

E. LOWER INTEREST RATES AND LOWER INFLATION

After a period of increasing interest rates in 1990, 1991 is beginning with significant rate declines. Many forecasters are predicting that rates will continue to moderate through 1992. The Conference Board of Canada, and other forecasters such as the Royal Bank of Canada forecasted in January 1991 a decline in interest rates of as much as two percentage points. In this context, it is important to see what impact a sustained decline in interest rates could have on helping farmers to manage the current debt levels.

Consequently, an analysis of the impacts of a potential drop in interest rates is developed in this section. While interest rates could drop by, say two percentage points, the decrease in rates on farm loans would be less dramatic as most of the debt outstanding is for fixed term loans. In the simulation, the following assumptions were made:

- i) interest rates are estimated to fall 1.1 percentage points from the base case simulation. (There already has been a slight moderation in the base case interest rates from early 1991 levels);
- ii) lower inflation and recessionary pressures are expected to reduce the rate of operating cost increases, the off-farm income and the living expenses by one percentage point; and
- iii) modest adjustments of one percentage point were made to overall levels of debt outstanding to farmers due to the impact of lower debt servicing costs.

The results of this analysis indicate that excess debt and its provincial distribution would not be markedly different from the base case. (Table 4.13) Nor are there significant different effects by type of enterprise, (Table 4.14) or by risk category. (Table 4.15).

The analysis reveals that while declines in interest rates will improve the financial risk position of farmers, this will not dramatically alter their debt position. Declining rates impact directly on the cost of operating capital. However, they do not significantly affect intermediate or long-term debt costs unless rates stay down for a period of two to four years.

The results of these five simulations are brought together in the next chapter.