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Projected Farm Credit System losses

In recent Congressional Testimony, Brent Beesley, Chairman of the Farm Credit Corporation of America, disclosed the results of a study that shows the Farm Credit System (FCS) will suffer operating losses of more than $3 billion during the three years ending with 1989. Because of the anticipated losses and the FCS's desire to abandon internal loss-sharing arrangements, Beesley also requested a $6 billion line of credit from the U.S. Treasury to restore the weak components of the FCS to a viable status.

Over the past two years, the FCS has suffered $4.6 billion in operating losses. Because of the losses, the earned surplus equity capital in the FCS (under generally accepted accounting practices) has declined from $6.2 billion at the end of 1984 to less than $1.5 billion at the end of 1986. With the losses expected over the next three years, the earned surplus capital, on a consolidated, System-wide basis, is projected to fall to a deficit of $1.8 billion by the end of 1989, signifying that the value of the stock owned by borrower-stockholders of the FCS will fall considerably below par value without federal assistance. The projected $3.1 billion in operating losses was translated into a request for $6 billion in federal assistance because of legal entanglements that have precluded effective loss-sharing arrangements between the weaker and the stronger components of the FCS and because of the intent of FCS officials to reverse earlier loss-sharing assessments. Without loss-sharing, the combined deficit among all System components expected to have a deficit in their earned surplus capital account by 1989 is projected to approximate $6 billion.

The projected FCS losses, to an increasing extent, will stem from a further erosion in net interest earnings. Both interest income and interest expenses for the FCS are expected to decline considerably over the next three years. But the projected decline in interest expenses is less than that for interest income. The slower decline in interest expenses is mostly due to the unfortunately large amounts of long-term FCS bonds that were issued during earlier periods of high interest rates, many of which will not mature for several years. Reflecting this, about half of the $35 billion in outstanding Federal Land Bank bonds will mature between 1989 and 1994. The average cost of this portion of the FLB bond portfolio is nearly 11.5 percent. With respect to the cost of new FCS bonds and notes that will be issued over the forecast period, the study assumes that market rates of interest will hold comparable to the more favorable levels of the past year, but that the amount of new issues will be constrained by further declines in the FCS loan portfolio. The combination of modest amounts of new funding and the high cost and long maturities of existing indebtedness implies that the average cost of funding for the FCS will be slow to decline.

The anticipated decline in interest income for the FCS partly reflects assumptions of stable interest rates and stepped-up efforts to restructure existing problem loans. But more importantly, it reflects assumptions that led to a projection of further declines in the FCS's portfolio of loans that accrue interest earnings. The study assumed that farm debt, which has already declined 13 percent from the ending 1982 peak, will decline another 20 percent over the three years ending in 1989. Moreover, it assumed that the FCS's share of the farm debt market will decline from the 27 percent level estimated for the end of 1986 to 24 percent three years later. While these assumptions encompass issues related to repayments and write-offs on existing farm indebtedness, they also imply that the FCS anticipates continuing problems in competing for new farm loans, despite implicit assumptions about competitive loan pricing and some form of protection for borrower stock. Other critical assumptions behind the projection of further declines in the FCS's portfolio of accruing farm loans pertain to trends in farmland values and farm income. The study assumed that over the forecast period farmland values would decline an additional 7 percent. The implications of continuing declines in farmland values were expected to offset those for the assumed higher farm earnings and lead to a high, but declining amount of loans that will become nonaccruing (i.e. no longer accruing interest earnings). In 1986, some $5.6 billion in FCS loans were downgraded to nonaccrual status. Over the next three years, another $9.6 billion in loans are projected to become nonaccruing.

The projected FCS operating losses also include expectations for continued high, but declining, annual provisions for losses. These provisions represent a charge against earnings that reflect anticipated losses on both problem loans and on other property owned

