FRB CHICAGO

AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO
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Farmland values down in fourth quarter

A recent survey of 525 agricultural banks in the Seventh Federal Reserve District indicated that the downtrend in farmland values continued during the latter part of 1986. However, the rate of decline showed further evidence of slowing. On average, District farmland values declined 1.2 percent in the three months ending with December and 11.6 percent during all of 1986. Following the most recent declines, District farmland values are down about 50 percent from the 1981 peak. Adjusted for inflation, farmland values are down about 60 percent from the peak.

The overall slowing in the rate of decline encompassed a wide difference in trends among individual District states (see map on page 2). Bankers from the District portion of Wisconsin reported that land values were unchanged during the final three months of 1986. Bankers from Illinois reported a fourth quarter decline of just over a half of one percent while those from Iowa noted a decline of nearly 1 percent. Declines of 3 percent were noted by bankers from the District portions of Indiana and Michigan. For all of 1986, the reported declines ranged from 7 percent in Wisconsin to 21 percent in Michigan. The sharp decline in Michigan apparently reflects the financial distress that hit many farmers in that state following extensive rainfall during harvest.

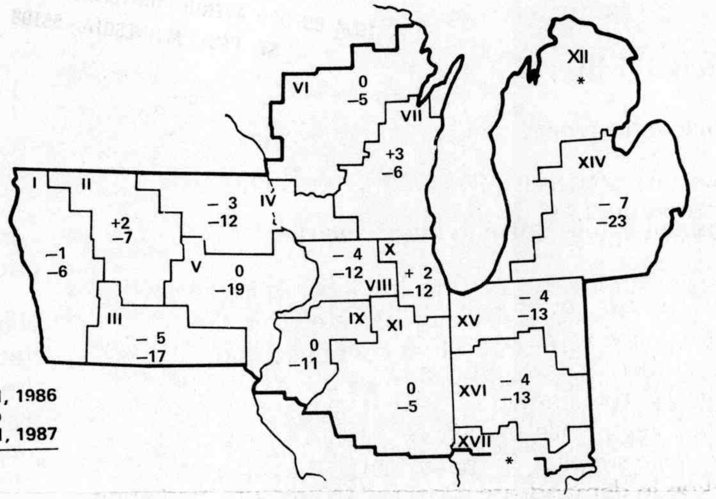
Near-term trends in farmland values are difficult to project with much confidence. The overall slowing in rate of decline last year was accompanied by some developments that provided support to the land market. Among other things, large government subsidies to agriculture, declines in the value of the dollar relative to the currencies of some other industrialized countries, and growing concerns that inflationary pressures may soon become more evident are developments that historically have been considered positive influences on farmland values. Moreover, the Conservation Reserve Program has apparently added some support to land prices. Enrollment of eligible land in the 10-year program at relatively favorable, and certain, annual returns has provided sufficient restructuring for some financially-stressed farmers to preclude their having to liquidate their land holdings. Other financially-stressed farmers who must still liquidate their land have used the program returns as a favorable bargaining chip for holding the transaction price on that land at a higher level.

The continued downturn in interest rates is probably the most significant development adding support to the land market. Lower interest rates render farmland a more appealing investment option for those who have funds invested in interest-earning assets. Also, lower interest rates translate into lower financing costs on debt-financed land purchases. The typical interest rate charged on farm real estate loans by District agricultural banks averaged 10.5 percent at the end of December. The ending 1986 average was 25 basis points lower than three months earlier, 250 basis points lower than a year ago, and the lowest since the early part of 1979. Moreover, several Federal Land Banks have implemented tiered loan-pricing structures in recent months that offer substantial interest rate reductions for new and existing borrowers with high credit ratings. Among three of the four FLBs that serve District states, the lowest farm mortgage rates offered in December ranged from 9.5 to 10.5 percent, roughly 300 basis points lower than a year earlier. In addition, several FLBs offer even lower rates to borrowers who purchase land presently owned by the FLB.

