1980: A DIFFICULT YEAR FOR FARMERS

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While many factors influenced the financial and credit conditions of Fifth District farmers in 1980, three provided the major keys to the final story for the year. These three were:

- The severe drought and searing temperatures which reduced crop output substantially and disrupted livestock production.
- The sharply higher prices of farm production inputs relative to the prices of farm products that exerted significant downward pressure on net farm income.
- The unusually high interest rates, especially during the spring planting season.

The three factors combined to reduce farmers' ability to service loans needed to buy farm operating inputs and to make capital investments. This situation caused many to reduce the use of purchased inputs and to delay the purchase of machinery and equipment.

Moreover, commercial banks early in the year were faced with credit controls and some evidence of rising liquidity pressures, factors that reduced their ability to provide loan funds early in the planting season. Many farm borrowers, particularly in drought-stricken areas, had loan repayment difficulties, and many had to request loan renewals or extensions, causing the quality of farm loans to deteriorate. All in all, it seems certain that many Fifth District farmers, and farm lenders alike, will remember 1980 as a difficult year.

Drought — A Major Cause of Farmers' Woes Farmers' financial conditions in 1980 varied, to a large extent, according to the severity of the drought in their area. Some were hit extremely hard. A few, however, will probably be able to count it a fairly good year. But when cash returns from marketing all crops and livestock are added together and the high production costs deducted, it is expected that farmers' net income in 1980 will show a sizable decline from that in 1979.

Geographically, the drought was widespread, with the most extensive damage apparently occurring in the Carolinas, Virginia, and to a lesser degree in Maryland. West Virginia appears to have had few problems with the dry weather. The severity of the drought also varied from area to area within the states. Farmers in the Northern Coastal Plain, where most of the peanuts are grown, and in the Southern Piedmont felt the brunt of the drought in North Carolina, for example. Coastal Plain and Piedmont producers were also hardest hit in Virginia.

The influence of last summer's dry, hot weather on local farm production, income, and credit conditions in 1980 was extremely unfavorable. The drought's role in causing sharp reductions in crop output, for example, was of unusual scope and severity. Yields per acre fell drastically, leading to sharp cutbacks in production. Four major crops—peanuts, soybeans, corn, and cotton—suffered the biggest declines. But there were also significant reductions in the output of all small grains except wheat, fire-cured tobacco, Irish potatoes, and sweet potatoes. While the peach and apple crops were only slightly below the previous season, dry weather limited the sizing of the fruit. There was also only a slight decline in the production of hay because the sharply larger output in West Virginia all but offset the smaller crops in other states.

Last year was an unusually poor year for the District's peanut farmers. Serious drought damage cut both yields per acre and overall production 35 percent below 1979 levels. Moreover, a fairly sizable proportion of the crop did not make edible grade because of poor quality. With short supplies, peanut prices rose sharply above loan levels, but the many growers who sold or contracted their peanuts early may not have benefited from the price increases.

Soybean producers fared almost as badly as the peanut farmers. Drought-reduced output and per-acre yields were both 32 percent under those in 1979. Yields on some farms were so low that the soybeans were cut for hay. This season's higher prices, although not as high as had been anticipated earlier, are helping to offset some of the sharp increase in production costs.

Feed grain producers, especially corn growers, came through the year in a little better condition than the peanut and soybean farmers. Even so, drought cut the total size of the crop by 25 percent and yields per acre even more. With short supplies and record disappearance (domestic use plus exports) anticipated, this season's corn prices at the farm are running well above last season's level. But the higher prices may not be able to offset the sharply smaller crop and increased costs of production.

Cotton farmers no doubt will also remember 1980 as a very poor year. Hit hard by the unfavorable growing conditions, yields per acre were down 33 percent. So, despite a 19 percent increase in acreage harvested, total cotton production dropped 20 percent below the 1979 harvest. Most cotton producers will probably receive some benefit from the higher prices this season, however.

Flue-cured tobacco growers—compared with the peanut, soybean, corn, and cotton producers—came through the year in fairly good shape. The hot, dry growing season that reduced the quality of the flue-cured crop was probably the most notable development of the year. Total production rose 16 percent from year-earlier levels in response to the 5 percent increase in yields per acre and an 11 percent larger acreage. Season average prices for the flue-cured crop were up 4 percent over 1979 to set a new record. The value of gross sales was 20 percent above 1979; however, costs of producing the 1980 crop were sharply higher and may have resulted in lower net returns to producers.

The drought also had its effects on livestock and poultry producers. With the reduced feed grain output, the price of corn and feed concentrates increased rapidly last summer and fall, boosting feed costs and hence the costs of production significantly. Moreover, the searing temperatures that accompanied the drought conditions caused thousands of broilers to die and reduced rates of gain. With broiler prices below the costs of production in the first half of 1980, broiler producers were in an unfavorable financial situation. But after mid-1980, broiler prices rose faster than costs, making production profitable. Egg producers, on the other hand, remained in a cost-price squeeze throughout the year, so they were in an unfavorable financial situation during most of 1980.

