FRB CHICAGO

AGRICULTURAL LETTER

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Land values and credit conditions

Our latest survey of agricultural banks in the Seventh Federal Reserve District provided a quarterly update on trends in farmland values and credit conditions. The responses of some 400 bankers suggest that farmland values, on average, were unchanged during the second quarter and up only 1.4 percent during the twelve months ending with June. Their responses also suggested that both the demand for farm loans and the availability of funds to make farm loans continued above year-earlier levels during the second quarter. Average loan-to-deposit ratios edged seasonally higher, but less so than in recent years. Farm loan repayment rates lagged year-earlier levels. Interest rates on farm loans continued to trend lower, paralleling the trend in overall market rates of interest.

The farmland market, while still drifting upward, has been sluggish for the past several quarters. The bidding on farmland has no doubt been held in check by the downturn in farm sector earnings the past couple of years. The belief that federal government subsidies to U.S. agriculture will be scaled back as part of the effort to reduce federal budget deficits has also had a tempering influence on land values. The changing developments in Eastern Europe and the former Soviet Union and uncertainties about the GATT and the NAFTA trade negotiations have also added some concerns about the future growth in U.S. agricultural exports. And although conditions have since turned around dramatically, concerns about drought and the potential 1992 crop harvest may have weighed on land values this spring.

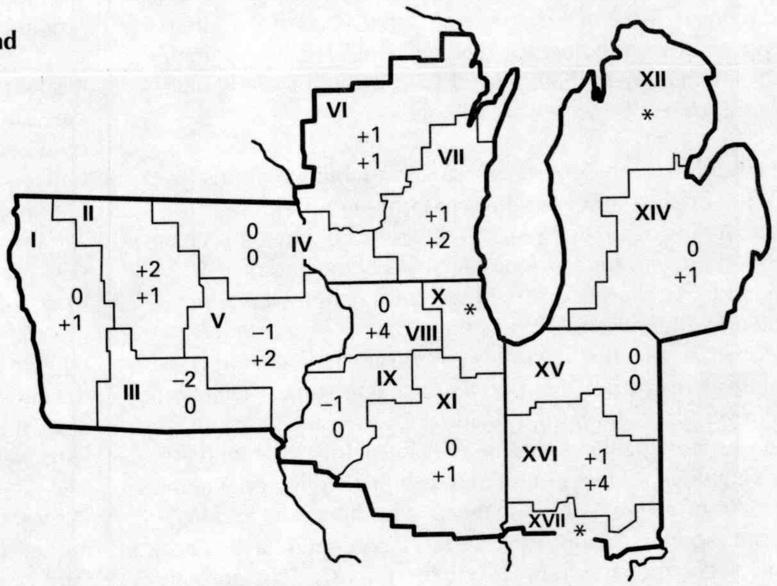
The second-quarter trends in land values varied among the five District states. Bankers from both Indiana and Wisconsin noted that land values in those two states edged marginally higher during the second quarter. In contrast, land values in Illinois and Iowa were virtually unchanged from three months earlier while those in Michigan were reported to be down slightly. Despite the generally sluggish second-quarter performance in land values, most bankers noted modest gains over the past year. Indiana bankers reported the largest gain in farmland values over the past year, up a little over 2.5 percent. Elsewhere, the gains from a year ago ranged from less than 1 percent in Iowa and Michigan to less than 2 percent in Illinois.

Declining interest rates have been cited as a factor that could help to strengthen farmland values in the future. The lower rates result in lower financing costs for those seeking to acquire farmland. In addition, more potential buyers of farmland can surface as lower interest rates translate into lower earnings on alternative investments. Perceptions that the stock market may be temporarily peaking and concerns about the continuing weakness in commercial real estate have also been noted as factors that could help to buoy the

Percent change in dollar value of "good" farmland

Top: April 1, 1992 to July 1, 1992
Bottom: July 1, 1991 to July 1, 1992

	April 1, 1992 to July 1, 1992	July 1, 1991 to July 1, 1992
Illinois	0	+2
Indiana	+1	+3
Iowa	0	+1
Michigan	−1	+1
Wisconsin	+1	+1
Seventh District	0	+1



*Insufficient response

demand to acquire farmland. However, an overwhelming majority of the bankers (86 percent) felt the farmland market would remain flat this summer. Another small share (10 percent) of the bankers expected land values would rise while the remaining 4 percent expected a decline.

