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Farmland values edge higher....

Our latest survey of 450 agricultural banks in the Seventh Federal Reserve District indicates that the modest uptrend in farmland values continued this summer. On average, District farmland values rose 0.8 percent during the third quarter and 4 percent during the year ending with September. Most of the responding bankers expect the farmland market to be stable to somewhat stronger during the current quarter.

While farmland values have continued to drift higher, the rate of gain has slowed from that experienced during the late 1980s. Moreover, the recent quarterly gains have typically fallen short of the rise recorded in most measures of overall inflation. In terms of inflation-adjusted dollars, it appears that the trend in farmland values is flat to perhaps somewhat lower.

Bankers from four of the five District states noted that farmland values, in current dollar terms, edged slightly higher during the summer quarter (see map on page 2). The exception was Wisconsin where bankers reported a decline of nearly 1 percent. The third-quarter gains among the other four District states ranged from a nominal 0.4 percent in Illinois to 1.6 percent in Iowa. In terms of the change in land values during the 12-months ending with September, Indiana bankers reported the largest rise, 6 percent. Bankers from Illinois, Iowa, and Michigan reported 12-month gains of between 4 and 5 percent. The third-quarter decline left farmland values in Wisconsin slightly below the year-earlier level.

It appears that bankers are expecting stable to strengthening trends in the market for farmland during the next few months. Nearly half of the bankers believe that the demand to acquire farmland, among both farmer and nonfarmer investors, will be unchanged from year-earlier levels during the fall and winter months. However, most of the remaining bankers are anticipating a stronger demand for farmland. Some 44 percent of the bankers thought that farmers would be more eager to acquire farmland this year while only 7 percent felt that the demand among farmer investors would be softer than last year. By a somewhat narrower margin (36 to 17 percent of the respondents) bankers are also expecting a stronger demand for farmland to surface among

nonfarmer investors this fall and winter. With respect to the anticipated volume of farm real estate transfers during the fall and winter months, about 57 percent of the agricultural bankers believe that the pace will be similar to year-earlier levels. Among the remaining bankers however, those expecting an increase in farmland transfers exceeded those expecting a decline by a margin of more than 2 to 1.

About 73 percent of the bankers expect farmland values to hold steady during the final three months of this year. Another 24 percent of the bankers believe that land values will continue to trend upward during the current quarter, while the remaining 3 percent of the bankers expect land values to decline. Among the five District states, the proportion of bankers expecting a continued uptrend in land values was notably higher in Illinois, Indiana, and Iowa than was the case for Michigan and Wisconsin.

The availability of farm mortgage financing appears to be rising among both banks and life insurance companies this year. Mid-year reports for commercial banks show that their combined portfolio of farm real estate loans was up 5 percent from a year ago nationwide and up 4 percent in District states. The year-over-year rise in farm mortgages held by life insurance companies was 6 percent as of the end of June. The increase for these two lenders more than offset the continuing declines in farm mortgages held by the Farm Credit System. As of the end of June, farm mortgages held by the FCS were down 3 percent from a year ago. Because of continued restructurings and constraints on new lending, the portfolio of farm mortgages held by the FmHA no doubt continues on the downtrend this year.