The overall financial condition of hog producers last year was mixed. With low hog prices during the first half of the year, producers' incomes were generally less than their cash expenses so meeting their cash-flow commitments was a problem. Improved hog prices during the second half brought some relief from cash-flow difficulties, but net returns increased only marginally because of the higher feeding costs.

Most cattle feeders experienced losses on fed cattle marketed during the first half of 1980. Fed cattle prices strengthened in the second half, however, more than offsetting the higher costs for feed and calves and bringing increased returns during the final quarter of 1980.

Dairymen who were not adversely affected by last summer's drought remained in a strong financial condition in 1980. Slightly larger milk production and higher support prices for manufacturing milk increased income from dairying to a level that mostly offset the steadily rising costs of production. The financial condition of dairymen whose pastures, hay, and other feed crops were damaged by drought was, of course, much less favorable.

A Tightening Cost-Price Squeeze The severity of last year's squeeze between farm costs and prices was a major factor determining farmers' financial conditions. On average, however, it was actually the soaring production costs, not falling farm prices, that caused 1980's relatively low net farm income. While prices paid by farmers for production items, interest, taxes, and wage rates jumped some 12 percent over 1979 levels, farm product prices averaged only about 2 percent higher. Farmers, in fact, had to pay higher prices for all items of production except feeder livestock.

While last year's big jump in production costs can be attributed to fairly sizable price increases for nearly all costs of production, there were five major culprits—namely, fuels and energy, interest, fertilizer, agricultural chemicals, and farm and motor supplies, in that order. Fuel and energy prices took the biggest leap, rising some 38 percent over 1979. This price increase not only caused farmers to have to spend more money to run their machinery and equipment, but it also pushed up the prices of fertilizer and chemicals. Fertilizer prices, in turn, jumped 24 percent over the 1979 price level, and prices of agricultural chemicals climbed 17 percent. Meanwhile, interest charges rose some 25 percent over 1979 rates, reaching historic highs. Farm and motor supplies advanced 17 percent as did prices for farm chemicals. Sizable price gains for two other important production items also took more money out of farmers' pockets—for example, a 13 percent increase in the price of feed and a 12 percent upturn in the prices of tractors and self-propelled machinery.

There is little doubt that all farmers felt the pinch of the cost-price squeeze last year. But of course it was more painful for some than for others. For the many crop farmers whose incomes were greatly reduced by drought, the squeeze was no doubt exceedingly painful. It was also a rough experience for many livestock and poultry producers, especially during the first half of 1980 when prices received for feeder cattle, hogs, broilers, and eggs were generally below year-earlier levels. For many of these producers, prices for their products were below the costs of production. Furthermore, the severity of the cost-price squeeze reportedly was expected to force many small farmers, including many small, nonmechanized tobacco growers, out of the farming business in 1980.

Interest Rates Volatile Bank interest rates charged on farm loans last year were unusually volatile, moving up and down from quarter to quarter as if they were on a roller coaster. The average rates charged on loans to farmers virtually skyrocketed during the first quarter, shooting up 3.5 percentage points over the previous quarter and 5.6 percentage points from a year earlier. With this surge, interest rates rose to record levels, and farmers found themselves having to pay an average of 16.6 percent interest to obtain a bank loan.

The trend in interest rates reversed in the second quarter and actually dropped almost as sharply as they had risen in the previous quarter. Then, after edging upward slightly during the third quarter, bank rates on farm loans soared again during the last quarter, hitting new highs that averaged 16.9 percent. Rates varied by type of loan from quarter to quarter, with interest charges on farm operating loans showing the largest year-to-year increase.

But average interest rates do not tell the whole story. Increasingly, as more bankers began pricing their farm loans at variable rates, many District farmers found themselves having to pay the prime rate, plus 1 or 2 percent.

Last year's interest rates forced many farmers into having to make some agonizing decisions: Whether to borrow or not to borrow was the big question. Many farmers who would have had to obtain loan funds to purchase "big ticket" items, such as machinery and equipment, decided against buying in 1980. Some had to make the decision to reduce the purchase of fertilizer, an item usually bought on time.

Farm Loan Demand Weak Because of the extremely high interest rates and the high and rising costs of production, the demand for farm loans remained weak throughout the year, particularly so at commercial banks. Bankers noted a continued weakening in the demand for farm loans as the year progressed, with the slowdown accelerating in the fourth quarter. Farmers apparently stayed away from loan windows in large numbers, since loan demand each quarter was reported to be well below year-earlier levels.

