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Rural Banking and Farm Credit Conditions

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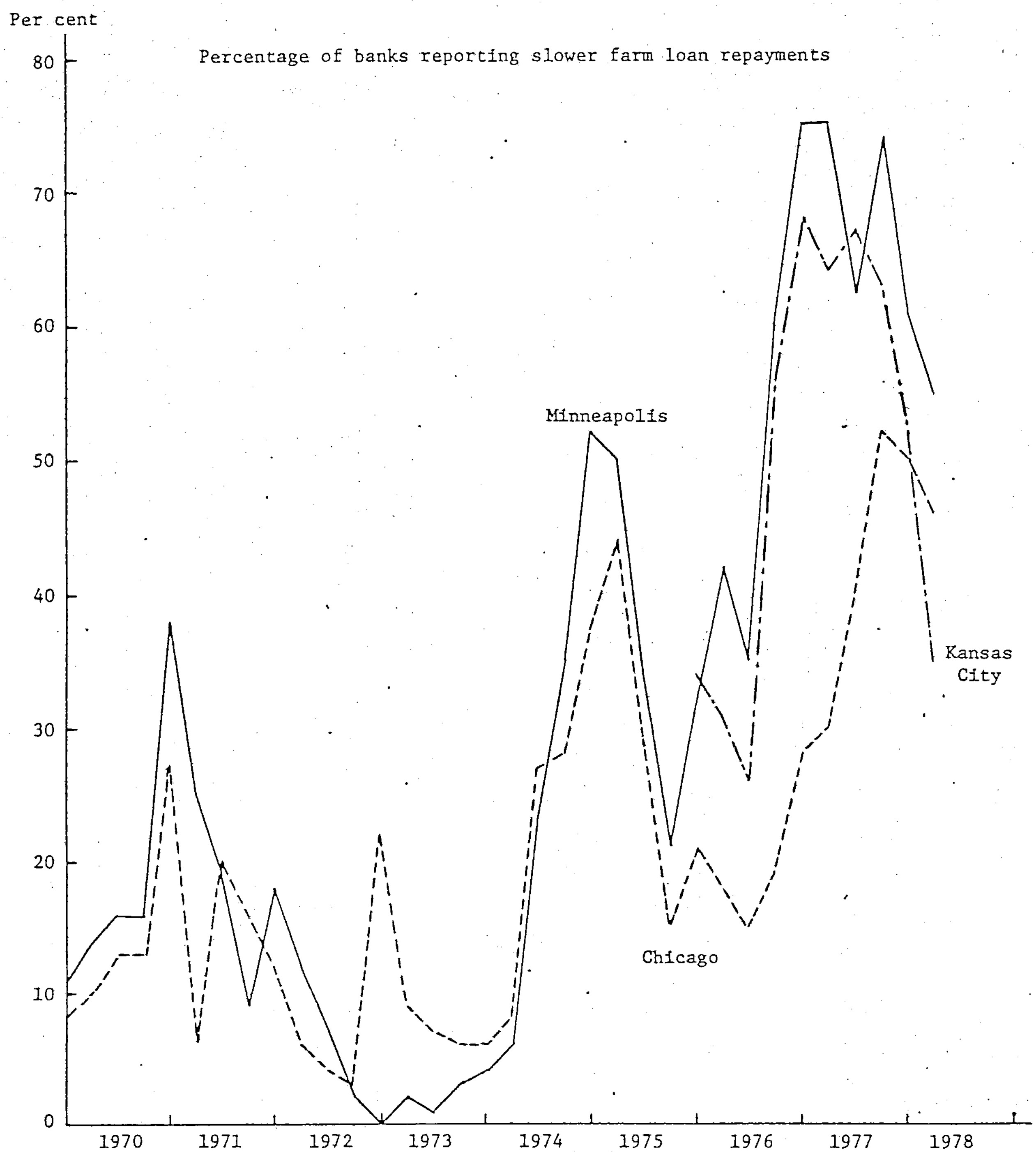
Two years ago when wheat prices and the income of wheat growers fell sharply, banks in the Great Plains area began to experience slow farm loan repayments and increased loan demands. Last year, after prices of corn, soybeans, and cotton also fell sharply in midsummer, banks in other major agricultural areas encountered similar conditions. Moreover, growth in deposits at rural banks slowed as farm income fell. Consequently, the liquidity of these banks was sharply reduced, while the creditworthiness of farm borrowers was eroded. At present, many rural banks remain under liquidity pressure, although their situation has improved since last summer as farm income recovered. Among farmers, many producers of major crops still face financial problems, but the proportion in serious trouble remains relatively low.

