FARM FINANCIAL AND CREDIT CONDITIONS

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Weather and the cost-price squeeze competed for top billing in the Fifth District's story of farm financial and credit conditions in 1976. Both played important parts, although geography determined which factor got the leading role. In localities where spring freezes, summer drought, or too much rainfall at harvesttime cut deeply into the year's harvest, weather took the spotlight; where weather was normal, the cost-price squeeze was the prime performer.

Weather's fickleness caused output to vary . . .

Where weather played the starring role, it often "played favorites"—at times exerting strongly favorable, at others, unfavorable, influences on local farm production, income, and credit conditions.

Weather's favorable role in crop output in 1976 was accomplished without too much fanfare. Adequate rainfall and a good growing season in many areas aided in producing better yields per acre. The improved yields plus larger acreages combined to produce favorable results for some crops. Cotton output jumped 49 percent. The corn crop increased 25 percent, and peanut production rose 12 percent. Tobacco yields averaged slightly higher, but drought conditions in some areas and cuts in acreage held total poundage down some 6 percent below 1975.

But weather's part in causing sharp declines in production was of unusual scope and severity. With the hard spring freezes, fruit crops suffered severe frost-freeze damage in large areas of the District. The apple crop, a telling case in point, was 29 percent below year-earlier levels. Soybeans were especially hard hit, both by extremely dry growing conditions and by a wet harvesting season, and yields per acre fell sharply. The lower yields in combination with smaller acreage cut soybean production 28 percent. Hay tonnage dropped 18 percent. And because of the shortage of hay and poor pasture conditions, some farmers were forced to sell their cattle early at low prices.

. . . and the cost-price squeeze tightened.

The squeeze between costs and prices continued to be a major factor in farmers' financial conditions in 1976. But the intensity of the squeeze varied with the type of farming. Costs of materials used in farm production, interest, taxes, and wage rates averaged around 7 percent above a year earlier. Even so, the rise in farm production expenses was slower than in other recent years, reflecting lower prices for fertilizer and seed and relatively small gains for feed and chemicals.

No doubt the role of the cost-price squeeze was not readily recognized by some farmers. For those producing tobacco, cotton, soybeans, peanuts, eggs, and milk, higher prices overshadowed cost pressures. But the lower prices for cattle, hogs, poultry—especially turkeys—and both feed and food grains made the pinch of the cost-price squeeze not only apparent to, but painful for, their producers.

Costs rose faster than income.

Whether the District's farmers remember 1976 as a poor year or as a good one will depend on what combination of crops and/or livestock they produced. Some will almost surely count it a good year. Others will not be so fortunate. But when the cash income from all crop and livestock marketings is added up, total cash receipts may run slightly higher than in 1975. Livestock production has provided the basis for a high and improved level of income from livestock and livestock products. But crop marketings may not be large enough to bring crop income up to the 1975 level. Much will depend on the volume of crops stored for sale later in hopes of a recovery in prices.

All in all, the situation points to only a slight increase in gross farm income in 1976. And with the modest gain in gross income likely to be offset by the rise in production expenses, realized net farm income seems almost certain to fall short of the 1975 figure.

Note: This article is based on summary reports of this Bank's Quarterly Survey of Agricultural Credit Conditions in 1976 and on the latest statistical information from the U. S. Department of Agriculture, the Farm Credit Administration, and the Federal Reserve Bank of Richmond.

Demand for farm loans was strong . . .

Farmers' demand for short- and intermediate-term loans was generally strong throughout the year, both at commercial banks and at production credit associations. This general increase in demand for loans stemmed in part from the continued rise in the costs of production and the sharply higher prices of farm machinery and equipment. Strength in loan demand also came from the expansion in poultry and hog operations and from new and expanding dairy operations. Moreover, there was a big demand for loans to build on-farm storage facilities, especially in the Carolinas.

Weather-induced problems also strengthened the demand for loans. After experiencing widespread dry weather conditions in the early fall, some livestock producers borrowed funds to buy feed. By late fall, however, wet weather delayed harvest of some fall crops and increased the demand for loan renewals.

Statistical evidence supports these findings. Short- and intermediate-term farm debt held by member banks at midyear was 14 percent above a year earlier, while the loan volume held by PCAs was up 10 percent. But farmers stepped up their borrowing from PCAs sharply during the third and fourth quarters, particularly so in the third. As a result, the volume of loans made by PCAs for the year as a whole was 18 percent larger than in 1975. And the year-to-year gain in PCA loans outstanding amounted to 14 percent.

