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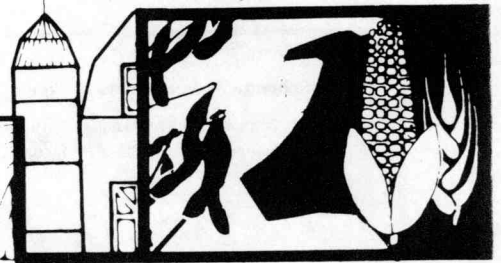
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FEDERAL RESERVE BANK OF CHICAGO

AGRICULTURAL



ISSN 0002 - 1512

January 22, 1982

Number 1569

LETTER

FARMLAND VALUES IN THE SEVENTH DISTRICT

declined during the fourth quarter. According to a recent survey of more than 500 agricultural bankers in the Chicago Federal Reserve District, the value of good farmland fell 2.9 percent during the three months ending in December. The fourth-quarter decline nearly offset the modest increases posted in the first three quarters of this year. For all of 1981, District farmland values, on average, were up only 0.7 percent—the smallest annual rise since 1960.

Land values in four of the five District states declined during the fourth quarter (see map on page 2). Wisconsin was the exception, as bankers in that state reported an increase of 1 percent. Bankers in Iowa and the District portions of Illinois and Indiana all reported declines of 4 percent. In Michigan land values decreased 2 percent in the fourth quarter. For all of last year, the change in land values varied considerably among the states. Annual increases were 5 percent in Michigan, 4 percent in Wisconsin, and 3 percent in Iowa. But farmland values slid by 4 percent in Illinois and by 5 percent in Indiana. The fall-off in land values in Illinois and Indiana may partially reflect the weakness in grain markets, because crop earnings comprise a much larger portion of overall farm earnings in those states than in other District states.

The fourth-quarter results capped a two-year period in which farmland values in the Midwest have exhibited widely changing trends. After an unusual 4 percent decline in land values during the first half of 1980, land values rose sharply in the second half of that year—reflecting a surge in commodity prices that followed the drought of 1980. The composite measure of crop prices received by farmers was up a fifth during the second half of 1980. The uptrend in land values continued, though at a slower rate, through the summer of 1981. Plummeting commodity prices during the second half of 1981—the composite measure dropped 13 percent—contributed to a weakening of the land market and to the downturn in land values during the fourth quarter. Farm earnings were substantially depressed during both 1980 and 1981. Net farm income (after inventory adjustment) in 1980 was 40 percent below 1979's near-record level and pre-

liminary estimates indicate that net farm earnings in 1981 were down a third from 1979. As a consequence, three of the four quarter-to-quarter declines in land values recorded in the 20-year history of the survey were reported in the last two years.

The decline in land values in the fourth quarter was widely expected. Many observers in the Midwest had indicated that the land market was quite weak—in terms of both the number of transactions and the resulting transfer price. Many bankers indicated that the quantity of land available for sale was above normal but that the number of potential buyers was down sharply. Some bankers commented that the only transactions taking place were the result of public auctions or forced sales. Many cited the cash-flow squeeze as the major factor contributing to the weakness in land markets. Low commodity prices reduce the earnings potential of land and imply that short-term operating returns may not be adequate to service debt.

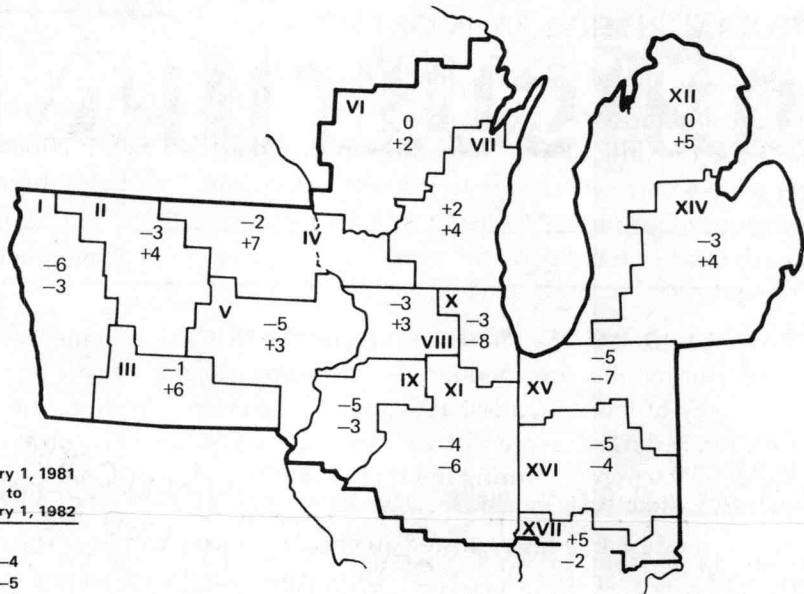
Debt service costs remain high, although rates charged by some lenders have come down from the record levels of last fall. At the end of the fourth quarter, District agricultural bankers were charging an average rate of 16.5 percent on farm real estate loans, down from 17.5 percent three months ago. However, rates charged by Federal Land Banks—the leading farm mortgage lender—continued to rise during the fourth quarter.

