FRB CHICAGO

AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO

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Acreage reduction programs

Cropland utilization is influenced by the expected returns from various farming activities, conservation concerns and government programs. During the 1970s and early 1980s U.S. cropland was used more intensively. Cropland acreage used to produce crops jumped 15 percent during the period as idled acreage dropped almost 60 percent and cropland used for grazing purposes was cutback by 26 percent. However, mounting surpluses since the early 1980s have spurred efforts to control production by idling large acreages. As a result, federal farm programs over the last several years have become the dominant force in changes in cropland use.

The more intensive use of cropland during the 1970s and early 1980s was spurred largely by expanding export markets for U.S. grains and feeds. Although that expansion gave way to a severe contraction in the 1980s, government price and income supports encourage farmers to continue to plant cropland. However, continued large crops in the face of eroding export markets triggered the accumulation of huge surpluses of commodities. As a result, federal farm programs have idled large acreages of cropland over the last several years.

Following very large crops in 1981 and 1982, the federal government initiated the Payment in Kind Program (PIK) in 1983. The program paid farmers in surplus commodities to sharply reduce their plantings of grains and cotton. As a result of PIK, cropland idled under government programs jumped to 78 million acres in 1983 compared to only 11.1 million acres idled the year before. When combined with a severe drought, the large idling of acreage in 1983 did cut into surpluses, but the benefits were short lived. Despite removing an average of more than 34 million acres from production between 1984 and 1986, continued high government price and income supports quickly returned commodity stocks to burdensome levels.

In 1987, farmers were once again encouraged to idle more cropland, setting aside from production some 68.5 million acres. Part of the increase is attributable to an increased set-aside requirement for participants in the 1987 wheat program, as well as an option to not plant an additional 15 percent of feed grain base acres. Moreover, an increased differential between market and target prices encouraged greater farmer participation in the programs.

These annual acreage reduction programs associated with price and income support programs accounted for about 52.7 million of the acres idled in 1987. The majority of these acres, almost 77 percent, are accounted for by corn and wheat base acres. More than 21 million acres of corn base and almost 8 million acres of other feed grains were idled in 1987 as program participants were required to set-aside 20 percent of the base acreage with an option to idle another 15 percent. Wheat producers were required to set aside 27.5 percent of their base acreage in 1987 to receive benefits under government programs, up from the 25 percent requirement of the previous year, removing more than 19 million acres from production. Acreage reduction requirements for the cotton and rice programs were unchanged in 1987 at 25 percent and 35 percent, respectively, idling 3.3 million acres of cotton and 1.3 million acres of rice.

The remaining 15.8 million acres idled in 1987 represents cropland enrolled in the Conservation Reserve Program (CRP). Participants in this program receive annual rental payments from the government for 10 years in exchange for removing highly erodible land from agricultural production activities. In addition, USDA provides payments for a portion of the costs associated with establishing a conservation cover of grasses or trees to control erosion.

Some 101.5 million acres of cropland are eligible for enrollment in the CRP. Of that total, 2 million acres were idled under the program in 1986 and will receive an average rental payment of $43 per acre over the next 10 years. Another 13.8 million acres were put into the program during the 1987 crop year and will generate an average rental of about $50. Program participation was boosted significantly in 1987 by a one time bonus payment of $2 per bushel of average yield for corn acreage enrolled in the CRP in early 1987. Through July of this year, an additional 7.15 million acres of cropland had been enrolled in the program to be removed from production beginning with the 1988 crop year, bringing total enrollment up to 23 million acres or more than half of the programs stated goal of idling 40 million acres by 1990. The average rental rate contracted on this land to be retired starting next year is about $47 per acre.

The largest acreage enrollments occurred in the Plains and Mountain States where 13.7 million acres have been retired from production. This enrollment accounts for more than a fourth of the eligible acres and 9 percent of all acres used for crops in these regions in 1987. Producers in the Corn Belt and Lake States had entered 5.3 million acres into the CRP through July of this year, idling almost 19 percent of eligible acres and almost 5 percent of the acreage under cultivation in 1987.

The largest enrollment for any single crop is wheat, with 6.8 million base acres enrolled in the program, representing 7.4 percent of the total base acreage. However, feed grains other than corn have even larger proportions of their base acreages enrolled in the CRP. Some 14.5 percent of barley base acreage and about 9 percent of the sorghum and oats base acreages were enrolled in the program by July 1987. In comparison, only 3.3 percent of the total corn base acreage has been idled by the program. Cotton base acreage enrollment in the program approached .9 million acres, about 5.8 percent of the total.