Unlike non-real-estate farm loans, demand for farm-mortgage loans in 1976 was comparatively weak. While farm real estate loans held by member banks in mid-1976 were down fractionally from the year-earlier level, outstanding loans held by the Federal land banks showed a gain of 12 percent. But the volume of new money loaned by the Federal land banks during the entire year was 10 percent below that in 1975. Most of the decrease came in the first half of the year and followed on the heels of even larger declines during the second half of 1975. By year-end 1976, loans outstanding at the Federal land banks were 11 percent above the level a year earlier. Could these changes represent a return to a more normal lending pattern when annual loan increases were not so high as they have been in recent years? Reportedly, farmers were less optimistic over farm income prospects in 1976 and hence were hesitant to make large long-term capital investments. Then, too, other lenders—especially life insurance companies—increased their share of the volume of credit-financed farmland transfers during the year.

. . . but fund availability was ample . . .

Bank funds available for making short- and intermediate-term loans to farmers were generally ample throughout the year even though farm loan demand was strong. (By contrast, fund availability for long-term real estate lending was reported to be a continuing problem for some banks.) While loan fund availability varied considerably from bank to bank and state to state, banks with the greatest availability of funds were most often located in the Carolinas. The general availability of loan funds at commercial banks has stemmed both from strong inflows of time deposits and from a continued weak, but improving, business loan demand.

Rarely 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—further evidence of the availability of ample funds for lending to qualified farm borrowers. Moreover, bankers reporting that they were actively seeking new farm loan accounts usually ranged from 60 to 70 percent of all respondents.

Since bank loan funds were ample, loan referral activity remained fairly weak. Generally, the number of bankers making referrals to correspondent banks was small, probably because many of the sampled banks are either large branch banks or bank holding companies. More banks as a rule reported referrals to nonbank credit agencies, but the volume of these referrals was not unusual.

Banker respondents in this five-state area do not appear to be too enthusiastic about the Farmers Home Administration's guaranteed loan program nor with the provisions whereby commercial banks and production credit associations can jointly participate in making farm loans. Some bankers indicate that too much red tape is involved; others say they would much prefer to have the opportunity to participate with the Federal land banks.

Merchants and dealers, especially those selling farm machinery and equipment, provided a higher volume of loan funds in 1976 by strengthening their lending activity over that in other recent years. Increased selling competition seems to have provided the impetus for this change in lending policy.

. . . and interest rates showed mixed trends.

On the average, bank interest rates on farm loans eased slightly during the first three quarters of 1976, with the most noticeable lowering of rates occurring in the third quarter. Rates on short- and intermediate-term loans softened much more than those

on farm real estate mortgages. This lowering of bank interest rates was in line with the general movement of interest rates during 1976 at PCAs and other major institutional farm lenders and was a boon to farm financing.

But average interest rates charged by banks on short-term farm loans edged upward again during the fourth quarter of the year. Rates charged on both feeder cattle and other farm operating loans averaged 8.89 percent, about the same as a year earlier. Rates reported for intermediate-term loans averaged 9.29 percent, down from the 9.48 percent charged 12 months before, while the average charge of 9.28 percent on farm real estate loans was up fractionally from the average reported for the fourth quarter of 1975. Bank interest charges on farm loans in 1976 generally varied widely, both among banks and by type of loan, with "typical" rates reported by banks ranging from a low of 7 percent to a high of 12 percent.

Farmers' financial conditions vary.

Despite the further tightening of the cost-price squeeze, some weather-induced shortages in cash farm income, and the continued upturn in farm debt, a majority of the District's farmers remain in generally good financial condition. With market values of farmland continuing to advance during the year, most farm owners are in an improved equity position.

But the cash income position of farmers varies substantially. Better incomes enabled a good many farm producers to meet their loan obligations on time. On the other hand, where cash returns were unfavorable, delinquencies were high—especially in certain sections of Virginia, Maryland, and South Carolina. Many of these farmers, unable to make their loan repayments as scheduled, found it necessary to renew or extend their loan obligations. Some no doubt began 1977 with larger debts or less cash, or both, than they had at the beginning of 1976.

Most of the District's farm lenders, however, will probably remember 1976 as a comparatively good year. Demand for non-real-estate farm loans was strong throughout the year. But bank funds available for making short- and intermediate-term loans to farmers were generally ample, and loan referral activity remained fairly weak. Bank interest rates charged on farm loans showed mixed trends, easing slightly earlier in the year and edging upward again in the fourth quarter. By and large, most bankers had little trouble with repayment rates, renewals, and extensions until the fourth quarter when the rate of loan repayments slowed noticeably and requests for renewals or extensions rose significantly.

THE RELEVANCE OF ADAM SMITH

The Federal Reserve Bank of Richmond is pleased to announce the publication of *The Relevance of Adam Smith,* a reprint of the *1976 Annual Report*'s feature article. This booklet discusses how Smith's ideas, as revealed in *The Wealth of Nations,* appear in contemporary public policy debates regarding, e.g., monopoly and government subsidies and centralized economic planning. It may be obtained free of charge by writing to Bank and Public Relations, Federal Reserve Bank of Richmond, P. O. Box 27622, Richmond, Virginia 23261.