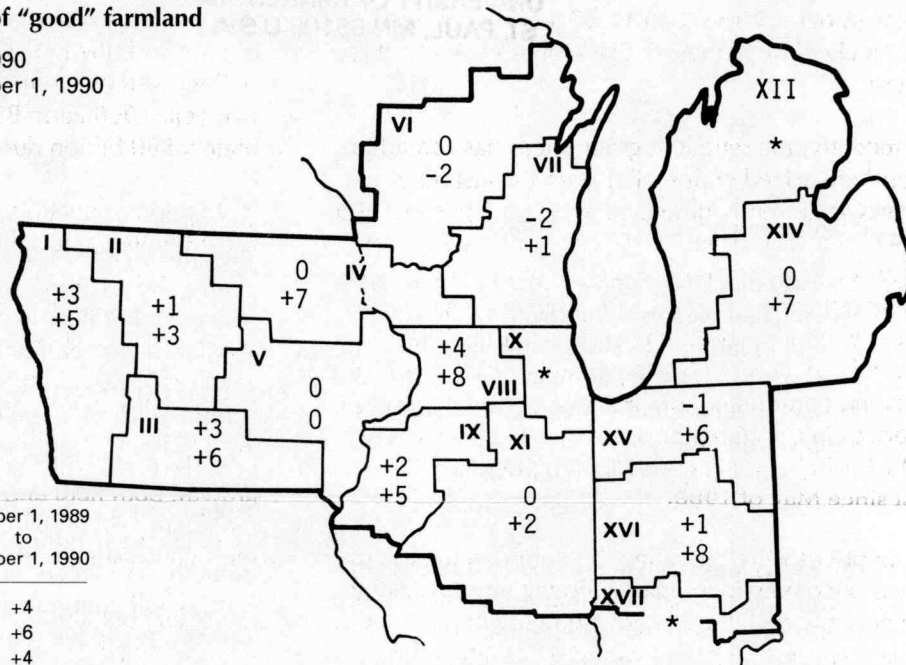
....but farm equipment sales weaken

After five consecutive quarters of strong gains, unit retail sales of both tractors and combines turned down this summer. Monthly reports from the Equipment Manufacturer's Institute show that combine sales dropped below year-earlier levels in August and that tractor sales followed suit in September. Media reports that note some companies are contemplating layoffs and reduced manufacturing schedules indicate the sluggishness likely continued into October. The sudden downturn probably stems from the recent declines in grain prices and

Percent change in dollar value of "good" farmland

Top: July 1, 1990 to October 1, 1990

Bottom: October 1, 1989 to October 1, 1990



*Insufficient response

the now inevitable down-scaling in government farm income and price support programs. The apprehensions triggered by the recent Persian Gulf developments may have contributed to the downturn.

Farmer purchases of new tractors and combines had been on a rapid increase since the winter of 1989. For all of last year, unit retail sales of tractors with 40 or more horsepower rose 15 percent while unit sales of combines (despite a sluggish first quarter) rose 52 percent. The strong pace continued into the early summer of this year. From January through June, unit sales of combines were up 68 percent from the same period a year earlier while unit tractor sales were up 16 percent. Larger tractors continued to pace the rise, as reflected in the 31 percent gain in sales of four-wheel drive tractors during the first half.

The year-over-year gain in sales began to abate in July. And while tractor sales held above year-earlier levels in August, combine sales slumped sharply. The eroding pattern continued in September as both tractor and combine sales were below a year earlier. With the summer reversal, third quarter unit retail sales of farm tractors were down 2.5 percent while combine sales were off 11 percent from a year earlier. The third-quarter downturn in tractor sales included a slight decline in sales of the large, four-wheel drive units.

The sudden decline in farm equipment sales was surprising to many analysts, particularly since it occurred while farmers were in the midst of a near-record harvest of wheat and growing hopes for a banner fall harvest of corn and soybeans. Yet the downturn, in many respects, parallels a similar pattern that emerged with the severe drought in 1988. Tractor and combine sales fell off sharply during the late spring and summer months of that year, bringing a sudden end to the string of large gains that had occurred the preceding four quarters. The downturn of 1988 extended into the early fall for tractors and into the following winter for combines.

The latest downturn probably stems from the steep declines in grain prices since spring and a growing awareness that the government safety net for farmers will be scaled back. Grain prices fell sharply this summer, pressured by prospects for a large harvest and a weakening in export shipments. As farmers were harvesting a 35 percent larger wheat crop, U.S. wheat exports during the four months ending with September fell 30 percent below the year-earlier level. Due to the steep decline this summer, USDA analysts are projecting that wheat exports for the entire 1990/91 marketing year that will end in May will be down nearly a tenth and off 30 percent from the peak in 1987/88. As these developments and prospects were emerging, wheat prices

received by farmers fell by nearly a third between April and September. At less than \$2.50 a bushel, wheat prices received by farmers in September were at a three-year low.

More recently, the retreat in grain prices has spread to corn and other feed grains. The corn harvest now underway is currently projected to be up 7 percent from last year. Because of earlier drawdowns in carryover stocks, however, total corn supplies for the 1990/91 corn marketing year remain comparatively low. Nevertheless, the combination of a larger harvest and a forecasted reduction of 12 percent in 1990/91 corn exports has contributed to a 20 percent decline in cash corn prices in Central Illinois since June. At less than \$2.20 a bushel in recent weeks, corn prices are the lowest since May of 1988.

