Federal Reserve Bank of Dallas
FARM and RANCH BULLETIN

December 1974

NATION'S FARM DEBT CONTINUES TO RISE

Agricultural debt increased some $10 billion in 1973—despite a historic surge of nearly $15 billion in net farm income. Both long-term and short-term debt shared in the increase.

With record demand for their output, farmers increased their purchases of such big-ticket items as machinery and equipment and improved their real estate assets. But even with record inflows of cash, these purchases called for more use of credit, as did the purchase of more production items needed to cultivate expanded acreages. Production expenses alone increased $12 billion last year—partly from the increase in production items farmers and ranchers bought and partly from the higher prices they paid.

And in response, the main institutional lenders—commercial banks, production credit associations, federal intermediate credit banks, and Farmers Home Administration—increased their non-real-estate farm loans outstanding by 19 percent in 1973.

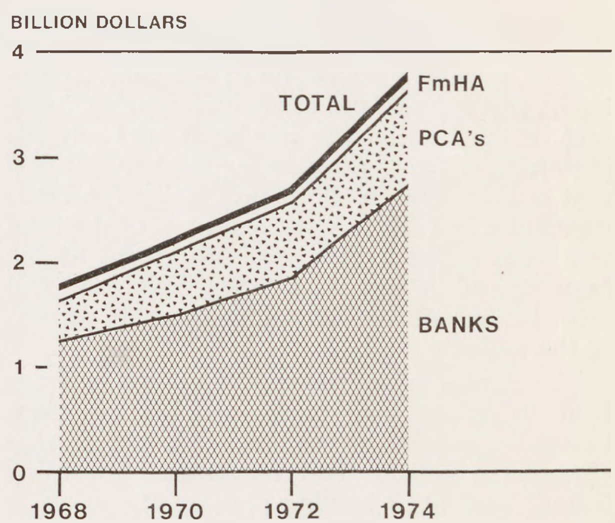
The growth in farm incomes helped expand deposits at rural banks, boosting the availability of loanable funds. Banks provided the largest amount of operating credit, expanding their agricultural loans 20 percent. Production credit associations followed as the second most important farm lenders, boosting their loans 18 percent.

Growth in bank lending seems to have slowed considerably since last year, although farm loans at banks are still running well ahead of levels a year earlier. Lending by PCA's has continued to rise. This fall, PCA loans outstanding were up nearly a fourth from a year before. These associations obtain most of their loanable funds by discounting loans with federal intermediate credit banks, which raise funds by selling their securities in major money markets.

Although a small part of the total, direct loans by federal intermediate credit banks to lending institutions other than production credit associations also rose sharply last year. The rise was related to an increase in borrowing by various types of financial institutions, including agricultural credit corporations.

Several new ACC's have been established in recent years. Sometimes, an ACC is affiliated directly with a commercial bank or indirectly

NON-REAL-ESTATE FARM LOANS HELD BY PRINCIPAL LENDERS, FIVE SOUTHWESTERN STATES, JANUARY 1



1974 figures estimated
SOURCES: American Bankers Association
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through a bank holding company. Other times, it is established as a nonbank financial institution, the choice of affiliation depending on state and federal laws and objectives of the institution. Major advantages of ACC's are their flexibility in raising loanable funds and their ability to service large farm accounts.

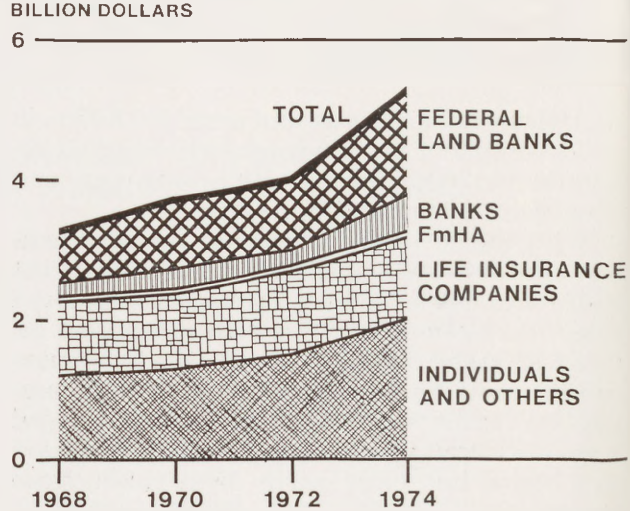
The Farmers Home Administration ended 1973 holding 12 percent more non-real-estate loans than at the start of the year. Because of recent legislation allowing the administration to guarantee loans, as well as make direct loans, much of the increase last year was in insured loans. By insuring loans, the administration can stretch budget funds to help more borrowers.