The near-term outlook for farmland values remains bleak. The USDA estimates that farm earnings will remain depressed for the third straight year. Current projections indicate that net farm income (after inventory adjustment) may be only half the 1979 level and a fifth below the dismal 1981 level. Cash receipts from crop and livestock enterprises are estimated to rise by 5 percent this year. But net income will be trimmed because production expenses are expected to rise more sharply. Some upturn in commodity prices from current levels is still expected—although the USDA recently lowered its estimate of the seasonal average price of corn. Price support programs will enhance prices somewhat, but other factors—including an export picture

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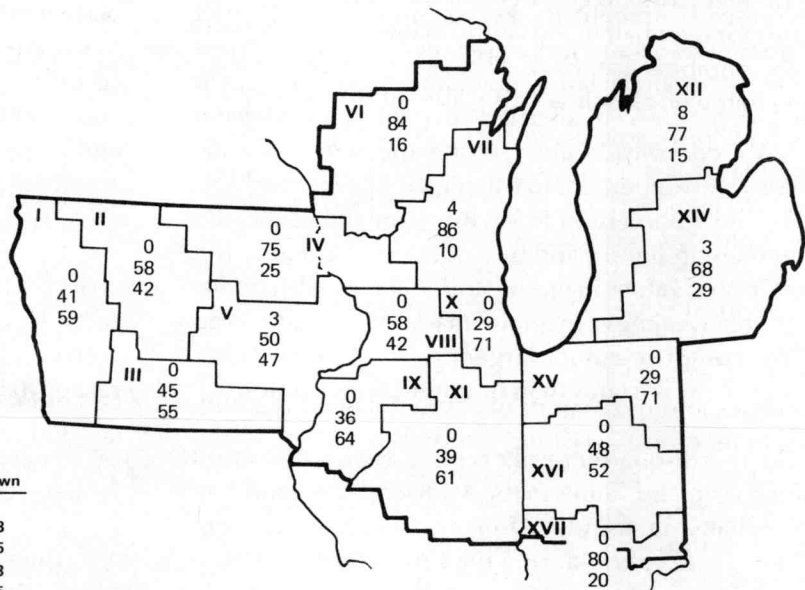
Percent change in dollar value of "good" farmland

Top: October 1, 1981 to January 1, 1982
 Bottom: January 1, 1981 to January 1, 1982



Percent of banks reporting the current trend in farmland values is:

Top: Up
 Center: Stable
 Bottom: Down



clouded by ample world supplies and uncertainties regarding further trade with the USSR and Eastern Block countries—make a significant recovery in prices less likely.

Bankers' expectations for farmland values paralleled the overall outlook for the farm sector. Only 1

percent of the bankers expected farmland values to be up in the current quarter, the smallest percentage ever to hold such a view. Forty-three percent expected land values to fall and slightly more than half thought land values would remain unchanged. Such short-run pessimism for farmland values has been evident only one other time—the first quarter of 1980—in the 20-year history of the quarterly survey.

THE INVENTORY OF CATTLE ON FEED remains well below year-earlier levels. According to the USDA, the number of cattle on feed January 1 in 23 major states—which account for over nine-tenths of the nation's total inventory—was 10.1 million, down 9 percent from the year before and substantially below 1979's level. The 6.9 million head of cattle placed in feedlots in the fourth quarter were 6 percent fewer than the year before and the lowest number since 1974. Fed cattle marketings in the fourth quarter fell 4 percent below a year ago but marketings in the current quarter may show only a nominal decline.

Considerable declines in inventories were evident for most categories of cattle on feed. The inventory of steers on January 1 was down 7 percent from a year ago, although one weight class—900 to 1,100 pounds—was up 3 percent from last year. The number of heifers on feed was 13 percent below a year ago while cow numbers were down a fourth. The largest decline was in steer and heifer numbers under 500 pounds, which dropped a third from the year before and now account for an even smaller portion of the inventory.

All District states reported declines in the number of cattle on feed. The biggest decline was in Iowa—which accounts for over half of the cattle on feed in the District—where numbers are down 18 percent. Michigan and Indiana followed closely with declines of 16 percent and 14 percent, respectively. Declines in inventories from year-ago levels were 6 percent in Illinois and 3 percent in Wisconsin. Inventories in other key states were mixed. In Colorado and Texas inventories declined by a tenth, but in Kansas the inventory was nominally higher than a year ago. In Nebraska inventories were unchanged.