The demand for farm loans at District agricultural banks this spring apparently exceeded year-earlier levels, a trend that has prevailed since 1988. The overall measure of farm loan demand for the second quarter stood at 123 (see table on page 3). That reading represents a composite that combines the 38 percent of the bankers who noted year-over-year gains in farm loan demand, less the 15 percent that said loan demand was softer. The remaining 47 percent of the bankers felt that loan demand was unchanged from the second quarter of last year. The continued strengthening in farm loan demand may stem partially from the downturn in farm earnings and the resulting need for farmers to use more debt financing to cover current operating expenses. In addition, a slight increase in planted acreage probably added to the operating expenses of most crop farmers this spring. Moreover, the continuing expansion in hog production probably added to farm loan demand in some areas. The latter factor may account for the particularly large share of Iowa bankers (over 50 percent) that noted the increase in farm loan demand this spring.

The amount of funds available for lending to farmers remains ample, despite the firming in farm loan demand. In the most recent survey, some 31 percent of the bankers indicated that the amount of funds available for lending to farmers exceeded year-earlier levels. Fewer than 8 percent reported a decline in second-quarter fund availability. Further evidence of the ample liquidity at agricultural banks is reflected in their loan-to-deposit ratios. The reported ratios in the most recent survey averaged 58.1 percent, up slightly from three months earlier but unchanged from a year ago. Most banks would like to expand their loans. Reflecting this, two out of every three of the surveyed banks noted their loan-to-deposit ratio was below the desired level. The proportion of banks with a lower-than-desired ratio was particularly high among the respondents from Illinois and Iowa.

The trends in loan demand and the availability of funds for lending imply that the portfolio of farm loans held by banks is expanding again this year. Farm loans held by banks have trended upward the last four years. As of the end of 1991, the amount of farm loans held by banks nationwide approximated $53 billion, up 22 percent from four years earlier. Among banks in the five states comprising the Seventh Federal Reserve District, the four-year rise was somewhat larger. However, the pattern for individual District states varied widely. Iowa banks registered the largest four-year increase with a gain of 40 percent. Banks in Illinois followed with an increase of 28 percent while those in both Indiana and Wisconsin reported a four-year gain of 17 percent in farm loans. Conversely, the growth in farm loans among Michigan banks did not resume until last year. As a result, the amount of farm loans at banks in Michigan at the end of 1991 still lagged the level of four years ago.

The growth in farm loans at banks over the last four years stands in marked contrast to the continuing declines in farm loans held by all other lenders. Total farm debt, although turning up slightly last year, remains below the level of four years ago and nearly 30 percent below the 1983 peak. About 36 percent of all outstanding farm debt is now owed to banks, up from 28 percent four years ago and 21 percent a decade ago.

The quality of farm loans at banks remains favorable and substantially above the conditions that existed in the mid 1980s when the farm sector was hit with a wrenching financial crises. Nevertheless, there has been some decline in the quality of farm loans over the past few quarters. For example, farm loan repayment rates have apparently slowed with the decline in farm earnings. In the most recent survey, 27 percent of the bankers indicated that farm loan repayment rates during the second quarter were down from the same period the year before. Only 6 percent of the respondents noted an increase in repayment rates while the remaining 67 percent of the bankers felt that loan repayment rates matched the year-earlier pace. This marked the fifth consecutive quarterly survey in which the proportion of bankers noting slower loan repayments has significantly exceeded the share reporting a pick-up in repayment rates. However, the pattern during that span has varied among individual District states. The slowing in farm loan repayments last year was especially apparent among bankers in Wisconsin, a state hit hard in 1991 by a slump in milk prices. With the rebound in milk prices this year, Wisconsin bankers now report the highest readings on farm loan repayment rates. The lowest readings on farm loan repayment rates so far this year have come from Iowa bankers. The slower repayments in Iowa probably reflect the tighter margins facing hog farmers which are so prevalent in that state.

A slight decline in the quality of farm loans was also indicated in the subjective ratings the bankers gave for their own portfolio of farm loans. In the most recent survey, the bankers, on average, characterized 84 percent of their farm loan portfolio as having no significant repayment problems. Another 10 percent was labeled as having only minor repayment problems. The remaining 6 percent of their farm loan portfolios were regarded as having significant repayment problems that might require long-term work-out arrangements or, in some cases, might entail some losses to the bank. In a similar survey one year ago, the proportion of farm loans judged as having significant repayment problems was 5 percent.

