Federal Reserve Bank of Dallas
FARM and RANCH BULLETIN

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FARM CREDIT DEMAND SURGES WITH IMPROVED INCOME OUTLOOK

Total agricultural debt is expected to reach $79.4 billion by year-end—a 10.6-percent increase over a year earlier and a record annual gain of $7.6 billion. Rising prices both paid and received by farmers, expanding demand for agricultural products, record farm income levels, and a bright economic outlook have all combined to stimulate this surge in credit demand.

Record advances

The growth in farm debt is fairly evenly distributed between the real estate and non-real-estate sectors, and both are expected to show record advances this year. Real estate debt is expected to increase 9 percent to $38 billion, while the non-real-estate debt could advance 11 percent to over $41 billion.

For the second consecutive year, all components of farm debt have been establishing record increases. Although credit has expanded because of higher farm prices, some of the current demand is borrowing postponed from the 1968-70 period. In that period, lower farm incomes, tight credit conditions, and fairly high interest rates markedly slowed the rate of growth in agricultural investment and farmland demand. Farm equipment purchases declined in 1970 and 1971. In 1970, average farm prices had increased only 3 percent—the lowest rise in a decade.

It now appears that investment demand is well above the normal rate of replacement plus postponed demand. Agricultural investment and the resulting credit demand are also responding to the expanding domestic and foreign market situation and the very favorable income outlook.

The resurgence in agricultural investment is reflected in both rising farmland prices and new equipment purchases. Average prices for farmland were up 5 percent in 1971 and 10 percent in 1972 and appear to be rising at an even faster rate this year. Tractor purchases, the largest component of equipment purchases, advanced 20 percent in 1972 and are running 23 percent ahead this year. The average size of equipment has also been increasing, with higher average prices and, consequently, large credit needs.

Interest rates in late 1971 and in 1972 were lower than in the tight money situation in 1969-70. But in the third quarter of 1973, interest rates in many cases were above the previous period of tight financial conditions. Like any input, however, the cost of credit is relative to expected returns. Farmers and ranchers currently expect returns that will service the higher carrying costs.

Demand for credit is broad-based, with virtually every sector of the economy attempting to expand capacity and consumer demand also quite high. In contrast to the late 1960's, agriculture is, however, competing well in the market for credit. This is because of agriculture's stronger financial position—due to record income levels and the response of agricultural lenders.

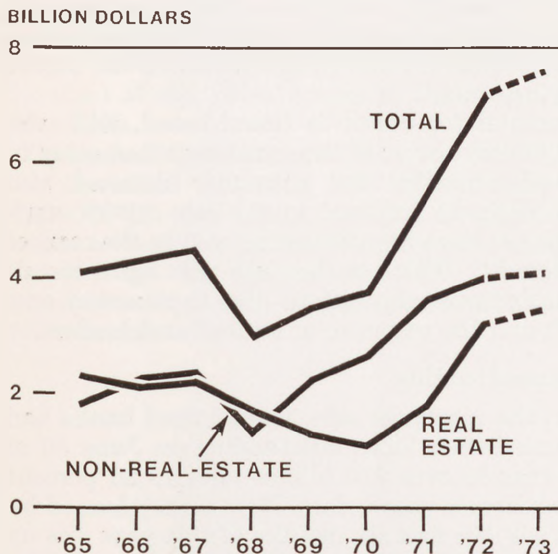
Increased lending

On the mortgage side, federal land banks had increased their loans outstanding on June 30 of this year to over $10 billion—nearly 20 percent higher than a year before. New money loaned by FLB's in the first six months of this year was up 69 percent from the same period last year. The Farmers Home Administration had increased its farm ownership loans outstanding by about 7 percent to $2.3 billion on June 30 and loaned new money for the first six months at a rate 38 percent above the same period last year.

Insurance companies, which showed declining agricultural loan portfolios the past few years, also had a small increase in outstandings as of June 30—to a level of over $5.5 billion. But more importantly, new money loaned by insurance companies to agriculture during the first six months was up 40 percent. Commercial banks reported $4.7 billion in farm real estate loans on March 28, a gain of more than 4 percent over mid-1972.

