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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary

Farmland values in the Seventh Federal Reserve District increased a little less than 1 percent, on average, between the end of June 2001 and the end of September. Data provided by 408 banks that responded to the Chicago Fed's quarterly survey of farmland values and credit conditions also indicated that as of the end of the third quarter the value of "good" farmland had increased by nearly 5 percent, relative to a year ago. Both the quarter-to-quarter and year-ago-quarter changes were similar to those reported in the five previous surveys.

Credit conditions, on balance, improved during the third quarter according to the survey respondents. Although the bankers reported a slight increase in their requirements for collateral on agricultural loans relative to a year ago, they also reported that the rate of loan repayment increased and that farmers' requests for loan renewals or extensions decreased. The respondents also indicated that the overall demand for agricultural loans decreased and the availability of funds to banks increased. Interest rates on farm related loans continued to decline

and at the end of the third quarter were at their lowest levels in more than 25 years. Finally, bankers indicated that they expect the incidence of forced sale or liquidation of farm assets by financially stressed farmers during the next three to six months to be less than was the case a year ago.

Farmland values

Farmland values in the District continued to increase in the third quarter with the District average up about 1 percent from the previous quarter and up 5 percent from a year ago. As one would expect, however, given the agricultural diversity and the mix of land-use, substantial variability in price changes was reported across the region.

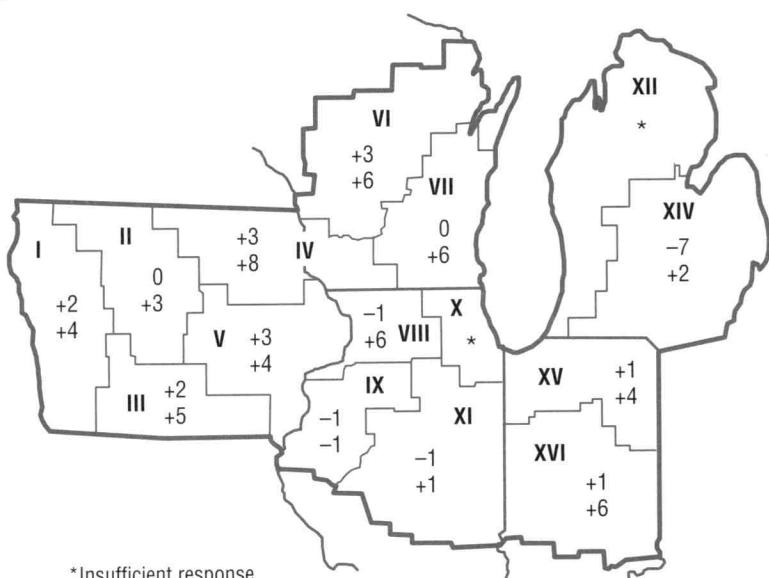
During recent quarters, bankers in Illinois consistently reported the weakest farmland market among the five states. The October survey indicated this pattern continued. Respondents in Illinois reported a 1 percent decline in farmland values, on average, from the second quarter. On a year ago basis, prices were reported up 2 percent.

Bankers in Michigan also reported a decline in farmland prices in the most recent period, down 2 percent, in contrast with a sharp increase relative to a year ago, up 8 percent. While the broad disparity in the Michigan

Percent change in dollar value of "good" farmland

Top: July 1, 2001 to October 1, 2001
Bottom: October 1, 2000 to October 1, 2001

	July 1, 2001 to October 1, 2001	October 1, 2000 to October 1, 2001
Illinois	-1	+2
Indiana	+1	+5
Iowa	+2	+5
Michigan	-2	+8
Wisconsin	+1	+6
Seventh District	+1	+5



*Insufficient response.

shorter-term and longer-term data is somewhat problematic, climatic and land-use developments in that state may provide some insight into that market. In the shorter-term, Michigan agriculture suffered severe drought conditions during the 2001 crop season. (Such conditions tend to locally depress farmland prices, a pattern observed in the western and southern portions of Illinois and Iowa in recent years.) In the longer term, Michigan's respondent bankers (and Wisconsin bankers) have repeatedly noted in recent years the upward price pressure on farmland values that stem from nonagricultural demand for farmland—responses in the latest survey continued that pattern.