Highlights of FCS combined financial projections

	Actual		Projected		
	1985	1986	1987	1988	1989
	(------------	billion dollars	----------)		
Earnings					
Interest income	8.97	7.17	5.49	4.96	4.79
Interest expenses	7.68	6.39	5.17	4.74	4.47
Net interest income	1.30	.78	.32	.23	.32
Less:					
Provision for losses					
Loans	2.97	1.80	.76	.46	.33
Other property	.28	.23	.15	.16	.72
Other expenses, net	.73	.66	.70	.69	.66
Net income (loss)	(2.69)	(1.91)	(1.28)	(1.09)	(.74)
Selected balance sheet items (year-end)					
Loans, total	69.8	58.2	50.8	46.5	45.0
Accruing	64.5	51.2	44.5	42.0	42.3
Nonaccruing	5.3	7.1	6.2	4.4	2.6
Loans, net of allowance for loan losses	66.6	54.6	48.0	44.4	43.3
Bonds and notes	68.9	62.5	55.6	54.1	53.3
Surplus (deficit)	3.4	1.5	.1	(1.0)	(1.8)
Total capital	8.4	5.6	3.4	2.0	1.2

by the FCS (typically property acquired through defaulted mortgages). When the provisions are taken, a corresponding amount of assets are set aside in a separate reserve, called the allowance for losses, against which the final losses, when actually charged off, are taken. In 1986, the provision for loan losses approximated $1.8 billion while that for other property totaled $233 million. Reflecting the study's assumptions about farmland values and farm earnings, the annual provisions for loan losses over the next three years are expected to sum to nearly $1.6 billion while the provisions for losses on acquired property are expected to sum to more than $350 million.

Without doubt, the failure to implement effective loss-sharing arrangements and the strong political desire to protect the par value of borrower stock implies that some form of federal assistance will be needed for the FCS this year. The amount of assistance that will be needed will ultimately hinge on the type of assistance provided and the unfolding conditions in both farm and financial markets in the years ahead.

On balance, the FCS study seems objective and the conclusions it reached are plausible. Yet there are reasons to believe that the amount of assistance needed could fall short of the maximum $6 billion requested. Recent indications that the downtrend in farmland values is leveling off suggests that the study's assumptions with respect to land values may be slightly pessimistic. If land values were to hold steady over the next few years, or even rise slightly, FCS earnings would be supported by a higher-than-projected volume of accruing loans and by smaller provisions for losses. Moreover, while interest rates are difficult to project, the recent upturn in market rates of interest raises a question as to the study's assumption that interest rates will hold steady at the average of the past several months. On balance, somewhat higher market interest rates would probably improve the performance of the FCS. If market rates of interest were to average higher than assumed in the study, the FCS could find it easier to offer competitive loan interest rates without sacrificing as much in net interest margins and might be able to overcome the assumed loss of market share in the years ahead. However, these potential benefits of higher interest rates could be partially offset by the adverse implications that higher rates would have for the volume of accruing loans. Finally, there are some observers who believe that the legacy of problem farm loans has been fairly well identified and that the study's projections on provisions for losses may somewhat exceed the amounts likely to be taken over the next few years.

Gary L. Benjamin

Agricultural price trends

Prices received by farmers edged steadily higher through the early months of the year and have registered significant gains in recent weeks. The increases this year in the index of prices received by farmers contrast with the downtrend that occurred during the first four months of 1986. Moreover, this year's uptrend has boosted the index above year-ago levels. The preliminary April index, at 125, indicates a year-to-year gain of 3.3 percent in the prices farmers received for all crop and livestock products. Prices paid by farmers, however, edged higher as well. At 162 in April, the quarterly index of prices paid by farmers was up almost 2 percent from both January and a year ago.

The overall gain in the prices received index is largely attributable to increases in livestock prices. The index of livestock and livestock product prices during the first four months of 1987 averaged more than 9 percent above the comparable period of a year ago, and a sharp rise in the April index indicated a 16.5 percent year-to-year gain for that month. A steep rise in meat animal prices throughout 1987 accounts for most of the gain. At 166, the April index of meat animals' prices is almost 26 percent higher than last year, and through April averaged 14 percent more than through the first four months of 1986.

Reinforcing the increases in meat animal prices, prices received for dairy products registered year-to-year gains. Although trending down seasonally through April, prices received for dairy products have held above year-ago levels. The April index, at 127, is 7 percent lower than the January level but more than 2 percent higher than last year. For the entire four-month period, dairy product prices averaged almost 4 percent above the same period in 1986.

Partially offsetting these gains, poultry product prices have held slightly below last year's levels as production has continued to expand. During the first four months of the year, poultry and egg prices have averaged more than 4 percent lower than a year ago. Much of the decline over the period, however, is due to a sharp year-to-year drop in poultry product prices in March.