Farm real estate debt rose nearly as fast in 1973 as non-real-estate loans. The main reason for this big gain was the record transfer of farmland ownership at prices that averaged a fourth higher than in 1972.

There has been some substantial shifting over the past ten years in the distribution of farm loans held by major lender groups. Basically, the Farmers Home Administration and commercial banks have maintained their shares of the total volume, holding 8 percent and 13 percent, respectively. But federal land banks held nearly 27 percent of the outstanding real estate debt at the beginning of 1974, compared with about 20 percent in 1964. And the share held by life insurance companies had fallen from 23 percent of the total ten years earlier to less than 15 percent at the beginning of the year. Altogether, individuals and other lenders still accounted for about 38 percent of the nation's total.

The change in the shares of outstanding loans held by federal land banks and life insurance companies reflects, on the one hand, considerable changes in policies and regulations governing federal land bank lending and, on the other, a slowing in the growth rate of funds available to life insurance companies for farm lending. One significant change was an increase in loan limits at federal land banks—which allowed the banks to become more progressive in their lending practices.

FARM REAL ESTATE LOANS
HELD BY PRINCIPAL LENDERS,
FIVE SOUTHWESTERN STATES, JANUARY 1



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Indications are that farm debt will probably continue its rapid advance. By the third quarter of this year, production expenses were still growing at an annual rate of about $12 billion—and gross farm income was about the same as a year earlier. With modern farming methods depending on capital outlays, it is not practical for farmers to cut their spending. Caught in a narrowing gap between receipts and expenditures, they will have to borrow more to keep up with their operating expenses.

This was amply pointed up last year. With record farm incomes, debt repayment increased sharply. But with the rising need for credit to expand farm production, the increase in repayments was not enough to keep the farm debt from rising.

The demand for farm credit is broad based. Although unit tractor sales have slowed this year, farmers continue to invest in expensive machinery and equipment. And the capital requirements for operating expenses have skyrocketed. Average prices paid by farmers in October were 17 percent above a year earlier.

Higher production costs have joined forces with crop failures and a dramatic decline in livestock prices to drive incomes down. And in the face of these setbacks, farmers and ranchers need more capital and credit to expand production. Without a marked increase in U.S. agricultural production, there is little hope of relieving the worldwide shortage of food commodities.

As a group, agricultural lenders apparently stand ready to help. But such roller coaster markets as have been seen in cattle and cotton over the past two years make planning hard. Producers and lenders alike view prospects for prices and incomes in 1975 with frustration. Conditions are uncertain in markets for both farm commodities and supplies used in farm production.

Despite expectations that grain prices will remain strong and that livestock prices will improve in 1975, the high costs of all farming inputs are generally viewed with caution in the development of farm lending agreements.

Looking further into the future, trends toward larger farms and ranches are expected to continue, requiring still larger capital investment. And although the outlook is for gross sales per operation to climb, for these operations to exist, liabilities must increase, causing owner equities to drop well below the current average of about four-fifths. As a result, demand for capital will continue to increase, with a growing proportion of capital being provided by some form of credit.

These developments—all pointing to larger farm loans in the future—emphasize that in evaluating credit worthiness, lenders and borrowers should give greater recognition to the importance of managerial competence, cash flows, and ability to repay debts than to equity positions. For farmers and ranchers, such a shift in emphasis will require adequate operating records and financial statements—including a set of records that can be analyzed for comparative earnings of other enterprises. For lenders, the shift will require not only information about financial markets but also a sound background in credit arrangements, general business procedures, and agriculture.

