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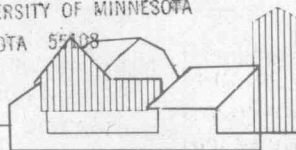
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### Farmland values strengthen

Survey responses from 500 agricultural bankers indicate that farmland values in the Seventh Federal Reserve District continued to rise during the final three months of 1988. Bankers reported an average gain of 3 percent during the period, recording a second consecutive strong quarterly gain after a small rise in the second quarter. For all of last year, District farmland values rose 11.5 percent, and have registered a 20 percent gain from the 1986 trough in land prices. However, farmland values in the District remain more than a third lower than the peak in value reported early in the decade. The renewed strength in the land market has contributed to a more optimistic outlook among the bankers regarding trends in farmland values in early 1989.

Most of the individual states shared in the overall gain in District farmland values. Bankers in Illinois reported the strongest gains, with land values up 5.3 percent from three months earlier. Land values in Indiana and Iowa were reported to have risen more than 3 percent during the fourth quarter, while Wisconsin bankers reported a 2 percent quarterly increase. Michigan bankers, on the other hand, reported that farmland values during the final three months of the year remained virtually unchanged. However, there was considerable disparity between the two regions in the state (see map on page 2) with the northwestern area showing a sharp decline.

The cumulative changes in land values through 1988 were considerably more variable. Iowa farmland values rose almost 18.3 percent during calendar 1988, registering the strongest gain among the individual states. Moreover, Iowa farmland values have risen more than a third during the last two years. Land values in the District portion of Illinois rose by 13.6 percent during all of last year, while Indiana bankers reported an annual gain of 9.3 percent. In both states farmland values are up about a fourth from the low recorded in the final months of 1986. The trends in farmland values in Michigan and Wisconsin have been somewhat more erratic than in the other District states. In 1988, Michigan farmland values were up 2.5 percent, accounting for about half of the 5.2 percent gain during the last two years. Farmland values in Wisconsin rose about 3 percent in 1988 and have risen about 4.1 percent over the last two years.

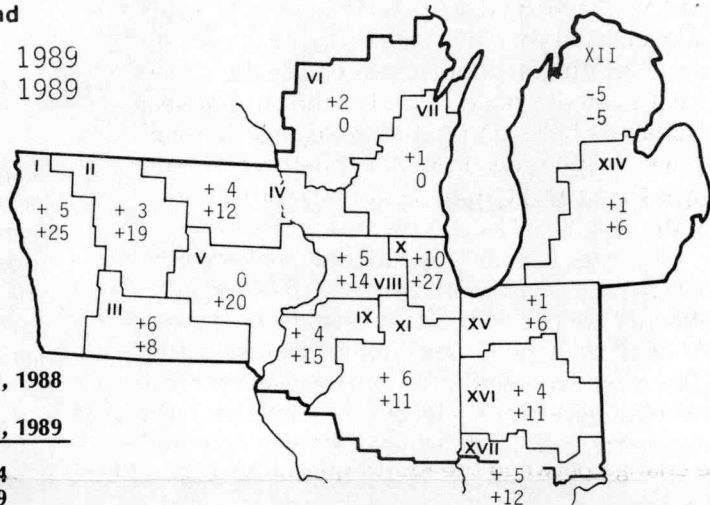
The improvement in farmland values over the last two years is attributable to a number of factors that have boosted the returns to land ownership. A downtrend over most of the period in farm production expenses, a period of strong returns to livestock producers, higher crop prices, and large government payments to the sector have kept income at high levels. Combined with the drop in farmland values that occurred between 1981 and 1986, the improved income has boosted the rate of return on farmland above the depressed levels that prevailed during the first half of the decade. Moreover, the outlook for farm income remains favorable in 1989. Although higher farm expenses are likely to be partially offsetting, generally strong crop prices, strong cattle prices, and somewhat lower but still large government payments will maintain sector income near year-earlier levels, lending support to farmland values.

The increases in farmland values over the last two years have occurred despite an upward trend in farm real estate mortgage rates. Following ten quarters of steady decline ending in early 1987, average rates on farm real estate loans began to firm in late 1987. At the end of the first quarter of last year, however, rates dropped to about 10.48 percent. During the remaining months of 1988 interest rates on farm real estate loans rose steadily, reaching 11.27 percent by the end of the year. That marks the highest average rate on farm real estate loans at District agricultural banks since spring of 1986. Following the pattern established earlier in the year, Iowa and Wisconsin bankers reported the lowest farm mortgage rates at 11.08 and 11.14, respectively, while Michigan respondents reported the highest average rate of 12 percent. Agricultural banks in Illinois and Indiana reported average interest rates on farm real estate loans at the end of the fourth quarter of 11.27 and 11.39 percent, respectively.

