FRB CHICAGO

AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO

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Farmland values and credit conditions

District farmland values drifted upwards this spring, according to the 430 bankers responding to our latest survey. The results show that farmland values rose 1 percent during the second quarter and posted a gain of 3 percent during the 12 months ending with June. The bankers reported that credit quality appears to have made a slight improvement over a year ago, but the impact of this summer's flood on grain production had yet to be fully assessed at the time of the July 1 survey. Nevertheless, the climate for farm borrowers continued to improve, with ample funds available for lending and a decline in interest rates.

Some analysts have characterized the current forces affecting farmland values as being both powerful and contradictory. Positive factors include relatively low mortgage interest rates and low returns on some common alternative investments such as certificates of deposit. Net cash farm income—in nominal terms—has been at historically high levels in recent years, allowing farmers to bolster their balance sheets by trimming debt. Past measures of farm income also provide a benchmark to farmers and investors when forming expectations of future income. Furthermore, the continuing trend to larger and fewer farms suggests demand will be firm for add-on tracts.

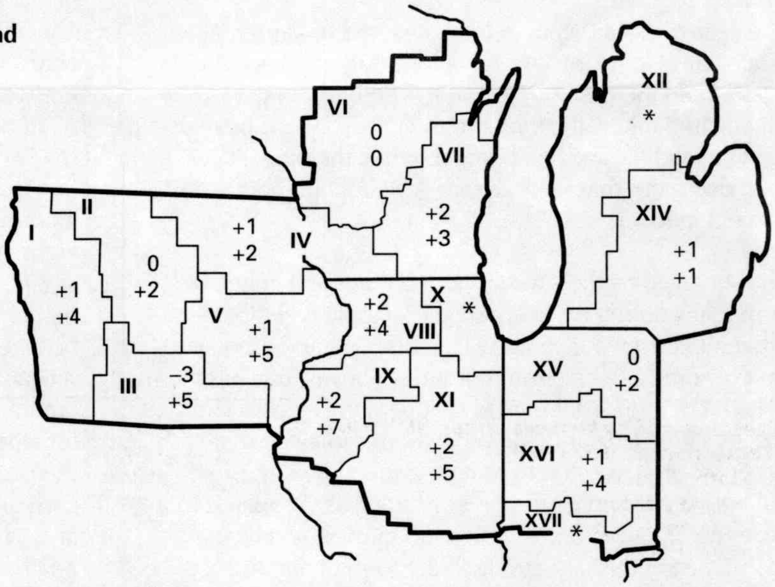
However, the effect of these factors on farmland values are counterbalanced by a host of other considerations that add to the financial uncertainty surrounding farmland ownership. International trade agreements—and their potential effect on agricultural exports—continue to be an important concern. Ratification of NAFTA by the U.S. Congress is not assured, despite the addition of side agreements, and the GATT negotiations remain pending. Furthermore, budget deficits continue to cast a shadow over the future of farm price and income support programs, and limitations on land use that result from environmental concerns add to the risk of farmland ownership. Finally, the sluggish performance of the U.S. economy has also contributed to a climate of uncertainty and restraint.

Against this backdrop, farmland values in the individual District states showed little change during the second quarter. An average increase of 1 percent was reported for Illinois, Michigan, and Wisconsin, while the bankers in Indiana and Iowa indicated there was no movement. However, a greater degree of variability was noted in the change over the previous 12 months. Gains of 5 percent and 4 percent were reported for Illinois and Iowa, respectively. In contrast, the average rise in both Indiana and Wisconsin was a modest 2 percent, while the Michigan bankers report a relatively minor increase of 1 percent.

Percent change in dollar value of "good" farmland

Top: April 1, 1993 to July 1, 1993
Bottom: July 1, 1992 to July 1, 1993

	April 1, 1993 to July 1, 1993	July 1, 1992 to July 1, 1993
Illinois	+1	+5
Indiana	0	+2
Iowa	0	+4
Michigan	+1	+1
Wisconsin	+1	+2
Seventh District	+1	+3



*Insufficient response

This sluggishness in District farmland values is expected to continue into the near future. Over three-quarters of the surveyed bankers expect farmland values to remain stable during the July-September period. However, the flooding that gripped a portion of the Midwest during July and August may have both positive and negative influences on farmland values. A negative impact on farmland values is probable in local areas that were hit hardest by the flooding that resulted from excessive rainfall and failed levees. Full restoration of the levee system is open to question since both the timing of repairs and the availability of funding is uncertain in this era of budget deficits. Furthermore, a debate is shaping up over the environmental and economic impacts of the network of levees along major waterways. Alternatively, the production losses from the flood will translate into higher crop prices and earnings for farmers not affected, which could send land values higher in areas not subject to flooding.