Net placements of cattle on feed—which adjust for death losses and movement of cattle between feedlots and from feedlots to pasture—were down 5 percent in the fourth quarter from a year ago. Down 13 percent from 1979, placements were at a seven-year low. Although fourth-quarter placements in all District states combined were down a comparable percentage, Illinois reported a 3 percent rise in placements over last year.

Reduced placements in the fourth quarter no doubt reflected the profit squeeze from high costs and low receipts that has been evident for some time for cattle feeders. Interest rates charged on feeder cattle loans, though declining moderately in the fourth quarter from the highs set in late summer, remained very high by historical standards. In addition, fat cattle prices have trended downward steadily since June. During the fourth quarter, fat cattle prices averaged almost a tenth

below both third-quarter prices and year-ago prices. Softening prices of grain and feeds and feeder cattle in recent months offset somewhat the effects on feedlot profitability of high interest rates, other rising costs, and low fat cattle prices. But, according to Iowa State farm budget analysts, the returns for finishing a yearling steer to a choice steer still averaged \$5 per hundredweight below breakeven during the fourth quarter. This was the ninth straight quarter that estimated returns were negative.

Fed cattle marketings in the fourth quarter were 4 percent below the year before and were nominally below the intentions reported in October. Despite the decline in fed cattle marketings, preliminary estimates indicate that commercial cattle slaughter was up at least 1 percent in the fourth quarter. Heavy slaughter of cows and non-fed steers and heifers more than offset the decline in fed cattle marketings. For all last year, 23 million head of fat cattle were marketed from feedlots in the 23 major states—the lowest number since 1975 and 1 percent below 1980's level. However, preliminary estimates indicate that commercial cattle slaughter was up 3 percent in 1981, owing to sharply higher non-fed cattle slaughter throughout most of the year.

In light of the smaller feedlot inventories, marketings of fed cattle are likely to average below year-earlier levels in the early months of 1982. Cattle feeders reported that they intend to market 5.9 million head in the first quarter, 1 percent fewer than they did a year ago. (In the very near-term, however, fed cattle slaughter could rise above year-earlier levels because of the larger number of heavy-weight cattle). Fed cattle marketings in the second quarter are also likely to hold below year-ago levels. But total commercial cattle slaughter will probably remain nominally above year-earlier levels in the first half as non-fed cattle slaughter continues to exceed year-ago levels.

Cattle prices have declined sharply from last summer's peak of \$70 per hundredweight. However, in the last couple of weeks there has been a slight recovery in prices so that choice steers at Omaha now average \$60 per hundredweight. With beef supplies expected to hold somewhat above year-earlier levels in the months ahead, prospects for a significant rise in prices are much diminished, particularly in view of sluggish consumer demand. Slow growth in real earnings and high unemployment levels have strapped consumer spending—and, in turn, the buying of higher value meats. As a result, it appears that there is little in the fundamentals that would help boost average cattle prices above the low \$60s in the first half.

Jeffrey Miller

Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from	
				Prior period	Year ago
Index of prices received by farmers					
Crops	1977=100	December	126	- 3.1	-13
Livestock	1977=100	December	133	- 1.7	-16
	1977=100	December		- 3.6	-10
Index of prices paid by farmers					
Production items	1977=100	December	150	- 0.7	+ 4
	1977=100	December	146	- 0.7	+ 1
Producer price index* (finished goods)					
Foods	1967=100	December	275	+ 0.3	+ 7
Processed foods and feeds	1967=100	December	253	+ 0.1	+ 2
Agricultural chemicals	1967=100	December	244	- 0.3	- 3
Agricultural machinery and equipment	1967=100	December	295	- 0.3	+12
	1967=100	December	301	+ 0.9	+10
Consumer price index** (all items)					
Food at home	1967=100	December	282	+ 0.3	+ 9
	1967=100	December	272	+ 0.3	+ 3
Cash prices received by farmers					
Corn	dol. per bu.	December	2.27	- 3.0	-29
Soybeans	dol. per bu.	December	5.93	- 1.7	-24
Wheat	dol. per bu.	December	3.65	- 5.2	-14
Sorghum	dol. per cwt.	December	3.90	+ 0.8	-29
Oats	dol. per bu.	December	1.87	- 0.5	- 3
Steers and heifers	dol. per cwt.	December	56.70	- 4.1	-13
Hogs	dol. per cwt.	December	38.90	- 6.3	-11
Milk, all sold to plants	dol. per cwt.	December	14.10	+ 0.7	0
Broilers	cents per lb.	December	24.6	- 2.4	-17
Eggs	cents per doz.	December	65.6	- 5.6	-10
Income (seasonally adjusted annual rate)					
Cash receipts from farm marketings	bil. dol.	3rd Quarter	145	- 0.5	+ 4
Net farm income	bil. dol.	3rd Quarter	25	+ 6.9	+26
Nonagricultural personal income	bil. dol.	December	2,439	+ 0.2	+ 9

*Formerly called wholesale price index.

**For all urban consumers.

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