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A Replay of 1977 . . .

FARM FINANCIAL AND CREDIT CONDITIONS

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Last year was a difficult one for many Fifth District farmers and farm lenders. Drought was a leading contributor to farmers' woes and, in combination with low prices—especially for cattle, cotton, grain, and soybeans—and high costs, created financial problems for many producers. By the same token, the overall quality of farm loan portfolios deteriorated at a number of banks. Large numbers of farm operators are reported to be in reasonably good shape, however, and all Fifth District bankers appear to be dealing successfully with most cases of problem farm loans. While many farm borrowers had loan repayment difficulties and many had to request loan renewals or extensions, no Fifth District bank expects to have to absorb any losses from loans to farmers. Farmers' demand for credit from traditional lenders continued fairly strong throughout the year, but bank supplies of loanable funds were generally ample.

Financial Conditions Vary Widely Farmers' financial conditions in 1977 varied, to a large degree, according to the extent and the severity of the drought in their area. Some were hit hard. Others will almost surely count it a fairly good year. But when cash receipts from all crop and livestock marketings are in, it is expected that total cash farm income in 1977 will be 5 percent or more below the $5.5 billion of 1976.

Geographically, farm financial conditions varied not only from state to state but also from area to area within the states. Some farmers in Virginia and the Carolinas, for example, suffered extensive drought damage, while those in Maryland and West Virginia appear to have had few problems with the dry weather. Piedmont farmers felt the brunt of the drought in North Carolina. Virginia producers from Northern and Central Virginia and the Shenandoah Valley were seriously affected. But drought damage covered most areas of South Carolina.

Farm financial conditions varied almost as much by type of farm as by geographical area. With last summer's dry weather and searing heat, yields per acre of most major field crops were below those of a year earlier. Drought hit the corn crop and pasturelands hardest, cutting corn output 40 percent from 1976 levels and searing summer pastures. These conditions, plus sharply lower corn and cattle prices, severely reduced the income of cash-grain producers and beef cattle farmers, many of whom were forced to sell their cattle early because of the lack of forage. Cow-calf operators were especially hard hit.

Most cotton farmers will probably remember 1977 as a very poor year. Hard hit by drought and low yields per acre, cotton production dropped 25 percent below the 1976 level. The reduced crop, coupled with prices substantially below the costs of production per bale, left many cotton growers in serious debt situations that required renewals or extensions of loan repayment dates.

Producers of flue-cured tobacco—the chief money crop—came through the year in fairly good shape. Although reduced acreage and lower yields per acre combined to cut production 17 percent, the season's average prices were at record levels, offsetting much of the smaller output. Growers' total net income was down sharply, however, because of higher production costs. As one banker describing the flue-cured situation last fall said, "Good prices, low poundage, but a high cost crop to produce . . . . Some farmers may need to borrow again before Christmas because they will probably have little left after paying their debts."

Peanut farmers appear to have done almost as well as in 1976. By and large, the peanut crop escaped serious drought damage. Both yields per acre and total production were down only slightly, while prices held near the support level. Moreover, as a precaution against crop losses, most peanut farmers now carry crop insurance.

Soybean producers may not have fared as well as peanut farmers. Total output was up 16 percent over 1976, but production was spotty. Yields averaged slightly higher but were so low on some farms that the soybeans in many instances were cut for hay. More importantly, soybean prices were down sharply.

Poultry and egg producers, on the other hand, had a comparatively good year. In general, the second

Note: This article is based on summary reports of this Bank's Quarterly Survey of Agricultural Credit Conditions in 1977 and on the latest statistical information from the U. S. Department of Agriculture, the Farm Credit Administration, and the Federal Reserve Bank of Richmond.

half was more profitable than the first. The year was also a relatively good one for hog farmers. With cheap corn and fairly good prices, they fared exceptionally well until prices began to decline in the fall.

Dairymen who were not adversely affected by drought had a rather prosperous year. Expanded milk production and higher support prices for manufacturing milk enhanced dairy income. With declines in feed costs more than offsetting gains in costs of other production inputs, net income from dairying increased. Financial conditions were, of course, much less favorable for dairymen whose pastures, hay, and other feed crops were damaged by drought.

Farm Loan Demand Strong Farmers' demand for credit from traditional farm lenders continued fairly strong throughout the year even though many were able to qualify for Federal drought disaster loans. Bankers surveyed indicated that the general increase in demand for loans stemmed in part from the continued tightening of the cost-price squeeze. On top of the rise in the costs of regular production inputs, many crop farmers were also faced with unusual insect and disease outbreaks that required the outlay of additional, and oftentimes borrowed, funds. Because of low farm prices, there was a big demand for loans to build on-farm storage facilities so that farmers could hold their corn and soybeans for higher prices.

The weather-related problems mentioned earlier also strengthened farmers' demand for loans. Because of last summer's severe and widespread drought, and as insurance against recurring droughts, many farmers sought financing for heavy investments in mechanized irrigation equipment. Drought also forced many livestock producers who normally grow their own feed to borrow funds to buy hay and other feed. Moreover, the drought-reduced output and low prices made it necessary for increased numbers of crop farmers to refinance short- and intermediate-term loans into long-term debt.