The acreage idled under government farm programs in 1988 will remain large. Wheat producers must idle 27.5 percent and feed grain farmers 20 percent of their base acreage in 1988, unchanged from last year. Although not yet announced, many observers expect a program similar to last year's 15 percent paid diversion for feed grains will be forthcoming for 1988. Although the target prices for wheat and feed grains were lowered about 2 percent, maximum deficiency payments remain large and will likely contribute to another year of widespread participation in government price and income support programs. In addition, another enrollment period for the CRP is scheduled for February 1988 and will likely draw more land into the long-term retirement program. As a result of these forces, crop acreage in 1988 is likely to register further declines.

Peter J. Heffernan

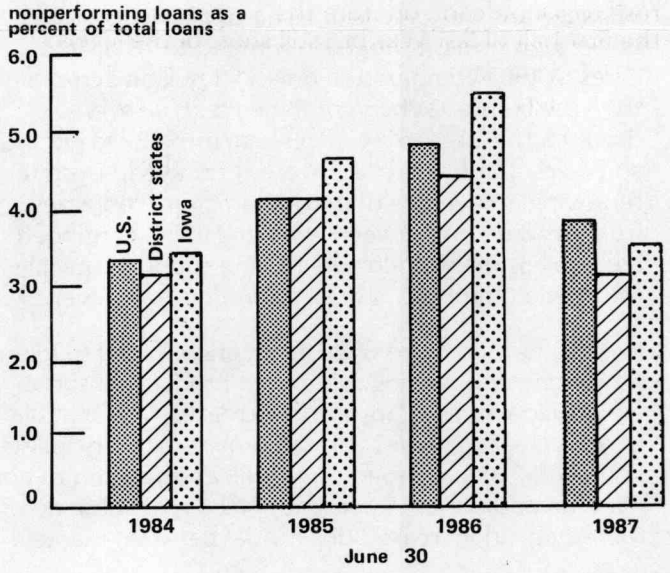
Problems easing among farm lenders

Several barometers, such as farm earnings, exports, and land values, have depicted improving conditions in the deeply distressed farm sector over the past few months. Similar indications are also emerging with respect to conditions among lenders that serve farmers. Both agricultural banks and the Farm Credit System have reported considerable declines so far this year in the losses taken on problem loans and in the amount of problem loans still held in portfolio. For the Farm Credit System, the improvement has delayed somewhat the urgency for federal assistance and increased the chances that the amount of federal assistance needed will fall short of the $6 billion projected by FCS officials earlier this year.

The improved quality of loan-related asset portfolios held by agricultural lenders stems partly from lender's expanded efforts to restructure problem loans. But more importantly, it stems from a marked improvement in farm sector earnings and from the emerging evidence of a firming in farmland values. Net cash farm earnings, supplemented with large federal government subsidies, have risen sharply the past couple of years. This rise in net cash earnings, coupled with continuing declines in capital expenditures, has accommodated substantial repayments on farm debts, including unanticipated repayments on some of the more troubled farm loans. In addition, firming farmland values have halted the erosion in collateral values supporting much of the farm indebtedness, reducing the actual and anticipated losses that were associated with some of the more distressed farm loans.

The improvement in the quality of loan portfolios held by agricultural banks[1] started in the latter half of 1986 and continued through the first half of this year. Reflecting the improvement, nonperforming loans[2] held by agricultural banks nationwide as of June 30 accounted for 3.8 percent of all loans held by those banks. Although still high by historical standards, the share of nonperforming loans at agricultural banks was down from 4.8 percent a year ago and the lowest since 1984. Another measure of the improving quality of loan portfolios held by agricultural banks is the decline in charge-offs on bad loans. During the first half of this year, charge-offs on bad loans, net of recoveries, at

Ag. banks in District states report the biggest declines in nonperforming loans



agricultural banks nationwide were equivalent to just over 0.5 percent of all loans held by those banks. In 1986, the ratio of first-half net charge-offs-to-total loans peaked at nearly 0.9 percent.

The improving quality of loan portfolios held by agricultural banks is more apparent in the Seventh Federal Reserve District, particularly Iowa, than elsewhere. For instance, the ratio of nonperforming loans-to-total loans among agricultural banks in Iowa declined to 3.5 percent as of June 30, down from the mid-year peak of 5.5 percent recorded in 1986. And the ratio of net loan charge-offs-to-total loans at agricultural banks in Iowa dropped to 0.5 percent during the first half of this year, down from more than 1.6 percent during the same period a year ago.