As grain prices were retreating this summer, the realization was becoming inescapable among farmers that the safety net provided through government farm income and price support programs would be significantly reduced in scope. Cuts were to be forthcoming, either in the form of a Gramm-Rudman sequestration or through negotiations to reduce the federal budget deficit. The latter option, as eventually adopted in the Budget Reconciliation Act last weekend, will significantly reduce the benefits proffered in the Congressional debate on the 1990 Farm Bill. Estimating future government outlays for farm income and price support pro-

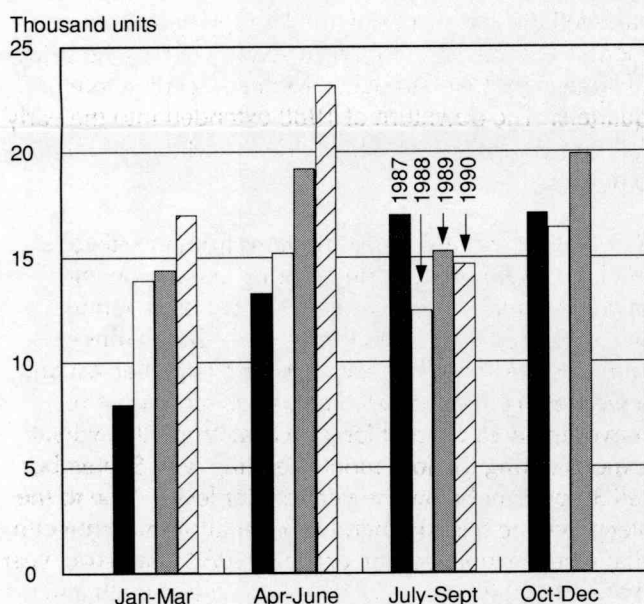
grams is, at best, tenuous. But the estimates behind the Budget Reconciliation Act suggest that farm program outlays over the next five years will approximate \$41 billion, well below the estimated \$54 billion under the five-year 1990 Farm Bill and actual outlays of approximately \$80 billion during the last five fiscal years.

In addition to declining grain prices and cuts in farm program provisions, the recent Persian Gulf developments may also have added to farmers' apprehensions for capital expenditures. Since energy-related inputs account for about a sixth of the farm sector's annual cash production expenses, farmers are well aware of the vulnerability of their net earnings to crude oil prices. Moreover, there is the increased risk that the Persian Gulf developments may translate into weaker economic growth, both here and abroad. That, in turn, could marginally alter food consumption patterns, especially for higher-value food commodities.

On balance, it appears that several recent events that threaten to cut farm sector earnings have led to the sudden downturn in capital expenditures for farm machinery and equipment. It is difficult to anticipate how long the downturn will prevail. On a somewhat more positive note, however, the strong earnings among livestock farmers are expected to extend well into next year. Market prospects for soybean and other oilseed farmers look somewhat better for next year. Moreover, the world still faces much tighter-than-normal stocks of corn and other feed grains. Grain prices are probably at a seasonal low. The subsequent recovery in grain prices into next year could prove to be stronger than the expectations that have been molded by the recent flurry of adverse developments.

Gary L. Benjamin

**Unit sales of farm tractors and combines
turned down in the third quarter***



*Figures plotted represent the combined unit retail sales of farm tractors (with 40 or more horsepower) and self-propelled combines.

SOURCE: Equipment Manufacturers Institute.

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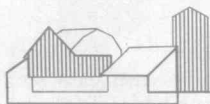
Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from		
			Prior period	Year ago	Two years ago
Receipts from farm marketings (\$ millions)	June	12,732	-0.3	1	-7
Crops*	June	5,536	17.8	-1	-8
Livestock	June	7,045	-5.2	9	16
Government payments	June	151	-76.3	-73	-90
Real estate farm debt outstanding (\$ billions)					
Commercial banks	June 30	17.1	2.2**	5	13
Farm Credit System	June 30	29.6	-1.1**	-3	-10
Life insurance companies	June 30	10.1	3.0**	6	6
Nonreal estate farm debt outstanding (\$ billions)					
Commercial banks	June 30	31.9	8.7**	4	6
Farm Credit System	June 30	10.5	8.7**	6	4
Interest rates on farm loans (percent)					
7th District agricultural banks					
Operating loans	October 1	11.94	0.0**	-2	2
Real estate loans	October 1	11.07	-0.2**	-2	0
Commodity Credit Corporation	October	7.87	1.6	-5	-3
Agricultural exports (\$ millions)	August	2,894	4.6	5	0
Corn (mil. bu.)	August	154	4.0	44	2
Soybeans (mil. bu.)	August	28	35.9	54	-24
Wheat (mil. bu.)	August	96	14.9	-31	-16
Farm machinery sales^p (units)					
Tractors, over 40 HP	September	3,914	1.6	-15	3
40 to 100 HP	September	2,550	-6.6	1	6
100 HP or more	September	1,364	21.5	-34	-3
Combines	September	1,167	130.2	-7	37

*Includes net CCC loans.

**Prior period is three months earlier.

^pPreliminary



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