These observations appear to be supported by available statistical evidence. Outstanding short- and intermediate-term loans held by all commercial banks at midyear were 17 percent above a year earlier. Loan volume held by the production credit associations on the same date was up some 16 percent. Farmers reduced their borrowing from PCAs sharply in the second half of the year, however, mainly because they bought less machinery and equipment. As a result, the volume of loans made by PCAs for all of 1977 showed only a 12 percent increase over the previous year—well below the 18 percent recorded in 1976. PCA loans outstanding for 1977 as a whole registered a gain of 14 percent. While the volume of loans made by PCAs rose at a slower rate than in 1976, loans outstanding increased at the same rate.

Both commercial banks and the Federal land banks recorded year-to-year increases in outstanding farm real estate loans by mid-1977. While the volume of outstanding loans held by banks was up 13 percent over midyear 1976, the amount held by the FLBs registered an 11 percent gain. The volume of new money loaned by the FLBs showed a much larger increase over a year earlier in the second half of the year than in the first and for the entire year recorded a 16 percent upturn. The 1977 increase in the volume of lending contrasts sharply with the 10 percent decline in 1976. With the lower cash flows of many crop farmers, the big jump in Federal land bank lending, especially in the fourth quarter, suggests that these institutions may well have increased their refinancing of short-term loans formerly held by other lenders. Loans outstanding of the FLBs at year-end 1977 were 11 percent above the level of the previous year. This gain was the same as that recorded the year before.

Loan Fund Supplies Ample While the demand for farm loans in 1977 was fairly strong, bank supplies of loanable funds for making short- and intermediate-term loans to farmers were generally adequate to meet the demand. There were indications, however, that loan fund supplies were perhaps not as abundant as in 1976. Even so, bankers' regular farm customers apparently did not find it difficult to get needed credit. Only once during the year did one of the surveyed banks report that it had been forced to refuse or reduce a farm loan because of a shortage of funds. Moreover, bankers indicating that they were actively seeking new farm loan accounts usually ranged from around 70 to 80 percent of those reporting—up significantly from a year earlier.

With bank loan funds generally ample, loan referral activity remained weak throughout the year. Few bankers as a rule made referrals to correspondent banks, presumably because many of the sampled banks are either large branch banks or bank holding companies. While more banks made referrals to nonbank credit agencies, the number of these referrals was not unusual until the fourth quarter, when nearly three-tenths of the bankers—highest proportion in the past two years—reported that loan referrals to these nonbank credit agencies were above average.

Banks' loan-to-deposit ratios are important indicators of credit availability. When they are high, banks generally have less money to lend. In general, the reverse is true when they are low. Loan-to-

deposit ratios of banks reporting during the year averaged 64.9 percent versus 62.3 percent in 1976, suggesting as pointed out earlier that District banks in 1977 had somewhat smaller supplies of loan funds than in 1976. Each quarter, however, while a good many bankers rated their current ratios above desired levels, an even larger proportion considered their ratios to be too low.

The SBA or FmHA drought disaster loan programs provided additional loan fund assistance during the year. Bankers in general encouraged farmers to apply for these low-interest loans. While the many who qualified waited to receive loan funds from the government agencies, bankers made additional loans to their farm customers if necessary or extended existing ones. Bankers expected that the farmers in return would use these disaster loan funds to pay off their 1977 bank loans. In this way, bankers said they would be able to finance their regular farm customers again in 1978.

Some bankers currently report that while they continue to receive FmHA disaster funds as payment on loans, they are coming in slower than expected. Others say that applications to obtain drought disaster loans are still being processed in their areas.

Interest Rates Mixed By and large, bank interest rates charged on farm loans in 1977 showed mixed trends, edging upward in the second and fourth quarters and easing slightly in the third. Rates on intermediate-term loans proved to be the exception by continuing to rise throughout the year.

Interest rates banks charged on all types of farm loans in the fourth quarter averaged slightly higher than a year earlier, with rates on intermediate-term loans showing the biggest gain and those on feeder cattle loans the smallest. Rates of 9 percent and over on short- and intermediate-term loans were charged by a much greater proportion of bankers reporting than was the case a year earlier.

Average interest rates charged by banks during 1977's fourth quarter were as follows: for feeder cattle loans, 8.94 percent; other farm operating loans, 8.98 percent; intermediate-term loans, 9.46 percent; and long-term farm real estate loans, 9.42 percent. As is customary, several of the larger banks reported that they priced their loans in the range of prime rate +1 percent and prime +2 percent on a floating rate.[1]

Repayment Rates Deteriorate, Renewals Rise Drought-reduced crop output and the tightening cost-price squeeze combined to create cash-flow problems for many Fifth District farmers. Reporting bankers, as a result, experienced much slower loan repayment rates and a sharp increase in requests for renewals or extensions of existing loans as the year progressed. By the fourth quarter, rates of loan repayments were the slowest and the number of renewals or extensions were the highest since this quarterly farm credit survey began a little more than two years ago.

These problems were confined primarily to Virginia and the Carolinas—states where crop output suffered from extensive drought damage and extreme heat last summer. Maryland bankers in recent months also pointed out the likelihood of some loan extensions in scattered areas of the Eastern Shore, but these were not expected to become problem loans.

By and large, the majority of bankers required average amounts of collateral most of the year. Roughly one-fourth of the respondents, however, stepped up their collateral requirements to above-average levels during the fourth quarter, suggesting perhaps that the risks of making farm loans were rated as somewhat higher.

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[1] The rate of interest is described as "floating" when the rate is tied to some other rate (such as the prime rate or a market interest rate) and neither the bank nor the borrower knows the exact rate of interest to be charged over the life of the loan.

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