Reserve's seasonal borrowing program. Smaller banks under $100 million in assets were more likely to use the seasonal borrowing program than were larger banks. Seasonal borrowings (median) as a percent of loanable funds were 4 percent.

In April 2002, the Nebraska Bankers Association (NBA) surveyed its members about agricultural credit conditions. In its April 2002 survey, 48 percent of the respondents stated that they experienced liquidity problems during peak lending periods. According to the NBA, 35 percent stated they resolved their liquidity problem by borrowing from the Federal Home Loan Bank, 27 percent borrowed Fed funds, and 11 percent used the Federal Reserve Discount Window.

However, the 2001 *ABA Farm Credit Survey Report* found that the cost of these non-deposit sources of funding inhibited use by rural and ag banks. About one-third of the bankers surveyed cited cost as the key factor in limiting their use of non-deposit funding sources. Banks in the Plains and the Corn Belt regions were more likely to identify cost as the key reason for not using alternative sources of liquidity. Previous surveys found that among



Source: Federal Reserve; H.4.1

banks where loan demand exceeded deposit growth, two out of three banks stated that the cost associated with non-deposit funds limited usage.

During the course of a year, the volume of seasonal borrowings from the Federal Reserve System can vary dramatically. Borrowings by banks tend to peak in late August and September and trough usually just before the start of the spring planting cycle. Therefore, any comparisons should be made to comparable periods of the year.

The graph above compares seasonal credit borrowings from the Federal Reserve during the past six years. In 2000, there was a strong demand for seasonal credit by farm banks because loan demand outpaced deposit growth. Borrowings peaked at $586 million for the week of Aug. 30, 2000.

Borrowings in 2001 and 2002 (year-to-date) are more closely tracking seasonal loans for years 1998 and 1999. The strong deposit growth tied to the volatility in the equity markets during the last two years has eased some of the funding pressures on banks and the need for seasonal credit. However, despite this deposit inflow, the average daily seasonal credit stood at $198 million for the week of Aug. 28, 2002 – up $59 million in volume from the week ending August 29, 2001.

Not surprisingly, banks that make the greatest use of the seasonal credit window are concentrated in four Federal Reserve Districts – Chicago, St. Louis, Minneapolis and Kansas City.

Interestingly, ABA's own research shows that rural and agricultural banks, particularly smaller financial institutions, rarely use the Federal Reserve's adjustment credit and extended credit programs. According to the *ABA Farm Credit Survey Report,* only 1 percent of farm lenders use the adjustment credit program and 0.5 percent use the extended credit program. The evidence indicates that the farm banks view the seasonal credit and the Federal Reserve's other credit programs as poor substitutes.

The data show that the seasonal credit program is an important tool for rural banks, especially smaller banks, in meeting liquidity and loanable funds needs. The ABA believes that the Federal Reserve should not alter its seasonal borrowing program.

For many community banks, access to Federal Home Loan Banks and the Federal Reserve's seasonal borrowing programs are the only games in town. Given supervisory concerns that a bank not become too dependent on a single source for funding and liquidity, maintaining the seasonal credit program gives most community banks another alternative. Moreover, the competition will help to discipline the Federal Home Loan Banks' pricing and other lending practices.

Based upon our research, and what our members told us, ABA filed a comment letter on July 25, 2002. We strongly opposed any attempt by the Federal Reserve Board to eliminate the seasonal credit program. We pointed out that "this is a very necessary program for rural and agricultural banks." ABA expects the Federal Reserve Board of Governors will review all comments received and make a final decision by late 2002. ABA will monitor the situation closely.

The seasonal borrowing program remains an important tool for rural and farm banks, especially smaller institutions, to meet peak lending period needs. Any changes in the program may disadvantage rural and farm communities. jal