With more investment capital needed per dollar of net income flow, loan maturities need to be brought into line with the useful life of the assets being bought. This includes farm improvements, machinery and equipment, and breeding livestock. Essentially, agricultural borrowers need an annual line of operating credit that will meet the cash flow of individual operations. To tailor credit to the cash flow plans of individual operators, all loans—short, long, and intermediate term—need to be packaged together.

GLOBAL COTTON STOCKS UP AS RESULT OF DROP IN DEMAND

World cotton stocks are expected to increase again this season, with the United States accounting for much of the gain. The world's 1974-75 crop will probably exceed world consumption by about 1 million bales. That will be on top of a 1.6 million-bale gain last year.

In the United States, weaker demand will cause use of cotton to fall well below last season's seven-year high of 13.6 million bales. Together, domestic use and exports are not apt to exceed 11 million bales.

Demand for cotton has been curtailed by the general slowdown in economic activity. With unemployment rising and inflation eroding the consumer's purchasing power, demand for textiles in general—and cotton products in particular—is shrinking. The results have been production cutbacks and mill closings.

Domestic mills are expected to consume less than 7 million bales this season, compared with 7.5 million last season. According to the USDA's

COTTON PRODUCTION

(Thousand 480-pound net weight bales)

Area	1974, estimated Nov. 1	1973	1972
Arizona	942	653	652
Louisiana	575	521	705
New Mexico	150	146	173
Oklahoma	330	427	332
Texas	2,825	4,699	4,277
Five states	4,822	6,446	6,139

SOURCE: U.S. Department of Agriculture

November estimate, domestic use will range from 6.3 million bales to 6.8 million. That opens the possibility of not only a 1 million-bale reduction from last season but a 2 million-bale reduction from the 8.8 million-bale annual average consumption of the sixties.

Shipments abroad have also dropped. There has been a substantial weakening in textile activity in the major consuming countries. Cotton and textile inventories abroad are also unusually large.

Current projections show cotton exports ranging from 4 million bales to 4.5 million. While far short of the 6.1 million bales shipped in the 1973 season, the projected range is still well above the 1968-72 average of 3.7 million.

With disappearance due to be less than production, cotton stocks next August could total 5 million bales. That would be the largest carryover since 1970.

Growers are now harvesting cotton from 13.1 million acres. While considerably more than the 12 million acres harvested in 1973, production is off sharply because of adverse weather. Production on November 1 was estimated at 12.1 million bales. Because of growing conditions that were too wet in the Mississippi Delta and too dry in the High Plains of Texas, the crop is expected to be 7 percent smaller than last year. The upland cotton crop in Texas—the largest cotton-producing state—is estimated at 2.8 million bales. Down sharply from the 4.7 million bales harvested in 1973, this will be one of the smallest Texas crops on record.

HIGH FEED PRICES CURTAIL LIVESTOCK OUTPUT

The nation's livestock producers are planning sharp cutbacks in production because of the shortfall in feed grain supplies and the resulting higher feed prices. Supplies of feed grains for the 1974-75 season are believed to be the lowest since 1957. By contrast, demand is much greater than it was then. Not only is world demand for grain strong, but U.S. livestock inventories are large. While the nation's dairy herd is 40 percent smaller than in 1957, with the increase in cattle feeding in recent years, the total inventory of cattle is 40 percent larger than it was then. In addition, poultry numbers are up 80 percent. And there are 8 percent more hogs.

As a result of the cost-price squeeze, hog and poultry producers are planning sharp cuts in production. The number of sows farrowing this fall is significantly less than last year, and the spring pig crop may be even smaller. Broiler producers have reduced their hatchings, and output should stay below year-earlier levels far into 1975. The slaughter of cattle remains high despite a drop in the number of head on feed.

If grain prices remain at current high levels well into next year, livestock production will probably be reduced even more than indicated now. Some farmer-feeders will decide to sell grain rather than risk feeding their own livestock for sale under depressed market conditions. Since the market for grain is worldwide but domestic demand dominates the livestock market, it is possible for high grain prices to reduce livestock production to a point where a big shortage of meat could develop, causing livestock prices to skyrocket.

Prepared by Carl G. Anderson, Jr.