The growth in farm loans at banks in District states has slowed in recent quarters. Commercial bank call reports show that agricultural loan volume in Seventh District states as of April 1 was up 2 percent from the previous year despite a decline in lending for agricultural production. Loans to finance agricultural production were down 2 percent from a year earlier, the first decline since reaching a cyclical low in 1988. Furthermore, there was considerable variation among the individual District states in the pattern of lending for agricultural production. Banks in Michigan and Illinois recorded declines of 3 and 4 percent, respectively, while those in Indiana experienced a slide of nearly 9 percent. In contrast, agricultural production loans were up 4 percent from a year earlier in Wisconsin and were unchanged in Iowa. The trend in the rest of the U.S. was flat, as the level of agricultural production loans was similar to last year.

The year-over-year gain in loans secured by farm real estate came to nearly 8 percent for District states, compared to an increase of 5 percent for the rest of the U.S. Michigan banks ran counter to the District trend by registering a decline of a half percent, while the other states recorded gains that ranged from 4 percent in Indiana to 13 percent in Iowa.

The surveyed bankers also reported that the demand for farm loans during the second quarter showed little improvement from a year ago. Late planting and a possible shift of some acreage from corn to soybeans may have delayed or reduced the need for operating credit. The USDA's June farm income projections indicated that cash expenses are expected to remain stable this year, providing little upward pressure on borrowing as compared to a year ago. In addition, eligible corn farmers received a cash infusion this past spring in the form of an advance deficiency payment of 36 cents per bushel, nearly double the 1992 advance payment rate.

Looking ahead, nonreal estate agricultural lending is expected to be fairly stable during the summer for the Seventh District as a whole. Approximately 23 percent of the surveyed bankers expect nonreal estate loan volume to rise, while, 18 percent anticipate a decline. The remaining 59 percent foresee no change from a year ago. There was some variation among the individual District states, however. A relatively larger group of bankers in Iowa and Wisconsin indicated there may be some modest gains in nonreal estate loan volume when compared to a year earlier, while those in the other three states did not foresee a change.

For the District as a whole, farm loan repayment rates dipped slightly in the spring as compared to a year earlier. Just over 18 percent of the respondents reported a decline in loan repayments, while 13 percent indicated there was an improvement. Nearly 69 percent stated the pace of loan repayments was similar to last year. However, the trend varied somewhat among the individual District states. Repayment levels strengthened in Illinois and Indiana, but appeared to weaken in the other three states.

Despite the apparent slowing of loan repayments, the agricultural bankers reported modest improvement in the quality of their farm loan portfolios. Overall, they stated that nearly 5 percent of their farm loan portfolio was experiencing major or severe repayment problems that might require long-term workout arrangements or result in losses to the bank. This was roughly one percentage point less than that reported a year ago. The bankers also indicated that 9 percent of their loan portfolio was suffering from minor repayment problems and that 86 percent had no substantial repayment problems.

It is still too early to assess the full impact of recent crop developments on loan repayments and portfolio quality. The anticipated harvest of major crops on nearly 8 million acres was lost due to flooding and ponding in nine midwestern states. Moreover, late planting and lagging plant development have reduced the yield potential on much of the remaining acreage and given rise to speculation that production may be further cut by an early or even a normal frost. Higher prices will cushion the impact on grain farmers—and some will receive federal disaster assistance—but livestock producers will be pinched by higher feed costs. On balance, though, many analysts believe that overall net farm income will not suffer a significant blow this year. Nevertheless, the uneven geographical distribution of crop losses may make it difficult for lenders in hard-hit areas to maintain loan quality over the near term. Among District states, a large number of corn and soybean acres were flooded out in Illinois, Iowa, and Wisconsin. In contrast, Indiana and Michigan were relatively unaffected. Furthermore, current USDA reports suggest that crop conditions are much less favorable in Iowa and Wisconsin than in the other District states.

Credit conditions at Seventh District agricultural banks

	Loan demand	Fund availability	Loan repayment rates	Average loan-to-deposit ratio[1]	Interest rates on farm loans: Operating loans[1]	Feeder cattle[1]	Real estate[1]
	(index)[2]	*(index)*[2]	*(index)*[2]	*(percent)*	*(percent)*	*(percent)*	*(percent)*
1989							
Jan-Mar	138	115	84	53.8	12.54	12.48	11.70
Apr-June	138	107	92	55.9	12.42	12.36	11.55
July-Sept	124	109	106	57.1	12.19	12.15	11.34
Oct-Dec	119	124	123	55.8	12.05	12.02	11.15
1990							
Jan-Mar	125	124	122	55.2	11.93	11.88	11.08
Apr-June	118	125	119	56.5	11.95	11.88	11.09
July-Sept	117	122	115	57.0	11.94	11.87	11.08
Oct-Dec	116	123	100	56.9	11.82	11.76	10.94
1991							
Jan-Mar	128	127	98	56.5	11.40	11.37	10.57
Apr-June	130	122	74	58.1	11.19	11.17	10.43
July-Sept	113	122	81	58.5	10.88	10.89	10.15
Oct-Dec	109	132	69	57.4	10.06	10.08	9.39
1992							
Jan-Mar	129	128	77	57.3	9.77	9.80	9.19
Apr-June	123	123	79	58.1	9.57	9.56	8.99
July-Sept	111	123	90	59.3	9.18	9.16	8.63
Oct-Dec	107	127	93	58.7	9.12	9.13	8.59
1993							
Jan-Mar	108	131	102	58.0	8.85	8.83	8.29
Apr-June	103	129	95	59.2	8.77	8.74	8.16

[1]At end of period.
[2]Bankers responded to each item by indicating whether conditions during the current quarter were higher, lower, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100.