Quarterly surveys of agricultural credit conditions conducted by five of the Federal Reserve Banks provide some indications of trends in the financial situation of borrowers. Chart 1 shows one aspect of farm loan quality--the farm loan repayment experience of banks. As farmers encountered cash flow difficulties--in 1976 in the wheat-producing areas of the Minneapolis and Kansas City Districts and a year later in the Corn Belt--their loan repayment record deteriorated considerably. Most farmers, however, had substantial net worth at current values of farm assets and needed only to achieve a better balance between their cash flow and their

Chart 1

Federal Reserve Bank Surveys of Agricultural Credit Conditions



In the Chicago and Kansas City surveys, banks are asked to compare repayment experience during the past quarter with that of a year earlier. In the Minneapolis survey, banks are asked to compare "current" with "usual" experience.

The latest data shown are from surveys made as of April 1, 1978.

debt obligations and living expenses. Thus, many borrowers sought and obtained loan renewals and refinancing.

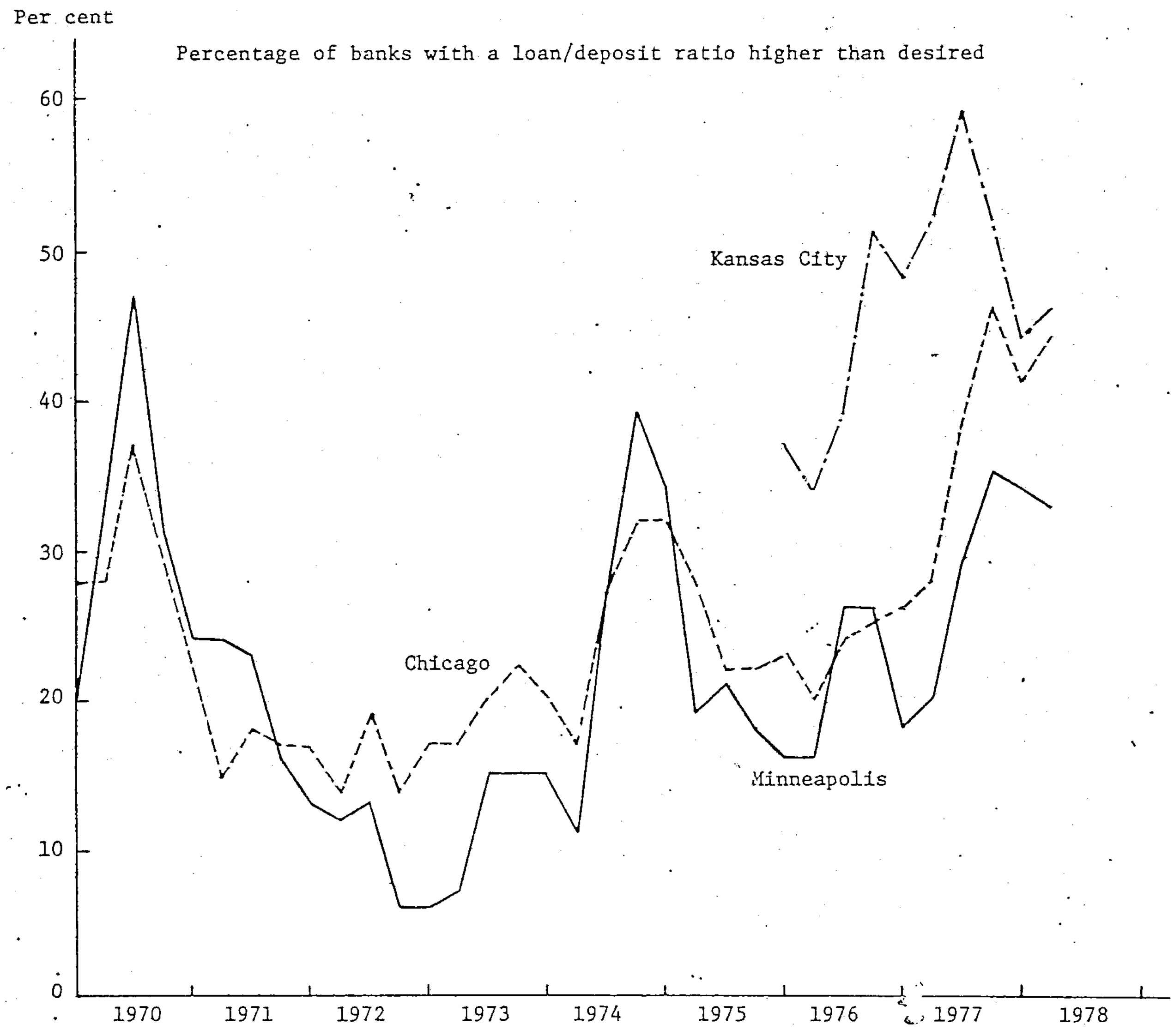
During the last two quarters, the cash flow position and loan repayment record of farm borrowers improved markedly. Last fall, grain prices recovered rapidly as farmers stored large amounts of grain under government price support loans. The income of wheat producers was further augmented by special government payments, totaling $1.1 billion, which were disbursed around year-end. In areas affected by severe drought last year--particularly Georgia and Iowa--farmers obtained Federal disaster loans, which totaled about $3 billion nationally.

