FRB CHICAGO

AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO
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Farm debt edged lower again last year

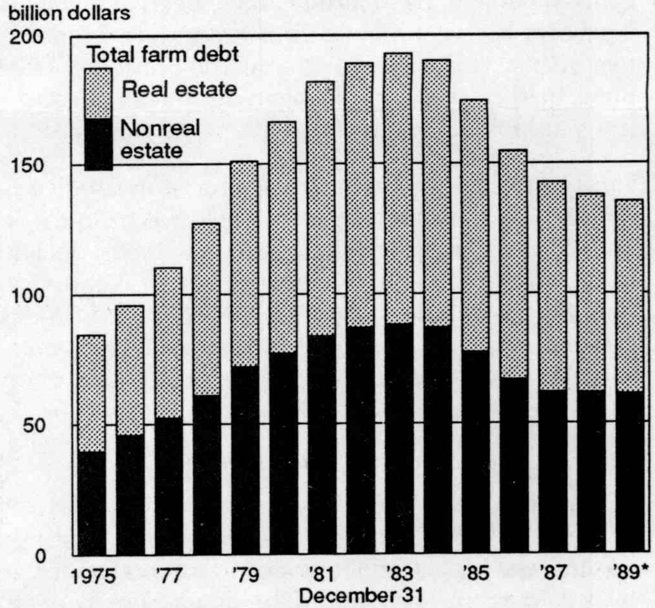
Recent reports from major farm lending institutions tend to confirm earlier expectations that outstanding farm debt retreated for the sixth consecutive year in 1989. Those reports, coupled with a preliminary USDA assessment of farm loans held by all other lenders, suggest that total farm debt declined nearly 2 percent last year to an 11-year low of about $135.6 billion. The ending 1989 total includes about $74.3 billion in farm loans secured by real estate and $61.3 billion in nonreal estate farm loans (mostly short- and intermediate-term loans used to finance production and equipment expenditures). Farm real estate debt declined about 3 percent last year while nonreal estate farm debt, for the second consecutive year, declined less than 1 percent. Compared to the 1983 peaks, however, both components of farm debt are down about 30 percent.

Institutional lenders that periodically report on their portfolio of farm loans account for about 80 percent of the USDA's series on outstanding farm debt (excluding CCC price-support loans and loans for farmer household goods and homesteads). Year-end reports from these lenders, with minor adjustments, provide a reliable indication of what forthcoming final USDA estimates will show with respect to their share of farm debt. The remaining share is held by a broad array of lenders that are categorized as "individuals and others." It includes farm debts accumulated through borrowings from input supply firms, such as feed, fertilizer, or farm equipment dealers or manufacturers. It also includes farm debts that arise through borrowings from individuals, such as family members or through seller-financed acquisitions of real estate. Because of the diversity of lenders and, for some components, the absence of a report-tracking mechanism, estimates of farm debt owed to "individuals and others" are difficult to formulate. But a recent USDA forecast suggested that farm debt owed to individuals and others declined about 3 percent last year to around $27.5 billion. The real estate component of the farm debt owed to individuals and others apparently declined nearly 6 percent last year to around $15.8 billion. Conversely, the nonreal estate component, at nearly $11.8 billion, was unchanged from the ending 1988 level.

Commercial banks are the largest source for loans to farmers, accounting for a third of all farm debt. In marked contrast to the continuing decline in overall farm debt, the portfolio of farm loans held by banks rose about 4.5 percent in each of the past two years. The upturn of the past two years has offset most of the earlier declines and pulled farm loans held by banks to within 5 percent of the peaked reached in 1984. Nationwide, the portfolio of farm loans held by banks now approximates $47.4 billion. Of that, about $44.5 billion will likely be included in the USDA's estimates of outstanding farm debt (excluding household debt) as of the end of 1989.

The farm real estate component of bank loans to farmers registered the largest rise again last year (7.6 percent) continuing an uninterrupted string of large gains that started in the early 1980s and continued through the intervening years despite a shrinking in total farm debt. With that string of gains, banks now account for more than 20 percent of all real estate farm debt, up from less than 10 percent a decade ago. Nonreal estate loans, which still dominate the portfolio of farm loans held by banks, rose just over 3 percent

Most of the recent declines in farm debt have been in real estate loans



*Preliminary, based largely on year-end reports from major institutional lenders.'