Many lenders have chosen to enhance the credit quality of some of their farm loans through the use of FmHA loan guarantees. Three-quarters of the agricultural bankers polled in our survey indicated they make use of such guarantees, ranging from two-thirds of the Indiana respondents to 94 percent of those in Iowa. However, a relatively small portion of these banks' farm loan volume is covered. Of those banks making use of FmHA guarantees, about 7 percent of the farm real estate portfolio is covered, compared to 6 percent of the nonreal estate portfolio.

The agricultural bankers stated that ample funds are available for nonreal estate farm lending. Overall, 34 percent reported that the supply of loanable funds was greater than the level of a year ago, while only 5 percent revealed a decline. The remaining 61 percent considered it to be unchanged. Moreover, the bankers expressed a desire to invest a greater proportion of their deposits in loans. The loan-to-deposit ratio posted a seasonal rise to hit 59.2 percent, its highest mid-year reading since 1981. However, over two-thirds of the respondents indicated a desire to raise lending levels further. Among the individual District states, the average loan-to-deposit ratio ranged from a low of 50.4 percent in Illinois to a high of 68.4 percent in Wisconsin.

In another favorable development for borrowers, the survey results indicated that interest rates charged on new farm loans registered another decline. The average operating loan rate as of July 1 came in at 8.77 percent, while the average farm mortgage loan rate was reported to be 8.16 percent. Both rates recorded a decline of approximately 10 basis points from 3 months earlier and were also down 80 basis points from a year ago. Among the individual District states, the average farm operating loan rate ranged from a low of 8.58 percent in Illinois to a high of 8.92 percent in Iowa. The farm real estate loan rate ranged from 7.96 percent in Indiana to 8.59 percent in Michigan.

Mike A. Singer

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Public Information Center
Federal Reserve Bank of Chicago
P.O. Box 834
Chicago, IL 60690-0834
Tel. no. (312) 322-5111

Selected agricultural economic indicators

	Latest period	Value	Percent change from: Prior period	Year ago	Two years ago
Prices received by farmers *(index, 1977=100)*	July	140	0.0	1	–5
Crops *(index, 1977=100)*	July	118	5.4	1	–12
Corn *($ per bu.)*	July	2.17	3.8	–7	–4
Hay *($ per ton)*	July	77.20	–4.1	10	8
Soybeans *($ per bu.)*	July	6.82	15.6	22	27
Wheat *($ per bu.)*	July	2.75	–2.5	–13	10
Livestock and products *(index, 1977=100)*	July	162	–2.4	3	0
Barrows and gilts *($ per cwt.)*	July	46.90	–4.3	2	–15
Steers and heifers *($ per cwt.)*	July	75.50	–2.7	2	1
Milk *($ per cwt.)*	July	13.00	–0.8	–3	10
Eggs *(¢ per doz.)*	July	57.6	–11.9	11	–11
Consumer prices *(index, 1982-84=100)*	July	144	0.0	3	6
Food	July	140	–0.1	2	3
Production or stocks					
Corn stocks *(mil. bu.)*	June 1	3,709	N.A.	35	24
Soybean stocks *(mil. bu.)*	June 1	683	N.A.	–2	–6
Wheat stocks *(mil. bu.)*	June 1	529	N.A.	12	-39
Beef production *(bil. lb.)*	June	2.05	10.4	1	9
Pork production *(bil. lb.)*	June	1.38	5.2	3	21
Milk production* *(bil. lb.)*	July	11.0	–0.3	1	5
Receipts from farm marketings *(mil. dol.)*	April	14,610	–13.2	13	7
Crops**	April	4,968	–7.2	8	–11
Livestock	April	7,642	1.2	15	11
Government payments	April	2,000	–49.2	16	62
Agricultural exports *(mil. dol.)*	May	3,366	–7.3	7	9
Corn *(mil. bu.)*	May	122	–20.4	17	1
Soybeans *(mil. bu.)*	May	35	–28.7	23	–10
Wheat *(mil. bu.)*	May	111	–17.8	71	29
Farm machinery sales *(units)*					
Tractors, over 40 HP	July	4,035	–35.8	–1	–5
40 to 100 HP	July	3,002	–33.0	–6	–3
100 HP or more	July	1,033	–42.7	20	–10
Combines	July	582	–2.0	10	8

N.A. Not applicable
*21 selected states.
**Includes net CCC loans.

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Public Information Center
P.O. Box 834
Chicago, Illinois 60690-0834
(312) 322-5111

LOUISE LETHES LIBRARIAN
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