The financial experience of rural banks paralleled that of their farm customers. As deposit inflows and farm loan repayments deteriorated, Chart 2 indicates that an increasing proportion of rural banks experienced liquidity pressure. Farm lending at such banks was adversely affected. In the Kansas City District, where liquidity pressure was most prevalent, one-fourth of the rural banks surveyed reduced or turned down at least one farm loan request last summer because of a shortage of funds. By fall, three-fourths of the banks were not actively seeking new farm loan accounts. More banks had referred some farm loan requests to correspondent banks and to nonbank credit agencies.

Higher cash receipts and Federal price support and disaster loans led to improved deposit inflows and loan repayments at commercial banks, relieving somewhat the liquidity pressure that many rural banks had been experiencing. Chart 2 indicates that the proportion of rural banks experiencing liquidity pressure may have peaked last summer. The improve-

Chart 2

Federal Reserve Bank Surveys of Agricultural Credit Conditions



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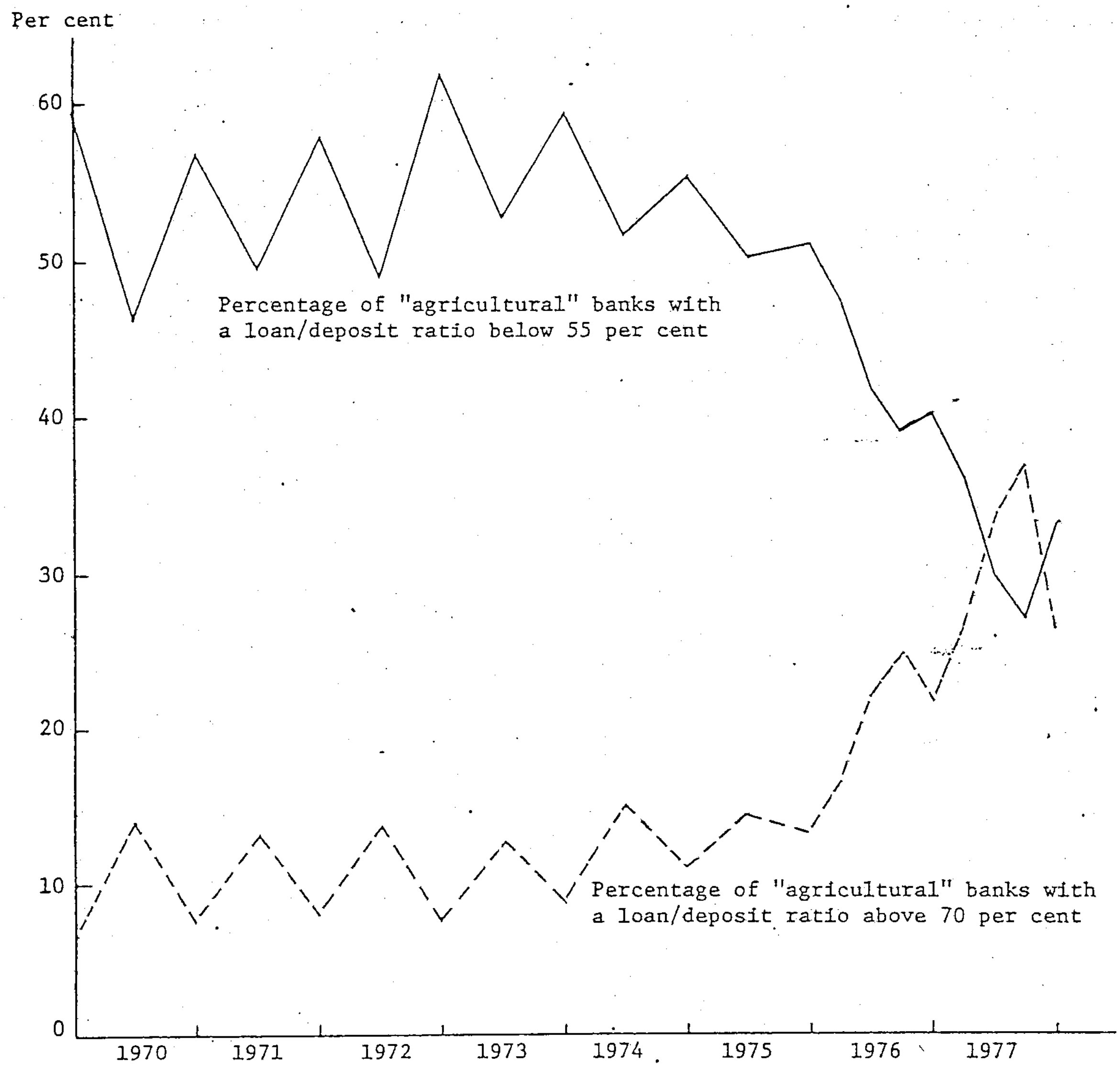
The Federal Reserve Bank of Chicago surveys about 600 banks at which farm loans comprise at least one-fourth of total loans (except in Michigan, where the criterion is one-tenth). The Kansas City survey covers 180 banks at which farm loans represent at least one-half of total loans, while the Minneapolis panel of about 150 banks is a cross-section of banks of all sizes in that District.