Farm loans held by commercial banks

	Amount	Percent change from		
	12/31/89	12/31/88	12/31/87	12/31/84*
	(mil. $)			
Nonreal estate farm loans				
Illinois	1,971	2.5	14.0	-26
Indiana	931	3.7	11.6	-18
Iowa	2,740	8.7	19.3	-29
Michigan	392	-6.9	-11.1	-30
Wisconsin	934	-0.5	2.5	-20
District states	6,968	4.0	12.2	-26
United States	30,782	3.1	6.0	-22
Farm real estate loans				
Illinois	1,340	6.3	18.1	99
Indiana	794	2.8	6.7	42
Iowa	1,210	9.3	22.9	136
Michigan	223	-1.7	-3.7	-1
Wisconsin	802	4.3	7.7	44
District states	4,369	5.6	13.8	73
United States	16,646	7.6	15.6	64
All farm loans				
Illinois	3,311	4.0	15.6	0
Indiana	1,726	3.3	9.3	2
Iowa	3,950	8.9	20.4	-10
Michigan	614	-5.1	-8.5	-22
Wisconsin	1,736	1.7	4.9	1
District states	11,337	4.6	12.8	-5
United States	47,429	4.6	9.2	-5

*December 31, 1984 marked the peak in farm loans held by banks, both nationwide and in District states.

last year and now account for about 48 percent of all nonreal estate farm debt.

Farm debt owed to banks in the Seventh Federal Reserve District rose 4.6 percent last year, paced by a comparatively large rise in farm real estate loans. Recent trends vary widely among the five District states, with continuing gains in four states contrasting sharply with sustained declines in Michigan. The strongest gains in bank loans to farmers have been in Iowa, up 9 percent last year and up 20 percent over the past two years. At the other extreme, the portfolio of farm loans held by banks in Michigan declined 5 percent last year and 8.5 percent over the past two years.

Farm loans held by the restructuring Farm Credit System (FCS), which suffered crippling losses from the financial stress in agriculture in the mid-1980s, declined in 1989 for the seventh consecutive year. Year-end data for the FCS show that loans to farmers (including modest amounts of farm-related business loans and rural housing loans but excluding loans to farm cooperatives) declined nearly 3 percent last year to $40.3 billion. Adjusted to the USDA series on outstanding farm debt, it now appears that farm debt owed to the FCS approximates $35.8 billion; down 44 percent from the peak in 1982 and the lowest since 1977. With the decline, the Farm Credit System now accounts for just over 26 percent of all farm debt, down from its peak share of 34 percent in the early 1980s.

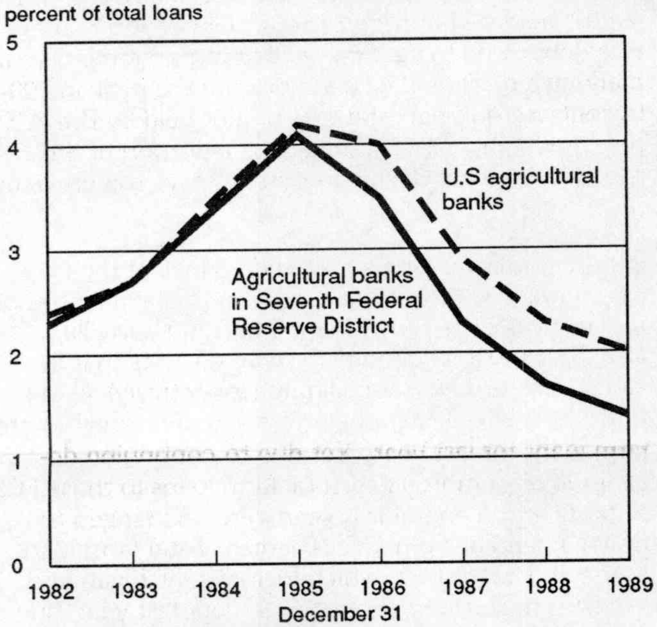
Three-fourths of the FCS's portfolio of farm-related loans represents real estate mortgages. Although its share continues to decline, the FCS remains the single largest holder of farm real estate debt. Farm real estate debt owed to the FCS declined 6 percent last year, marking a decline of 42 percent from the peak in 1984. In contrast, nonreal estate farm debt held by the FCS rose 8 percent last year, reversing a portion of the nearly 60 percent decline registered over the previous seven years.

Reports from the four Farm Credit Banks of the FCS that serve Midwest farmers show mostly similar trends for last year. The Farm Credit Banks of Louisville, Omaha, and St. Louis (which serve districts that include Indiana, Iowa, and Illinois, respectively) all reported sizable gains in their portfolio of nonreal estate farm loans for last year. Yet due to continuing declines in farm mortgages, total farm loans in those FCS districts at the end of last year were unchanged to down 3 percent from a year earlier. Total farm loans in the St. Paul district, which includes Michigan and Wisconsin, declined about 5.5 percent last year, due to continuing cuts in both the real estate and the nonreal estate components.