Even though interest rates at production credit associations and Federal land banks were lower than those at banks, there was also a decided slowdown in the rate of farm loan demand at these lending institutions. The pace of new farmer borrowing from PCAs and the FLBs slackened during the first half of 1980 and then fell below year-earlier levels in the second half—PCAs by 5 percent and the FLBs by 28 percent.

The generally weaker loan demand by farmers last spring and summer was most unusual. But there is little doubt that the situation helped to improve the liquidity conditions of banks heavily involved in farm lending. This slack in farmer borrowing appears to have resulted from many factors. The most obvious, perhaps, were these:

- High interest rates that caused some farmers, normally bank customers, to shift their loan demand to PCAs where funds were available at lower rates of interest.

- Many farmers voluntarily cut back on their purchases—and hence the need for borrowed funds—because soaring production costs and depressed prices for many farm commodities were reducing expectations for a break-even year, much less a profitable one.

- The Special Credit Restraint Program, particularly the misunderstandings pertaining to it, surely played a significant role in reducing the demand for non-real-estate farm loans at banks during the spring quarter.

The continued weakness in farm loan demand in the third and fourth quarters, however, would appear to have been related largely to:

- The serious cash-flow problems that many farmers were experiencing—problems that reduced their ability to repay outstanding loans and made them hesitant to assume additional debt.

- Moreover, widespread areas of the District were declared drought disaster areas, so many farmers became eligible for disaster loans from the Farmers Home Administration and/or the Small Business Administration at lower rates of interest.

- And, as one banker pointed out, "Current high interest rates have caused farmers to take a wait-and-see attitude."

Supplies of Loanable Funds Ample Bank supplies of farm loan funds in the Fifth District remained relatively ample throughout the period of the expected crunch last spring, although credit was extremely tight in some parts of the country. There was a little evidence that some banks heavily involved in farm lending were faced with liquidity pressures in the spring, yet the supply of production credit seemed adequate to meet demand in most sections of the District. But in an effort to help farmers obtain loan funds at better rates of interest, one-third of the bankers reporting said they referred would-be borrowers to nonbank credit agencies in above-normal numbers.

With the generally weaker farm loan demand evident in the first quarter continuing throughout the year, the aforementioned liquidity pressures eased. Bank supplies of farm loan funds improved from both the spring quarter and year-ago levels during the second quarter, showed further improvement in the third quarter, and remained at that improved position during the final quarter of the year. Moreover, from one-fifth to one-fourth of the survey respondents in each of the last three quarters indicated that funds available for lending to farmers were greater than usual.

Other conditions also pointed to the improved availability of farm loan funds at banks during the last nine months of 1980. The best indication, perhaps, occurred in the second quarter when not a single District bank—member or nonmember—took advantage of the opportunity to borrow from the Federal Reserve Bank's discount window under the Fed's temporary, simplified seasonal loan program implemented in April.

Repayments Down, Renewals Up Measured in terms of loan repayment rates and loan renewals, the quality of farm loans held by banks deteriorated significantly during 1980. While the declining quality of farm loan portfolios represented problems for many bankers throughout the year, these problems intensified as the harvest season progressed. By the fourth quarter, the combination of drought-reduced crop output and income and one of the tightest cost-price squeezes in years had created cash-flow problems for many Fifth District farmers. Bankers, as a result, experienced much slower loan repayment rates and a sharper increase in requests for loan renewals than in the same period a year earlier. Not only was the quality of farm loans held by banks much poorer than at the same time in 1979, but it was also well below the level in 1977 when drought-reduced farm income also plagued District farmers.

Because of current farm financial and credit conditions, some refinancing of farm loans will be necessary. Some farmers reportedly will have to obtain the second disaster loan in recent years from the Farmers Home Administration or the Small Business Administration or sell out.

In Summary Last year was, indeed, a difficult year for Fifth District farmers. It was also a year that many farmers would like to forget. As one South Carolina banker described the situation, "Bad weather, inflation, and high interest rates combined made 1980 the worst year for farmers in recent history." Because of the need to obtain renewals and extensions of existing loans, many farmers in the drought-stricken areas are heavily burdened with debt. Some have experienced losses for three out of the last four years, and for them conditions seem bleak. Fortunately, however, the situation is not as grim for all farmers. Those not affected by last year's adverse weather, the better managers, and those with other resources to fall back on remain in a strong financial condition.

In view of the heavy financial losses experienced by many Fifth District farmers in 1980, it is encouraging to note that the agricultural outlook for 1981 is much more promising. Higher farm prices and improved farm income are expected because of tighter supply conditions. Gross farm income promises to increase substantially, rising more than production costs. Under this set of circumstances, net farm income will probably rebound from last year's level and may recover all of 1980's losses. Of course, the full realization of these prospects will depend, to a great extent, on whether growing conditions are more nearly normal and on whether higher farm prices materialize as expected.