Commercial banks are the largest institutional source of production credit for agriculture. As of March 28 this year, the amount of these loans at banks was $14.3 billion, about 5 percent above mid-1972. Weekly reporting banks have shown continued growth in their agricultural loan portfolios, and an even larger gain is expected for the remainder of the year.

Production credit associations represent the second largest source of short-term credit for farming. Their total outstandings on June 30 were about $7.5 billion, or nearly 10 percent above a year earlier. The amount of new loans, including renewals, in the first six months was 18 percent ahead of the same period last year.



1972 figures preliminary
1973 figures projected
*Data are for 48 states only.

SOURCE: U.S. Department of Agriculture

Credit conditions

The surge in agricultural debt and growth in farm lending are indications that agriculture, in general, has been able to obtain large amounts of credit. But since some income declines may develop, such as in cattle feeding in late September, there is concern about future conditions.

There is always uncertainty about the future levels of agricultural prices and farm incomes. If prices and incomes break—either in general or for specific commodities—farmers, ranchers, and lenders could be caught with large amounts of credit under difficult terms. Many smaller rural banks are also concerned about the general elimination of Government payments. These have served, in the past, as both loan guarantees and as a source of deposits to service additional credit needs. Although loanable funds in some local areas could become scarce, it does not appear that loan repayment or servicing next year will be a major problem.

Problem areas

Currently, some localized problems seem to be appearing. The uncertainty of prices in the future, coupled with tight credit conditions, has been cited as a possible reason for the slow expansion in hog numbers and could also be moderating expansion of other enterprises. Some local market areas are feeling a credit squeeze because of the unusually large demand from merchants and processors. There is some concern that the plight of these businesses might have a dampening effect on local prices—or at least, might slow

cash flows. A similar concern is arising in the cattle feeding sector—a large user of short-term credit—as some investors from outside agriculture have lost money on cattle contracts recently. They could shift to alternative investments, leaving a larger need for internal financing.

These problems may never develop or may be minor in impact. Farmers, ranchers, and lenders are, however, being challenged to find ways to realistically finance agricultural expansion and maintain their mutual viability.

HOG CYCLE NOT RESPONDING TO RECORD PRICES

The hog cycle, at least until recently, has been a classic economic example of production response to price change. The typical hog cycle averages four years from peak to peak, with peak production lagging peak prices by slightly more than a year. The low point for prices generally coincides with the high point in production. The difference between the time relationship of prices and production is the result of their respective reaction times. Prices respond constantly to market conditions, but production is constrained by the biological cycle of pigs, which exceeds a year.

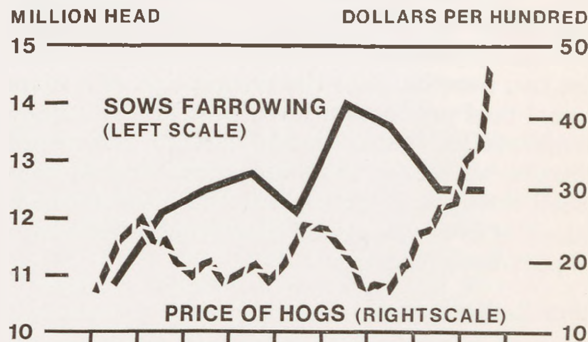
The current cycle began in 1970, when prices peaked and the pig crop soared to the highest level since World War II. Prices plummeted in 1971, and the pig crop fell sharply in 1972—as would be expected from past cycles. But in spite of record hog prices in 1972 and so far this year, production has not increased noticeably and farrowing intentions into next year are at about last year's level. The question of why the hog cycle has apparently lost its predictable nature is being raised.