Evidence for the other two categories of reporting institutional lenders suggests that farm debt owed to life insurance companies was unchanged at $8.9 billion as of the end of last year while that owed to the Farmers Home Administration declined 13 percent to less than $18.9 billion. The farm debt owed to life insurance companies is largely secured by real estate and accounts for 6.5 percent of total farm debt. The farm loans held by the FmHA encompass both real estate and nonreal estate loans and represent about 14 percent of all outstanding farm debt. After peaking in 1986, farm debt owed to the FmHA recorded comparatively large declines the past two years. As a federal government agency that focuses on farmers unable to qualify for loans from commercial lenders, the recent declines in FmHA farm loans partially reflect changes in Congressional appropriations that have cut funding for direct loans to farmers while expanding the FmHA's farm loan guarantee program for other lenders. More importantly, the recent declines reflect 1987 legislation mandating that the FmHA enter into extensive restructurings on its large backlog of problem farm loans. Those restructurings have led to substantial loan write-downs and write-offs the past two years.

While total farm debt retreated again last year, commercial lenders experienced further improvement in the quality of their farm loan portfolios. For banks, the improved quality is reflected in smaller charge-offs of bad loans and in the declining share of nonperforming loans (problem loans no longer accruing interest and accruing loans that are delinquent 90 days or more).

Nonperforming loans* at agricultural banks have retreated to lowest levels since early 1980s



*Problem loans no longer accruing interest and accruing loans that are delinquent 90 days or more.

Net charge-offs of farm loans by banks nationwide last year declined to less than $100 million, down from $140 million the year before and an annual average that reached $1.2 billion during the height of the financial distress in agricultural from 1984 through 1986. Similarly, nonperforming loans among agricultural banks at the end of 1989 retreated to 2.0 percent of all loans, down from 2.3 percent the previous year and levels of 4 percent or higher in the mid 1980s. Except for banks in Michigan, both measures of loan quality at banks registered comparable improvement in District states.

The Farm Credit System, despite components that are still struggling, also benefitted from further significant gains in the quality of its farm loan portfolio in 1989. Charge-offs of problem loans, net of recoveries on earlier charge-offs, for the entire FCS (including loans to farmers cooperatives) fell to less than zero last year, down from annual levels that ranged from $400 million to $1.4 billion and averaged more than $750 million the previous 5 years. Simultaneously, the amount of FCS loans not accruing interest dropped to $2.6 billion at the end of 1989, down from $3.3 billion a year earlier and well below the ending 1986 peak of over $7 billion. Other "high-risk" loans held by FCS institutions (excluding restructured loans which now approximate $2.4 billion) have declined to $2.2 billion versus $2.7 billion a year ago and the peak of $5.7 billion.

The vastly restructured Farm Credit System still faces major challenges as it recovers from the crippling setback it experienced earlier in the 1980s. Yet the improved quality of its loan portfolio has led to a recovery in earnings and prospects for a quicker, and more inclusive recovery among the components of the FCS than had been generally expected when Congress approved up to $4 billion in federal financial assistance for the system in 1987. So far, less than $1 billion of that assistance has been used.

While the 1980s marked a decade during which farm debt fell substantially following a period of widespread financial distress, most analysts are looking for a modest upturn in farm debt this year. Reflecting the painful lessons learned during the financial distress of a few years ago, both lenders and farm borrowers remain cautious with respect to new borrowings. Prospects for another year of strong net cash farm earnings, particularly in the Midwest, suggest that repayments on existing farm debts will remain favorable and that many farmers will continue to rely heavily on internally-generated funds to cover new expenditures. At the same time, however, prospects for further, but modest gains in farmland values and farm operating expenses, coupled with the continuing rebound in expenditures for farm machinery and equipment, imply farm loan demand will be somewhat stronger this year.

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Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from: Prior period	Year ago	Two years ago
Receipts from farm marketings *($ millions)*	December	14,293	-18.4	6	3
Crops*	December	6,883	-21.6	2	5
Livestock	December	6,846	-12.4	9	15
Government payments	December	563	-39.2	20	-60
Real estate farm debt outstanding *($ billions)*					
Commercial banks	December 31	15.3	0.9†	8	15
Farm Credit System	December 31	26.3	-0.8†	-6	-13
Life insurance companies	December 31	8.89	3.1†	0	-4
Nonreal estate farm debt outstanding *($ billions)*					
Commercial banks	December 31	29.2	-2.2†	3	6
Farm Credit System	December 31	9.49	-2.1†	8	1
Interest rates on farm loans *(percent)*					
7th District agricultural banks					
Operating loans	January 1	12.05	-1.1†	1	7
Real estate loans	January 1	11.15	-1.7†	-1	4
Commodity Credit Corporation	April	8.25	1.5	-13	25
Agricultural exports *($ millions)*	January	3,759	5.6	12	30
Corn *(mil. bu.)*	January	239	-7.6	36	79
Soybeans *(mil. bu.)*	January	77	17.7	16	-4
Wheat *(mil. bu.)*	January	83	-2.5	-31	-44
Farm machinery sales[P] *(units)*					
Tractors, over 40 HP	March	6,652	57.4	20	31
40 to 100 HP	March	3,466	51.0	6	9
100 HP or more	March	3,186	65.2	39	70
Combines	March	618	28.8	95	7

*Includes net CCC loans.
†Prior period is three months earlier.
[P]Preliminary

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