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Agricultural Letter

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FARM LOAN DEMAND continued to grow in the third quarter of 1973, and the trend will likely be maintained for the next several months. One-half of the nearly 750 Seventh District rural bankers responding to an October 1 survey reported that the demand for non-real estate farm loans exceeded the year-earlier level during the third quarter. The strong loan demand apparently coincided with a reduced availability of funds at many banks. Over one-fourth of the bankers indicated that the availability of funds was down from a year ago, the largest proportion of bankers holding such views since 1970.

These findings are substantiated by the relative loan and deposit growth rates recorded by over 220 rural district banks heavily engaged in agricultural lending. Although deposits grew substantially—total deposits were 18 percent above a year ago in September—loan volume continued to grow at a faster pace, up 21 percent in the past year. The average loan/deposit ratio of the sample banks rose from 61 percent to 62 percent.

Production Credit Associations (PCAs) and Federal Land Banks (FLBs) also experienced an increase in loan demand during the third quarter. PCA and FLB loans to farmers in Seventh District states during September were up 20 and 30 percent, respectively, from a year ago. Outstanding loans at PCAs in September were 10 percent above a year ago; FLB outstanding loans were up 14 percent. PCAs and FLBs at the national level have experienced a more rapid growth rate during 1973, and in September outstandings were up 16 and 21 percent, respectively, from a year ago.

Interest rates charged by rural district banks rose sharply in the third quarter, reflecting tightening money conditions. The average interest rates on feeder cattle loans ranged from a low of just under 8 percent in Illinois to a high of nearly 9 percent in Michigan. The average interest rate for the district was 8¼ percent, slightly over ¾ percentage points higher than a year ago. The lower Illinois rate may reflect the 8 percent usury ceiling applicable to individuals. However, many observers view agricultural loans as business loans which are exempt from the Illinois usury ceiling. Moreover, national banks are permitted to charge 1 percentage point over the Federal Reserve discount rate. Nevertheless, interest rates on farm loans from banks located in rural areas are usually subject to smaller interest rate fluctuations than experienced in the national money markets. A sample of larger banks at the national level shows that the average interest rate on feeder cattle loans increased from just over 7½ percent in September of 1972 to nearly 9½ percent in September 1973, more than twice the increase among district agricultural banks.

Over two-fifths of the agricultural bankers surveyed expect fourth-quarter non-real estate loan demand to remain above the same year-ago period. This may reflect the bankers' concern over the fuel and fertilizer shortages, and the attendant price increases currently taking place. Fertilizer prices reportedly have risen 30 to 50 percent following the recent exemption of fertilizer from Phase IV controls. It is estimated that higher fertilizer prices alone may increase total farm production cost as much as 2 percent in 1974. This would likely boost the fertilizer bill of farmers in Seventh District states by more than $250 million, and bankers are likely to experience a proportionate increase in farm production loan demand.

Important shifts in available credit for these products are also occurring. In the past, farm retailers typically provided extended credit or delayed billing to farmers purchasing fertilizer and other production inputs off-season. As a result of the current shortages, most of these nonprice inducements are being discontinued necessitating farmers to seek funds from other sources.

Loan demand will increase as farmers pursue strategies designed to reduce 1973 taxable income. Many farmers reportedly are storing a higher percentage of grain this fall either to avoid low harvesttime prices or to delay income until 1974. Farmers are also stepping up machinery purchases and other capital expenditures that qualify for the 7 percent investment tax credit in order to reduce their 1973 tax payments.

Grain transportation problems may also boost agricultural credit needs. Farmers in some areas may not be able to sell their grain to local elevators; elevator operators who have already purchased the grain may not be able to ship it to central markets. Some banks will probably experience a much larger than normal credit demand if the elevators experience transportation difficulties.

Availability of farm credit will undoubtedly vary from area to area. As part of the current harvest is sold, deposits in most rural areas will rise. Cash inflows should increase again in early 1974 as grain held past December 31 flows to market.

Loan demand will remain strong in most areas. Higher than usual credit demands are likely late in the year with the employment of various tax reduction strategies. Seasonal loan demand for feeder animals will also be greater due to the higher price levels. Although interest rates may decline at the national level, given the anticipated demand for farm loans and the comparatively low current farm interest rates, it appears unlikely that rates on agricultural loans will be subject to downward pressures.

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