There has also been considerable improvement in the quality of the loan-related assets held by the institutions comprising the FCS. A recent report showing the consolidated results for the FCS through the third quarter noted that net loan charge-offs in the FCS dropped to $430 million during the first nine months of this year, down from $975 million during the same period a year ago. Even with the reduction in net charge-offs, the amount of nonperforming loans still owed to FCS institutions declined to $6.9 billion as of the end of September, down 14 percent from the ending 1986 level and down a fourth from the near peak of a year ago.

The improving quality of the loan portfolios at banks and the FCS has lessened the need to take large provisions for potential losses. Since provisions for loan losses represent an accounting charge against income, the smaller provisions have helped to improve the trend in lenders net earnings. In turn, the more favorable trend in net earnings increases the capital base of those lenders with positive net earnings and slows the erosion of the capital base of those lenders that still suffer negative net earnings. Among agricultural banks nationwide, net after-tax income during the first-half of this year, as a percent of equity capital, rose to 4.4 percent, up from the 3.7 percent return in the first half of last year but still short of the levels achieved in the same periods in 1984 and 1985. Among agricultural banks in Iowa the first-half recovery in net income return to equity capital was even more pronounced, reaching 4.7 percent this year, the highest first-half return since 1984 and well above the dismal 1.1 percent return for agricultural banks in Iowa during the first-half of last year.

For the FCS, the string of negative net earnings that started in 1985 has continued so far this year. But the improved quality of its loan portfolio has trimmed those losses more than had been expected. During the first three quarters of this year, the FCS had net losses of less than $200 million, well below the more than $1.5 billion in net losses recorded during the same period a year ago. In Congressional testimony earlier this year regarding the need for federal financial assistance, FCS officials projected net losses of about $1.3 billion for all of this year. Based on its performance through the first three quarters, net losses for all of 1987 will fall far short of the projected level. Moreover, the smaller losses have markedly slowed the erosion of capital within the FCS. FCS officials had assumed a few months ago that this year's losses would virtually deplete the earned surplus capital of the FCS, thus eliminating the buffer that kept the value of borrower-stockholders' capital stock and certificates, on a consolidated basis, at par. Yet the surplus capital of the FCS still approximated $1.2 billion as of the end of September, marking a comparatively modest decline of only $237 million since the end of 1986.

Gary L. Benjamin

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[1] Agricultural banks are insured commercial banks with a ratio of farm loans to total loans that is above the average of such ratios at all insured commercial banks.

[2] Nonperforming loans represented loans no longer accruing interest and accruing loans that are delinquent by 90 days or more.

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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)*	October	127	-1.6	5	3
Crops *(1977=100)*	October	106	1.0	9	-5
Corn *($per bu.)*	October	1.55	4.0	11	-27
Oats *($per bu.)*	October	1.54	4.1	40	43
Soybeans *($per bu.)*	October	5.00	0.2	10	3
Wheat *($per bu.)*	October	2.62	3.1	14	-15
Livestock and products *(1977=100)*	October	148	-2.6	2	10
Barrows and gilts *($per cwt.)*	October	50.50	-8.0	-6	15
Steers and heifers *($per cwt.)*	October	67.80	-0.1	15	20
Milk *($per cwt.)*	October	12.80	0.8	-3	2
Eggs *(¢per doz.)*	October	51.3	-14.1	-12	-20
Prices paid by farmers *(1977=100)*	October	166	1.2†	5	2
Production items	October	151	1.3†	6	2
Feed	October	105	0.0†	6	-3
Feeder livestock	October	190	4.4†	19	28
Fuels and energy	October	172	1.2†	15	-15
Producer Prices *(1967=100)*	October	298	0.5	3	1
Agricultural machinery and equipment	October	342	0.2	0	1
Fertilizer materials	October	219	-0.2	11	-4
Agricultural chemicals	October	498	1.7	5	9
Consumer prices *(1967=100)*	October	345	0.3	4	6
Food	October	335	0.1	4	8
Production or stocks					
Corn stocks *(mil. bu.)*	September 1	4,882	N.A.	21	196
Soybean stocks *(mil. bu.)*	September 1	436	N.A.	-19	38
Beef production *(bil. lbs.)*	October	2.10	2.8	-2	0
Pork production *(bil. lbs.)*	October	1.36	11.0	6	0
Milk production *(bil. lbs.)*††	October	10.0	1.6	3	-1

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

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