ment over the last two quarters has been relatively modest, however, and the proportion of banks under pressure still remains unusually high.

The reports by these surveyed banks of uncomfortably high loan/deposit ratios are clearly supported by U.S. call report data for banks heavily involved in farm lending. Chart 3 shows data for about 5,000 banks at which farm loans comprised one-fourth or more of total loans. These "agricultural" banks account for more than half of all farm loans in the banking system and serve an even greater proportion of the farmers borrowing from banks. As can be seen, the percentage of these banks in a relatively easy position has been sharply reduced, and simultaneously the percentage in a relatively tight position has increased markedly.

Because most of these banks are small, averaging $14 million in deposits, they have limited access to money-market and nondeposit sources of funds. In September 1977, large time certificates of deposit represented less than 5 per cent of the resources of "agricultural" banks, only one-third of the relative proportion found at the nation's large banks. Sales of bankers' acceptances by "agricultural" banks were insignificant. More "agricultural" banks did become buyers of Federal funds (very short-term unsecured borrowing from other banks or financial institutions) during last summer, but such purchases still represented less than 1 per cent of the resources of all "agricultural" banks. The group as a whole remained a net seller of Federal funds, in accordance with the current practice at small banks of maintaining a portion of liquid reserves in this form. After reaching a tight position, therefore, the ability of "agricultural" banks

Chart 3



"Agricultural" banks are insured commercial banks at which farm loans comprised 25 per cent or more of total loans.

Data shown are based on reports of condition (call reports) from insured commercial banks. Data are not seasonally adjusted and are available and plotted semiannually for 1970-75 and quarterly for 1976-77. The latest data plotted are preliminary data for December 31, 1977.