Changing practices on the part of some mortgage lenders in disposing of acquired farmland properties represent another recent development of uncertain implications for farmland values. The Federal Land Bank of St. Paul recently announced a trial program in which some of its acquired properties will be offered with particularly attractive financial terms—including interest rates as low as 5 percent—to buyers who will purchase the land at no less than the appraised value. If successful, this program could complement reports from other FLBs who have had some success in using concessional financing options to sell acquired properties without pushing farmland transaction prices still lower. Alternatively, the FmHA recently lifted a blanket moratorium on the disposal of its acquired farm properties in several states, including Iowa and Illinois. Any such sales presumably will be subject to the FmHA's restrictions on permissible buyers and its continuing guideline that no sale can be consummated at prices below existing land values in the area. Nevertheless, it will be interesting to see if the resumption of sales of FmHA-acquired farm properties puts further downward pressure on land values.

Percent change in dollar value of "good" farmland

Top: October 1, 1986 to January 1, 1987
Bottom: January 1, 1986 to January 1, 1987

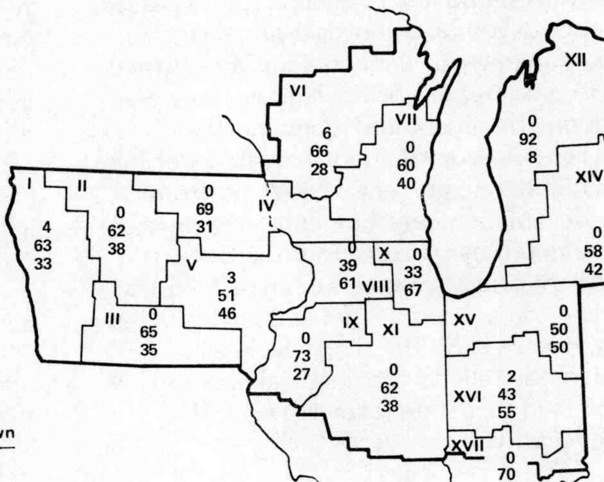


*Insufficient response.

	October 1, 1986 to January 1, 1987	January 1, 1986 to January 1, 1987
Illinois	−1	− 8
Indiana	−3	−12
Iowa	−1	−12
Michigan	−3	−21
Wisconsin	0	− 7
Seventh District	−1	−12

Percent of banks reporting the current trend in farmland values is;

Top: Up
Center: Stable
Bottom: Down



	Up	Stable	Down
Illinois	0	58	42
Indiana	1	48	51
Iowa	2	62	36
Michigan	0	66	34
Wisconsin	2	62	36
Seventh District	1	59	40

While there have been some developments that would tend to support farmland values, some major offsetting influences are still evident. The new tax legislation could have a negative effect on non-farmer investor demand for land. A near 30 percent cut in fiscal 1987 appropriations for the FmHA's Farm Ownership Loan Program, and the continuing shift from direct to guaranteed lending under that program, are negative influences on land values. In addition, while government subsidies to agriculture have risen to new highs, there is considerable speculation that those subsidies may be trimmed in another year or two. Moreover, the huge overhang of grain stocks here and abroad, and the lack of any evidence that the near-term export potential for grains and soybeans has been rekindled by lower prices and the lower value of the dollar, result in deep lingering doubts about the sustainability of current income returns to land ownership in the absence of large government subsidies. Also, reports of proportionately large cuts in land rental rates this year and the restructuring yet needed among financially stressed farmers leaves considerable doubt in the minds of many analysts that land values have yet bottomed out.

Gary L. Benjamin

Corn and soybean stocks at record levels

The USDA recently released final estimates of 1986 crop production as well as estimates of grain and soybean stocks on hand at the end of the first quarter of the marketing year. The final production estimates boosted corn output slightly while cutting the estimated 1986 soybean crop by a negligible amount. The December 1 stocks estimates show a substantial increase in the amount of corn in inventory compared to last year, while soybean stocks increased slightly. The huge supplies, in the absence of a substantial pickup in demand, are expected to pressure marketing year average prices for corn and soybeans well below last year's levels.

The 1986 corn crop was pegged at 8.25 billion bushels, about 30 million bushels above earlier estimates, but 7 percent below the previous year's record. The large crop was harvested from 69.2 million acres, down 8 percent from 1985. The drop in acreage was partially offset by an average yield of 119.3 bushels per acre, eclipsing the year-earlier record of 118 bushels. Soybean production in 1986 totaled just over 2 billion bushels, down 4.4 percent from the 1985 outturn. A 3.5 percent year-to-year drop in harvested acres accounted for most of the decline, although a 1 percent drop from last year's record yield contributed as well.