The volume of farm real estate lending during the first three months of 1989 is expected to be up from a year ago. A majority of the surveyed bankers, 60 percent, expect the volume of farm real estate lending to be unchanged from last year's high level. However, more than a fourth are forecasting an increase in volume compared to the first quarter of 1988. The volume of farm real estate lending also reflects the bankers' expectations regarding the trend in farmland values during the early months of this year. More than 29

**Percent change in dollar value of "good" farmland**

Top: October 1, 1988 to January 1, 1989  
 Bottom: January 1, 1988 to January 1, 1989

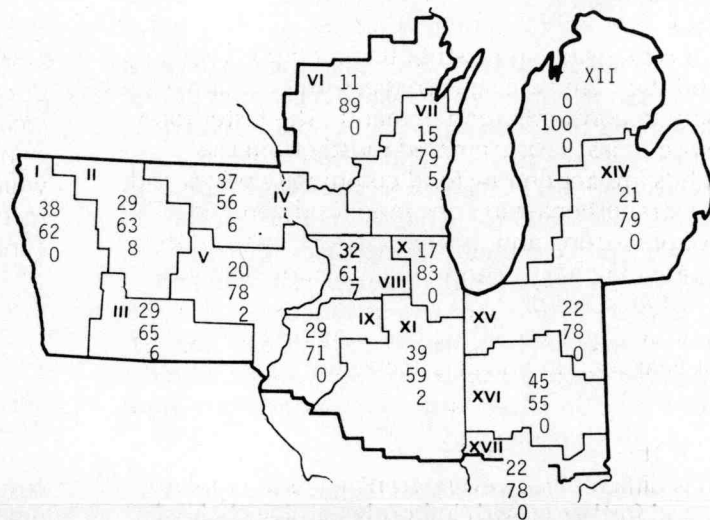


**October 1, 1988 to January 1, 1989**      **January 1, 1988 to January 1, 1989**

Illinois .....	+5	+14
Indiana .....	+3	+9
Iowa .....	+3	+18
Michigan .....	0	+3
Wisconsin .....	+2	+3
Seventh District ....	+3	+12

**Percent of banks reporting the current trend in farmland values is:**

Top: Up  
 Center: Stable  
 Bottom: Down



**Up      Stable      Down**

Illinois .....	35	62	3
Indiana .....	36	64	0
Iowa .....	31	65	4
Michigan .....	16	84	0
Wisconsin .....	16	82	2
Seventh District ....	29	69	2

percent of the survey respondents expect land values to move higher during the period while only 2.5 percent expect a downturn. The remaining 69 percent of the bankers expect farmland values to remain stable during the first three months of 1989. Sentiments for a continued rise in farmland values are greatest in Illinois, Indiana and Iowa where about a third of the respondents expect increases. Bankers in Michigan and Wisconsin are somewhat more cautious with only 15 to 16 percent expecting increases. However, virtually all of the remaining bankers in both states expect

farmland values to remain stable during the early months of this year.

Peter J. Heffernan

**Retail food prices**

Despite widespread concern about the implications of last year's drought, the rise in retail food prices has not been as pronounced as many had expected. Although the rate of increase accelerated during the



spring and summer, the index of retail food prices for all of last year averaged 4.1 percent above the year-earlier level. That matched exactly the rise in food prices the year before, but was otherwise the largest average annual rise since 1981. For the current year, USDA analysts believe that the average rise in retail food prices might range from 3 to 5 percent, somewhat less than the 4 to 6 percent range projected during the height of last summer's drought.

Because of differing trends in the rate of increase in retail food prices over the past couple of years, it is somewhat misleading to gauge the 1988 rise on the basis of the average index for the year. A more realistic measure that captures the accelerating trend of last spring and summer would gauge the rise on the basis of the change between the fourth quarter of 1987 and the fourth quarter of 1988. On this basis, the 1988 food price rise was 5.2 percent, up from 3.4 percent the year before.

Changes in the rate of increase in retail food prices can usually be traced to one of three major sources; changes in farm level production that cause sudden swings in raw farm commodity prices, changes in the cost of processing and distributing food commodities beyond the farm gate, and changes in the relative strength in consumer food demand. The faster food price rise of last year stemmed mostly from the drought's impact on raw food commodity prices and from a strengthening in consumer food demand. The cost of processing and distributing food beyond the farm gate may have risen somewhat more last year than in 1987. Yet preliminary USDA figures show that the index of food marketing costs in the third quarter of last year was up only 3 percent from the year before.