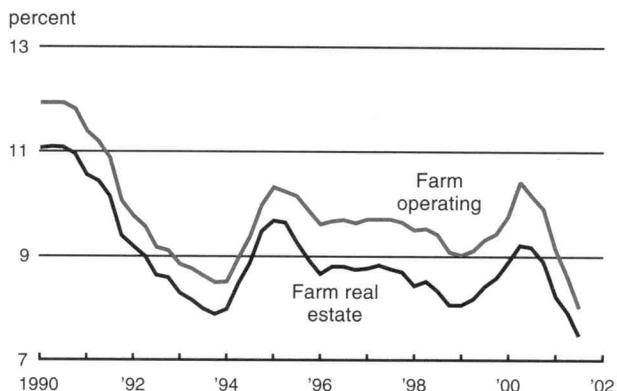
Elsewhere in the District, the third quarter change in farmland values (relative to the second quarter) generally ranged from up 1 percent to up 2 percent, while the change relative to the third quarter of 2000 ranged between up 5 percent and up 6 percent. (Ranges within states were broader—see map.) However, bankers' expectations of the fourth-quarter trend in farmland prices suggested some softening in the land market. Overall, nearly twice as many respondents in the District thought farmland values would decline during the last quarter of the year (relative to a year ago) than those who expected an increase. This expectation was most prevalent in Illinois where less than 1 percent of the bankers expected a fourth-quarter increase, against 15 percent who thought farmland prices would decline (the remainder expected no change). A similar pattern, although less pronounced, was observed in the responses of Iowa bankers. Respondents in Indiana and Michigan were about evenly split on this issue.

Wisconsin bankers leaned toward an expectation of higher farmland values, as they looked forward three months. Their modestly contrarian outlook likely reflected the marked improvement in the financial condition of the dairy industry during 2001, which, no doubt, contributed to the generally improved agricultural credit conditions Wisconsin bankers reported.

Credit conditions in the District

Credit conditions reported in the October survey were generally more favorable than has been the case for some time. This was reflected in several measures. Bankers reported, for example, that on average the rate of loan repayment improved substantially. A summary measure of that indicator rose to its highest level since the fourth quarter of 1997. In addition, farmers' requests for loan renewals or extensions of existing loans were at their lowest level since the fourth quarter of 1997. For the District overall, an index that reflects the proportion of bankers who observed an increase in loan demand (relative to a year

Quarterly District farm loan interest rates



ago) as compared to those who observed a decrease, declined sharply in the latest survey—to the lowest level in more than ten years. At the same time, bankers reported that the availability of funds increased sharply. The index for this measure rose to its highest level since 1993.

Interest rates on farm related loans continued their recent downward trend. Since peaking in the second quarter of 2000, the District average rate on real estate loans declined 174 basis points to 7.47 percent at the end of the third quarter 2001. Over the same period, the average rate on farm operating loans dropped 242 basis points to 8.01 percent. In turn, the interest rate differential/spread between operating and real estate loans continued to narrow. From its recent peak in the second quarter of 2000, the differential narrowed by 68 basis points, standing at 54 basis points at the end of the third quarter 2001. This constituted the smallest differential recorded since the end of 1994. Narrowing of the spread may reflect a reduction in the risk premium on less-well-secured operating loans and represents another indication of improved credit conditions in this market.

Having noted an improvement in credit conditions in the District overall, it remains the case that a larger proportion of the respondent bankers reported a "lower" rate of loan repayment than the proportion who reported a "higher" rate of loan repayment (see footnote 2 in the table on page 3). Likewise, a larger proportion of bankers reported "higher" loan extensions or renewals than those who reported "lower" extensions or renewals. Thus, even with improving credit conditions, it is not surprising that a substantial proportion of District's reporting bankers (22 percent) noted that they required higher levels of collateral on agricultural loans than was the case a year earlier.

Looking forward

In addition to obtaining information about the present state of the agricultural credit market, the survey also asked the

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
<i>(index)²</i>							
1998							
Jan-Mar	134	113	84	68.9	9.52	9.51	8.50
Apr-June	127	102	74	72.7	9.54	9.55	8.52
July-Sept	117	104	60	72.0	9.43	9.41	8.33
Oct-Dec	113	121	57	70.3	9.09	9.07	8.06
1999							
Jan-Mar	120	119	40	69.9	9.03	9.01	8.06
Apr-June	115	107	50	71.7	9.11	9.08	8.18
July-Sept	109	94	63	72.7	9.32	9.28	8.42
Oct-Dec	107	104	72	72.7	9.44	9.41	8.59
2000							
Jan-Mar	121	95	77	72.9	9.78	9.72	8.89
Apr-June	109	76	72	75.5	10.43	10.14	9.21
July-Sept	106	82	77	76.9	10.17	10.14	9.18
Oct-Dec.	105	92	81	74.9	9.92	9.90	8.90
2001							
Jan-Mar	118	101	67	75.0	9.16	9.17	8.23
Apr-June	106	109	73	75.1	8.60	8.58	7.91
July-Sept	91	127	86	74.9	8.01	8.07	7.47

¹At end of period.