New influences

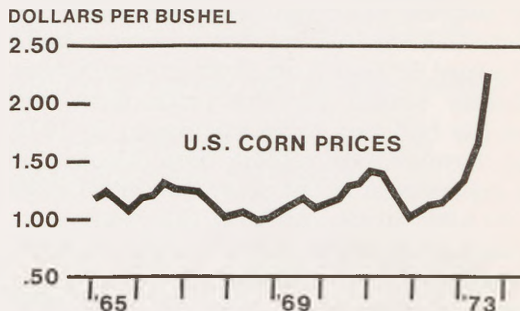
A major factor seems to be that pork production continues to be tied to farmer-feeders that operate both corn and hog enterprises. In the past, many of these farmers have marketed their corn in the form of pork. The main determinant in hog production has, historically, been hog prices. Corn prices have not been a major determinant because of their relative stability, but the hog-corn ratio has determined profit levels.

But this year, corn prices have rocketed upward, allowing these farmers to sell their corn at unexpectedly high prices—guaranteeing good incomes with none of the risk associated with feeding hogs. So, in spite of a favorable hog-corn ratio in most of the past year, the potential profits may not be adequate to offset the uncertainties associated with the hog market.

FARROWINGS FOLLOWED LEAD OF PRICES UNTIL '72 . . .



. . . WHEN CORN PRICES SOARED



SOURCE: U.S. Department of Agriculture

Some hog feeders undoubtedly consider the recent price levels of hogs to be somewhat artificial, due to marketing distortions associated with price controls. After the record hog prices in August, prices have declined sharply in the past two months. And the resumption of a more normal beef production level, plus broiler supply normalization, could cause further downward pressure. Moreover, most indicators suggest continued strength in grains but the possible moderating of livestock prices. This would discourage the part-time feeders.

Other limitations

It has also been suggested that the failure of farrowings to expand in line with expectations last winter and spring was due, in part, to wet weather and an extremely late harvest in the Corn Belt. As a result, many farmers never had a chance to turn to hogs from their crop activities. And another reason for the production level could be the bad hog price experience in 1971. Although farmers have seldom been discouraged by such experiences in the past, they have often lacked the alternatives available this year.

Hog feeding is increasingly following the lead of beef feeding. Feeders are becoming specialized, which promises more stability in the future. But the prevailing high interest rates could be slowing expansion plans, especially in light of current price uncertainties. If prices of corn and protein meal moderate in the coming months and if hog prices hold up, expansion of the pig crop can be expected in 1974.

URBAN EXPANSION ABSORBING SMSA FARMLAND

The proximity of farmland and urban land is often overlooked. About 17 percent of the nation's farms are, in fact, within standard metropolitan statistical areas (SMSA's). And although SMSA's have only 13 percent of the nation's land, the value of agricultural production exceeds a fifth of the national total.

A core city of at least 50,000 people is requisite to establish an SMSA, but the designation is countywide and, therefore, often includes large tracts of nonurban land. Of the total land area within SMSA's in 1970, only 10 percent had urban uses while over two-fifths was used for agricultural enterprises.

Historically, the importance of agriculture in the development of areas now designated as SMSA's is understandable. Food storage and transportation limitations demanded that most cities develop in areas with adequate agricultural capabilities to support their populations. Also, many cities have developed as service, processing, or shipping centers for local agriculture. In addition, the same terrain, climate, and soil types that are advantageous to agriculture are the most compatible for urban uses.

Urban expansion is exerting pressure on the SMSA farmlands, however. It was estimated in 1970 that for every person added to the 242 SMSA's, a third of an acre was lost to urbanization. For cropland specifically, that meant 40 acres an hour were lost to other uses. Moreover, such pressures as rising taxes and higher land costs are dampening SMSA farm operations.

Increasing population poses a twofold threat to farmland. On the one hand, the nature of population concentration—suburban expansion and necessary transportation systems—is land-consuming. And on the other, proposals of deconcentration—such as the creation of "new towns" —would likewise retire farmland.

Persistent farm surpluses and rapid gains in agricultural productivity have, until recently, minimized concern about the loss of farmland to urbanization. But the current drop in food and fiber stocks is raising the issue of farmland loss as it affects future production capability. For the country to have an abundance of food and fiber and maintain a firm footing in the growing world market, consideration must be given to the general question of land use.

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