How 14½% prime will effect farmers

LANCASTER—As the prime interest rate hit 14½ per cent this week farmers throughout the area began reviewing financial plans. The prime rate is the rate banks charge their best customers.

Predictions from all sectors of the commercial banking industry were gloomy as the federal government attempted to combat inflation by making money less available to potential borrowers.

Still, there are at least two brighter spots in the farm financial community.

Becuase of its unique situation, the Farm Credit System may not be effected as dramatically by the interest hikes as some commercial institutions. And observers in the market say the commodities exchanges should not experience the beating taken by issues traded on the New York and other stock exchanges.

All segments of the money market predict expensive money and add that money will be difficult to come by.

Still, the Production Credit Association's rate to farmers for operating cost loans is expected to remain at 11 per cent for the near future.

The current discount rate for commercial banks is set at 12 per cent. This is the rate commercial banks pay for the money they borrow to lend, in turn, to their customers.

By increasing the cost of money the banks lend to farmers and other customers, the Federal government hopes to discourage spending and thus slow inflation.

The PCA's do not foresee any change in their interest rate at least until the end of the year. In the changing money market of today, that rate is not guaranteed to hold through December, though.

PCA loans will remain at the 11 per cent rate despite the PCA's own cost of 11.4 per cent as of October 1 for the money it lends. The PCA can hold its costs lower because it blends the current interest costs with old loan money lent at year-ago rates nearer 9 per cent.

Carl Brown at the Lancaster Farm Credit Association office explains the PCA was established to make sure farmers have money available for operating expenses no matter how far interest rates rise.

He points out there is little way a farmer can cut back on borrowing for needed imputs. It would be difficult to fertilize only 100 acres of a 150 acre operation and let the rest go simply because interest rates for operating costs are too high.

Many farmers are hesitant to commit themselves to borrowing at current interest rates. Brown says he feels people are waiting until the last minute to make a decision on whether to borrow and how much to ask.

He does foresee a slowing of major purchases such as machinery and less expansion of physical facilities on many farms.

The Farm Credit system is regulated by the Federal government on its interest rates. All interest has been on a sliding scale since 1970.

Mortgage money for farm purchases remains at 9.5 per cent. As of December 1 the rate is expected to rise to 9.85 per cent, where it should stay for about six months.

The current skyrocketing market in interest rates, accompanied by plummeting stock market, probably will have little effect on the Chicago Board or other commodity exchanges.

Commodities brokers at Merrill Lynch, Pierce, Fenner and Smith say the current money squeeze is likely to have a harsher effect on the non-perishable commodities like precious metals than it will on agricultural futures.

Major effect on markets like the corn or soybean futures will be seen in an opening up of the price spread between quoted prices for different months.

This spread would widen to cover the increased interest costs incurred for grain stored over a longer period than grain sold out of the field at harvest, explains commodities specialist Jerry Pryor.

While most farmers in the market are hedging—selling contracts to cover grain they actually are growing—the speculator segment of the market may grow more active in coming months as non-farmers attempt to beat inflation by speculating on farm futures.

Whether this will result in price increases or in a widely fluctuating market remains to be seen.

For most farmers it will matter little whether or not the speculator is able to meet margin. No interest is charged on commodity contracts as it is on stock sales made on margin. So the interest rates should not scare speculators out of the commodities markets. Rather, they may encourage speculators to put money in the futures.

As far as the hedging farmer is concerned, it makes little difference who holds the other side of his contract. The farmer will have made a firm commitment to market his product at that price and the contract is valid whether the opposite side of the contract is a grain buyer or a city speculator.

Most sources in the money market agree the current interest rates will hurt commercial bank loan departments more than any other lending agency.

How tight the squeeze becomes, and what the ultimate effect is on farmers in this area, remains to be seen.—CH

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