²Bankers 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.

bankers to indicate their short-term expectations for the likely pattern of lending activity. The frame of reference was for fourth quarter 2001 relative to fourth quarter 2000.

For the District overall, 23 percent of the respondents expected lower demand for all non-real-estate loans, and 18 percent thought they would experience increased demand. Operating loans were the one category that reported a pattern that was contrary to that of the total. For such loans, 27 percent of the bankers expected increased lending while only 13 percent expected a decline. The most dramatic of the non-real-estate farm loan categories continued to be the depressed expectations for new loans on machinery purchases. More than 42 percent of the respondents expected lower machinery loans. Only 11 percent of the bankers indicated they expect an increase in machinery loans in the fourth quarter. Given these responses, the sluggish state of the agricultural machinery industry should not be a surprise.

Despite the improvement in credit conditions for agriculture, lenders expect to continue to increase their reliance on loan guarantees. Thirty percent of the bankers indicated they intend to rely more heavily on the USDA's Farm Service Agency (FSA) farm loan guarantees during the October to December period than they did during the same period a year ago.¹

Finally, District bankers continued to expect a weakening in real estate loan demand by farmers. Thirty

percent of the respondents expected that farmers' demand would be lower in the fourth quarter than a year ago while only 15 percent expected it would be higher. However, 41 percent of the bankers expected demand by non-farm investors to be higher in the fourth quarter while 23 percent of the respondents expected it would decline.

Jack L. Hervey
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¹FSA guarantees apply to ownership and operating loans to farmers who do not meet the standards of conventional lenders. Guarantees may apply up to 90 percent of the loan principal, and lenders may resell the guaranteed portion in a secondary market.

AgLetter (ISSN 1080-8639) is published quarterly by the Research Department of the Federal Reserve Bank of Chicago. It is prepared by Jack L. Hervey, senior economist, and members of the Bank's Research Department, and is distributed free of charge by the Bank's Public Information Center. The information used in the preparation of this publication is obtained from sources considered reliable, but its use does not constitute an endorsement of its accuracy or intent by the Federal Reserve Bank of Chicago.

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SELECTED AGRICULTURAL ECONOMIC INDICATORS

	Latest period	Value	Prior period	Year ago	Two years ago
Prices received by farmers (index, 1990-92=100)					
Crops (index, 1990-92=100)	October	95	-9.5	2	4
Corn (\$ per bu.)	October	87	-13.9	-4	0
Hay (\$ per ton)	October	1.79	-6.3	3	6
Soybeans (\$ per bu.)	October	99.40	0.8	17	31
Wheat (\$ per bu.)	October	4.10	-9.5	-8	-8
Livestock and products (index, 1990-92=100)	October	2.86	0.4	7	11
Barrows and gilts (\$ per cwt.)	October	106	-3.6	9	10
Steers and heifers (\$ per cwt.)	October	41.40	-9.4	-1	19
Milk (\$ per cwt.)	October	70.80	-1.8	0	1
Eggs (¢ per doz.)	October	16.20	-4.7	30	9
Consumer prices (index, 1982-84=100)	October	62.6	10.4	-6	19
Food	October	178	-0.3	2	6
Food	October	175	0.5	3	6
Production or stocks					
Corn stocks (mil. bu.)	September	1,899	N.A.	11	6
Soybean stocks (mil. bu.)	September	248	N.A.	-14	-29
Wheat stocks (mil. bu.)	September	2,155	N.A.	-8	-12
Beef production (bil. lb.)	October	2.39	12.6	2	5
Pork production (bil. lb.)	October	1.84	21.5	7	8
Milk production* (bil. lb.)	October	11.8	3.5	0	2
Receipts from farm marketings (mil. dol.)					
Crops**	August	15,390	-10.6	-4	0
Livestock	August	7,598	-0.3	4	6
Government payments	August	7,792	-18.8	-11	-5
N.A.	August	N.A.	N.A.	N.A.	N.A.
Agricultural exports (mil. dol.)					
Corn (mil. bu.)	August	4,468	13.4	5	13
Soybeans (mil. bu.)	August	220	20.2	17	19
Wheat (mil. bu.)	August	43	31.1	-26	-25
August	92	39.7	-14	-18	
Farm machinery sales (units)					
Tractors, over 40 HP	October	7,588	37.7	1	26
40 to 100 HP	October	5,006	14.5	-4	28
100 HP or more	October	2,582	126.3	12	22
Combines	October	821	-10.1	-2	-9

N.A. Not applicable

*20 selected states.

**Includes net CCC loans.

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DEPT OF AG & APPLIED ECONOMICS
1994 BUFFORD AVE STE 231
SAINT PAUL MN 55108-6006

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