While not yet compiled in the index, cattle and hog prices have continued to strengthen in recent weeks. Prices for choice steers at Omaha were holding at $72.50 per hundredweight in mid May, up from the high $60-per-hundredweight range recorded in late April and more than a fourth higher than a year ago. Hog prices have also continued to register substantial gains. Hog prices at Omaha rose above $57 per hundredweight in mid May, up from the low $50 range recorded in April. Compared to a year ago, Omaha hog prices in mid May were up about $10 per hundredweight.

In contrast to livestock and livestock product price trends, crop prices remained well below year-earlier levels through April before registering their recent sharp gains. Although following a slight upward trend during the first four months of 1987, the index of all crop prices for the period averaged more than 10 percent below the comparable period of a year ago.

Prices for feed grains were particularly weak during the four-month period, averaging almost a third below a year earlier. Food grain prices were also depressed, falling about a fourth from the average for the same months in 1986. The sharp year-to-year declines in feed and food grain prices stem from the burdensome supplies on hand and the effects of generic PIK certificates which effectively removed the loan rate price floors for these crops.

Prices of oil-bearing crops did not fare much better over the four-month period. Although not directly affected by generic PIK certificates, prices for oil-bearing crops, principally soybeans, were pressured by weak demand and large market supplies of feed grains. As a result, the index of prices for oil-bearing crops through April averaged almost 8 percent below a year earlier.

Like meat animal prices, however, grain and soybean prices have registered substantial gains in recent weeks. Wheat prices in St. Louis in mid May were up 12 percent from both a month ago and last year. Soybean prices in central Illinois have risen more than 10 percent since mid April, exceeding the year-ago level by about 4 percent. Corn prices have also jumped in the last month, gaining 15 percent since mid April. However, corn prices remain well below the year-ago level. At $1.78 per bushel during the second week of May, central Illinois corn prices remain 26 percent below last year.

The recent strength in crop prices is attributable to a number of factors. Export prospects have improved with recent purchases of feed grains by the Soviet Union and increased purchases by Asian trading partners. In addition, a somewhat smaller coarse grain crop in South America along with a rain-delayed soybean harvest there have contributed to higher prices. Domestically, high livestock feeding margins have spurred utilization above expected levels.

Prices paid by farmers moved higher during the early months of 1987. At 162, the April index of prices paid for commodities and services, interest, taxes, and wages registered a 1.9 percent gain from the beginning of 1987 and a year earlier. An increase in the index of feeder livestock of 22 percent from last year, and gains of 6.6 and 4.5 percent in the price indexes of vehicles and fuels, respectively, accounted for most of the year-to-year gain in the overall prices paid index. These increases were partially offset by declines in the prices of feed and fertilizer of 11.5 and 6.4 percent, respectively, from their year-earlier levels.

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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)*	April	125	1.6	3	-5
Crops *(1977=100)*	April	102	0.0	-11	-19
Corn *($ per bu.)*	April	1.49	1.4	-35	-45
Oats *($ per bu.)*	April	1.43	-2.1	27	-15
Soybeans *($ per bu.)*	April	4.82	1.9	-8	-18
Wheat *($ per bu.)*	April	2.59	0.4	-23	-24
Livestock and products *(1977=100)*	April	148	4.2	17	9
Barrows and gilts *($ per cwt.)*	April	51.10	6.7	28	23
Steers and heifers *($ per cwt.)*	April	66.90	6.5	25	12
Milk *($ per cwt.)*	April	12.30	-1.6	2	-5
Eggs *(¢ per doz.)*	April	55.6	2.2	-2	5
Prices paid by farmers *(1977=100)*	April	162	1.9†	2	-1
Production items	April	147	2.8†	1	-4
Feed	April	100	1.0†	-12	-17
Feeder livestock	April	179	9.1†	22	10
Fuels and energy	April	164	3.8†	4	-18
Producer Prices *(1967=100)*	April	295	0.9	3	1
Agricultural machinery and equipment	April	341	-0.2	1	1
Fertilizer materials	April	213	1.0	-2	-8
Agricultural chemicals	April	472	0.3	0	3
Consumer prices *(1967=100)*	April	338	0.5	4	5
Food	April	331	0.3	5	7
Production or stocks					
Corn stocks *(mil. bu.)*	March 1	8,247	N.A.	25	78
Soybean stocks *(mil. bu.)*	March 1	1,384	N.A.	1	30
Beef production *(bil. lbs.)*	April	1.93	1.1	-9	0
Pork production *(bil. lbs.)*	April	1.17	-4.6	-10	-9
Milk production *(bil. lbs.)*††	April	10.4	0.0	-2	2

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

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