Gauging the relative strength in consumer food demand is difficult. However, strong gains in employment and further growth in hourly earnings helped boost disposable personal income 8.2 percent last year, well above the average annual rise of 6.4 percent the previous three years. Even adjusted for inflation, last year's rise in disposable income was a robust 3.8 percent. Consumers apparently used their higher earnings to expand and upgrade their diets. Reflecting this, personal consumption expenditures on food in the fourth quarter of last year were up 6.5 percent from the year before. Similarly, the combined retail sales of food stores and of eating and drinking places in the fourth quarter of last year was up more than 7.5 percent from the year before. Since these gains exceed the rise in food prices, it appears consumer food demand strengthened considerably last year.

The strengthening in consumer food demand probably contributed to the rise in prices for several types of

### Recent trends in retail food prices

	Percent change	
	4th Q 1986 to 4th Q 1987	4th Q 1987 to 4th Q 1988
All food	3.4	5.2
Food away from home	3.8	4.3
Food at home	3.2	5.8
Beef and veal	7.4	5.5
Pork	0.1	-4.7
Poultry	-9.2	17.1
Fish & seafood	10.2	4.5
Eggs	-10.6	13.1
Dairy products	2.2	3.6
Fats and oils	2.0	9.2
Fruits and vegetables	9.3	9.4
Cereal and bakery products	3.8	8.4
Sugar and sweets	1.7	4.4
Other prepared foods	4.3	4.6

foods last year. But analysts believe it particularly contributed to the rise in meat prices, especially poultry. Total meat production rose to another new high last year, paced by an 8 percent rise for pork and a 4 percent rise for poultry. Although retail pork prices declined last year, the decline was less than normally would have been expected given the rise in production. Similarly, even though beef production held steady, retail beef prices rose 5.5 percent. The most significant rise in meat prices occurred for poultry which, on a fourth-quarter over fourth-quarter basis, rose more than 17 percent last year, despite a 4 percent rise in production. The strengthening in poultry demand in 1988 may have reflected a bounce back from the year before when poultry prices declined, in part because of consumer concerns about the sanitary conditions at poultry processing plants.

An accelerated price rise for several different types of food can be traced largely to the drought effects on farm-level production, and prices, of raw food commodities. Final estimates show U.S. soybean production in 1988 fell 20 percent from the year before while grain production fell 26 percent. With the shortfall in production, farm level prices of feed grains during the fourth quarter of last year averaged 54 percent higher than the year before, while those for food grains and oilseeds averaged 38 percent higher. At the retail level, the effects of the sharply higher farm level prices were significantly cushioned by the modest rise in processing and distribution costs. Nevertheless, the shortfall in grain and soybean production largely accounts for the 9.2 percent rise in retail prices of fats and oils during the four quarters ending in late 1988 and the 8.4 percent rise in cereal and bakery products.

Both the strength in consumer demand and the drought contributed to the 9.4 percent rise in retail prices of fruits and vegetables during the year ending

with the fourth quarter of 1988. A growing consumer demand was probably the major factor helping to boost retail prices of fresh and processed fruit by 12.7 and 11.4 percent, respectively. In contrast, fresh vegetable prices rose 4.0 percent while processed vegetable prices rose 10.3 percent during the year ending with the fourth quarter of 1988. The large rise in processed vegetable prices largely stems from the drought effects in the Great Lakes region which produces a proportionately large share of several major vegetables that are canned or frozen.

Gary L. Benjamin

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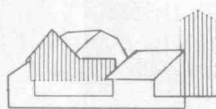
### Selected Agricultural Economic Indicators

	Latest period	Value	Percent change from		
			Prior period	Year ago	Two years ago
<b>Receipts from farm marketings (\$ millions)</b>	September	14,225	17.2	9	14
Crops*	September	6,761	24.7	12	39
Livestock	September	7,310	9.6	10	16
Government payments	September	154	294.9	-55	-88
<b>Interest rates on farm loans (percent)</b>					
7th District agricultural banks					
Operating loans	January 1	11.97	2.6†	6	8
Real estate loans	January 1	11.27	2.2†	5	7
Commodity Credit Corporation	February	9.00	1.4	26	53
<b>Agricultural exports (\$ millions)</b>					
Corn (mil. bu.)	November	3,350	1.5	19	33
Soybeans (mil. bu.)	November	151	-13.8	23	31
Wheat (mil. bu.)	November	61	22.0	-39	-37
	November	98	-4.3	24	43
<b>Farm machinery sales<sup>P</sup> (units)</b>					
Tractors, over 40 HP	December	4,480	22.1	-6	28
40 to 139 HP	December	2,852	10.5	-20	1
140 HP or more	December	1,628	49.8	34	142
Combines	December	505	-17.1	-37	2

\*Includes net CCC loans.

†Prior period is three months earlier.

<sup>P</sup> Preliminary



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