Interest rates charged on farm loan by District banks eased further during the spring quarter. In general, the typical rates charged on farm operating loans and on feeder cattle loans among the surveyed banks averaged just over 9.5

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)*
1988							
Jan-Mar	102	137	143	50.2	11.06	11.02	10.48
Apr-June	113	127	114	52.1	11.24	11.17	10.63
July-Sept	120	115	88	54.3	11.67	11.62	11.03
Oct-Dec	127	123	87	53.3	11.98	11.92	11.28
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

[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.

percent as of mid year. The reported rates on farm real estate mortgages averaged just under 9.0 percent. The mid-year rates for feeder cattle and farm operating loans were down more than 160 basis points—or 1.6 percentage points—from the averages reported a year ago. The decline in rates on farm real estate mortgages over the past year was somewhat less, 140 basis points. Interest rates continue to vary widely among District states. Rates on operating loans averaged the highest among Iowa banks (9.8 percent) and the lowest among Michigan banks (9.1 percent). State average farm mortgage rates ranged from a low of 8.7 percent among banks in Indiana to a high of 9.3 percent at banks in Wisconsin.

In looking ahead, a sizable portion of the bankers from all five District states expect the demand for farm operating loans to continue above year-earlier levels. But the demand for both feeder cattle and farm machinery loans is expected to be weaker. Bankers from Michigan and Wisconsin believe the demand for dairy loans will match or slightly exceed year-earlier levels while those elsewhere foresee fewer dairy loan requests this summer. Except for Iowa, most bankers were expecting the demand for crop storage loans to fall short of last year's level. But the sharp rebound in harvest prospects since mid year may yet lead to some pickup in loans to finance crops in storage. For all types of farm loans, it would seem likely that the continued easing in market rates of interest since mid year will translate into still lower interest rates on farm loans. The combination of declining farm debt since 1983 and, more recently, declining interest rates have significantly lowered the farm sector's interest expenses. USDA estimates suggest that the farm sector's interest bill in 1991 approximated $14 billion, down from a peak of nearly $22 billion in 1982.

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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	137	–2.1	–7	–9
Crops *(index, 1977=100)*	July	116	–4.9	–14	–9
Corn *($ per bu.)*	July	2.28	–7.7	0	–13
Hay *($ per ton)*	July	71.80	–4.9	2	–12
Soybeans *($ per bu.)*	July	5.55	–6.6	4	–7
Wheat *($ per bu.)*	July	3.20	–6.4	28	15
Livestock and products *(index, 1977=100)*	July	158	0.6	–2	-8
Barrows and gilts *($ per cwt.)*	July	44.10	–7.0	–20	–29
Steers and heifers *($ per cwt.)*	July	74.40	1.1	0	–3
Milk *($ per cwt.)*	July	13.40	1.5	14	–4
Eggs *(¢ per doz.)*	July	52.3	–1.3	–19	–9
Consumer prices *(index, 1982-84=100)*	July	141	0.2	3	8
Food	July	137	–0.1	1	3
Production or stocks					
Corn stocks *(mil. bu.)*	June 1	2,739	N.A.	–8	–4
Soybean stocks *(mil. bu.)*	June 1	696	N.A.	–4	17
Wheat stocks *(mil. bu.)*	June 1	472	N.A.	–45	–12
Beef production *(bil. lb.)*	June	2.04	7.3	9	3
Pork production *(bil. lb.)*	June	1.33	3.5	17	17
Milk production* *(bil. lb.)*	June	10.8	–4.3	2	0
Receipts from farm marketings *(mil. dol.)*	March	13,702	11.7	–2	–8
Crops**	March	5,035	6.5	0	–1
Livestock	March	7,087	5.5	–1	–5
Government payments	March	1,580	92.2	–10	–34
Agricultural exports *(mil. dol.)*	May	3,156	–14.8	2	–3
Corn *(mil. bu.)*	May	105	–26.5	–13	–51
Soybeans *(mil. bu.)*	May	28	–50.4	–27	23
Wheat *(mil. bu.)*	May	64	–46.6	–24	–14
Farm machinery sales *(units)*					
Tractors, over 40 HP	July	4,131	–16.8	–3	–4
40 to 100 HP	July	3,271	–13.4	6	5
100 HP or more	July	860	–27.7	–25	–28
Combines	July	529	4.1	–2	–46

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

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