The stocks report provides estimates of the amounts of various grains and soybeans held on and off farms on December 1. When compared with the estimates of total supply available at the beginning of the marketing year, December 1 stocks estimates provide an indication of utilization through the first three months of the marketing year. The implied soybean utilization rate from the stocks report supplements the more frequent measures of soybean crushings and exports available throughout the marketing year. The soybean utilization level implied by the stocks report, almost 563 million bushels, shows a sharp 24 percent increase from the first quarter of the previous marketing year. Monthly figures on soybean exports and crushings show year-to-year gains of 30 percent and 10.6 percent, respectively, suggesting that soybean use during the period was up 18 percent from a year earlier. The apparent discrepancy results in a large residual disappearance of 51 million bushels.

While comparable measures of exports are available for corn, the stocks estimate provides the best measure of domestic utilization of corn. The 10.3 billion bushels of corn stocks on December 1, when subtracted from the 12.3 billion bushel total supply of corn available for the marketing year, implies that total utilization of corn during the September-November period was about 1.99 billion bushels, up 3.7 percent from a year earlier. With corn exports lagging the year-ago pace through November by 23 percent and processing uses of corn up only slightly, the bulk of the year-to-year gain is attributable to increased feed use. At 1.4 billion bushels, implied feed use during the quarter was up more than 13 percent from last year.

Utilization rates for corn and soybeans during the first quarter imply sluggish use rates during the final nine months of the marketing year. Deducting first quarter use from projected corn demand for the entire marketing year suggests that utilization during the rest of 1986/87 will about equal the year-earlier level. Corn exports for the period may hold about 2 percent below the year-earlier pace, but will be offset by a slight increase in domestic utilization. Soybean use during the remaining months of the marketing year is expected to drop 4 percent from a year earlier. Virtually all of the drop is attributable to a likely 5 percent cut in the pace of exports over the period as competition intensifies when Southern Hemisphere production, rebounding from a sharp drop last year, flows into marketing channels. Soybean crushings, the major domestic utilization of the crop, are expected to be unchanged from a year ago during the remainder of the marketing year.

With lackluster demand prospects and burdensome supplies leading to record carry-out stocks, average prices for the marketing year are expected to drop from last year's levels. The latest USDA estimates point to soybean prices averaging \$4.50 to \$4.90 per bushel in 1986/87, compared to \$5.10 last year. Corn prices are expected to be under even greater pressure, averaging between \$1.35 and \$1.65 per bushel, well below the \$2.35 average of 1985/86.

Peter J. Heffernan

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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 *(1977=100)*	December	121	-2.4	-5	-10
Crops *(1977=100)*	December	99	-2.9	-16	-21
Corn *($per bu.)*	December	1.50	2.0	-34	-41
Oats *($per bu.)*	December	1.37	3.8	14	-20
Soybeans *($per bu.)*	December	4.66	0.4	-7	-20
Wheat *($per bu.)*	December	2.42	-0.4	-26	-28
Livestock and products *(1977=100)*	December	141	-2.8	3	-3
Barrows and gilts *($per cwt.)*	December	52.20	-2.1	13	5
Steers and heifers *($per cwt.)*	December	58.80	-1.7	-2	-7
Milk *($per cwt.)*	December	13.40	0.0	6	-4
Eggs *(¢per doz.)*	December	65.2	-1.7	-2	10
Prices paid by farmers *(1977=100)*	October	160	-0.6†	-1	-2
Production items	October	143	-1.4†	-3	-6
Feed	October	98	-8.4†	-9	-22
Feeder livestock	October	160	3.9†	8	7
Fuels and energy	October	154	-0.6†	-24	-23
Producer Prices *(1967=100)*	December	290	-0.3	-3	-1
Agricultural machinery and equipment	December	340	-0.1	1	1
Fertilizer materials	December	197	0.7	-12	-14
Agricultural chemicals	December	479	0.2	6	5
Consumer prices *(1967=100)*	December	331	0.1	1	5
Food	December	325	0.2	4	7
Production or stocks					
Corn stocks *(mil. bu.)*	September 1	4,038	N.A.	145	301
Soybean stocks *(mil. bu.)*	September 1	536	N.A.	70	205
Beef production *(bil. lbs.)*	December	1.97	9.0	6	8
Pork production *(bil. lbs.)*	December	1.22	9.4	0	0
Milk production *(bil. lbs.)*††	December	9.77	3.4	-3	5

N.A. Not applicable
†Prior period is three months earlier.
††21 selected states.

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