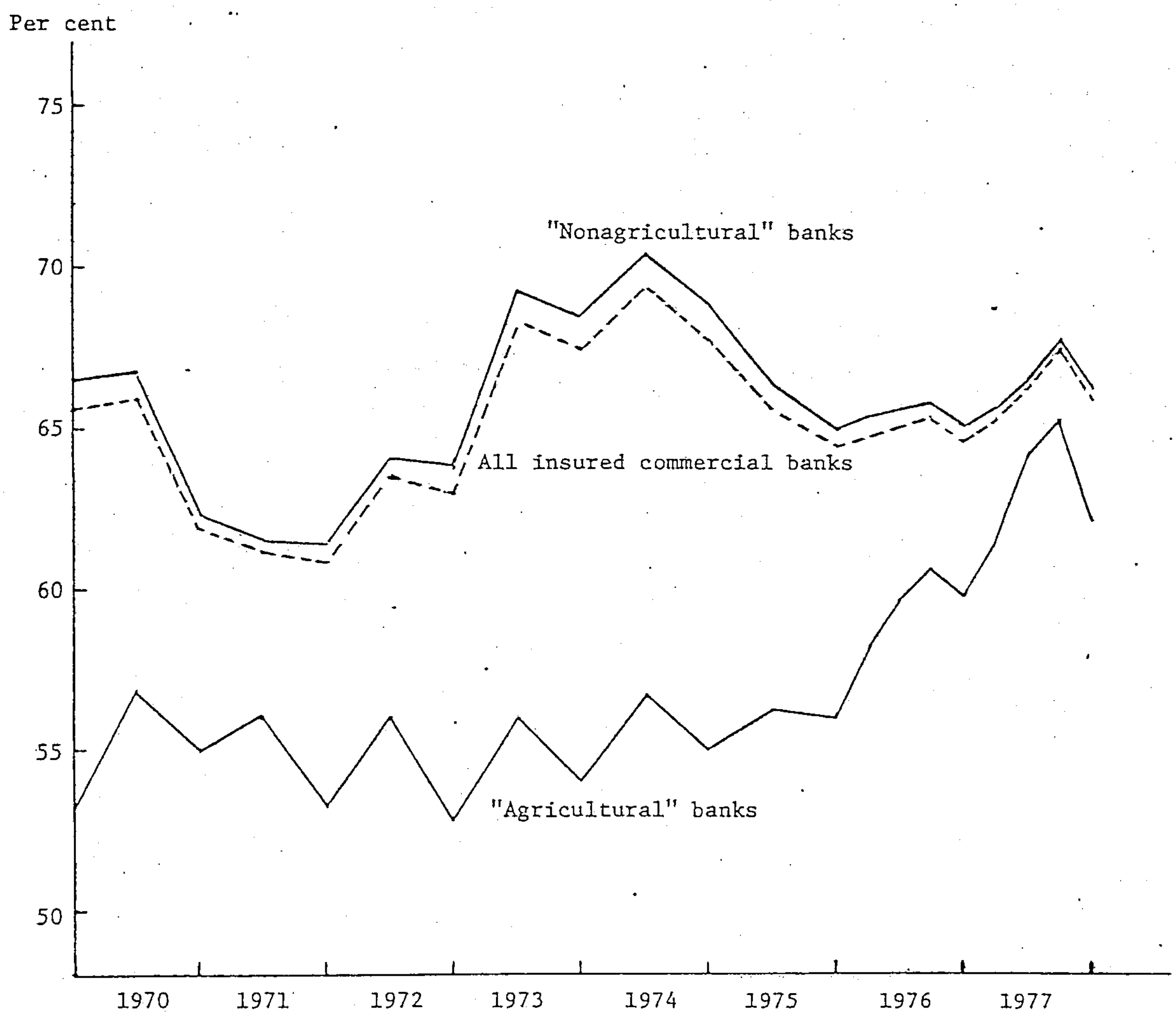
to accommodate further loan demands becomes highly dependent on their local deposit growth. In contrast, large banks in the same situation could more readily resort to other sources of funds.

The generally small size of "agricultural" banks has another consequence, which is illustrated by Chart 4. Though they comprise about a third of all commercial banks, the "agricultural" banks represent only 6 per cent of total banking resources. Thus, their experience is lost in aggregate banking data, which are dominated by large banks. Moreover, as indicated by the earlier years in the chart, "agricultural" banks were largely unaffected during past cycles in over-all liquidity of the banking system. During 1976-77, however, adverse developments in the farm economy led to an increase in their average loan/deposit ratios roughly comparable in rapidity and relative magnitude to that experienced by the Nation's large banks during 1973-74.

In last year's fourth quarter, this trend was arrested. Some of the improvement may reflect seasonal influences, but the substitution of Federal price support and disaster loans for private bank credit and a recovery in farm income also contributed to the strengthening of financial positions. Further improvement in the positions of "agricultural" banks and farm borrowers is in prospect if, as currently projected by the Department of Agriculture, farm income in 1978 rises noticeably above the average for the past two years. Rural banks and borrowers nonetheless will remain unusually vulnerable to any new financial setbacks.

Chart 4

Average Loan/Deposit Ratio



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