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Farmland values still declining

Farmland values in the Seventh Federal Reserve District continued to trend lower during the last three months of 1985. According to a recent survey of nearly 500 agricultural bankers, the value of good farmland declined 3.5 percent on average during the fourth quarter. Although substantial, the fourth-quarter rate of decline was considerably below the 5.2 percent average of the five preceding quarters. Despite the slower rate of decline, District farmland values at the end of 1985 were 20 percent below the year-earlier level and 42 percent below the 1981 peak. The decline over the past four years has pushed District farmland values, in nominal dollar terms, down to 1976 levels and, in terms of inflation-adjusted dollars, down to 1973 levels.

Trends in farmland values continue to vary widely among the five District states, or portions thereof, covered by the survey. Iowa bankers again reported the steepest rate of decline. But at slightly over 5 percent, the fourth quarter rate of decline in Iowa farmland values was noticeably lower than in most recent quarters. Wisconsin bankers reported a decline of nearly 5 percent in the fourth quarter, marking a far more pronounced rate of decline for that state than had been the case in previous quarters. Wisconsin was the only state where the apparent rate of decline in land values steepened, perhaps reflecting the more serious harvesting problems experienced by farmers in that state. In Indiana and Michigan, the fourth quarter declines in farmland values were 4 and 2 percent, respectively. Bankers from the District portion of Illinois reported virtually no change during the fourth quarter.

The apparent leveling-off in Illinois farmland values and the slower rate of decline in most other District states in the fourth quarter may represent early signs that the land market is approaching a bottom. Without doubt, the land market remains weak and continues to be affected by financially stressed farmers who need to liquidate some or all of their real estate assets. However, the heretofore weak buyer demand for farmland may be beginning to exhibit some strength. If that proves to be the case, several recent developments may have been contributing factors. For one, potential land buyers may have been encouraged by the recently enacted legislation that will shape federal government farm programs through 1990. Although resulting in sharply lower price supports, that legislation, barring the uncertain implications of the Gramm-Rudman legislation, could have been encouraging because of the large government deficiency payments it offers to farmers for the next few years and because of the more favorable longer-term implications for agriculture if the sharply lower loan support prices are successful in rekindling export demand for U.S. grains. In addition, recent legislation that will restructure and, if necessary, provide federal financial aid to the Farm Credit System may have buoyed the demand for farm land. Among other things, the legislation had a significant effect in lowering prospective borrowing costs of existing and future borrowers in the FCS. It also led to a lowering of interest rate spreads at some federal land banks in the FCS.

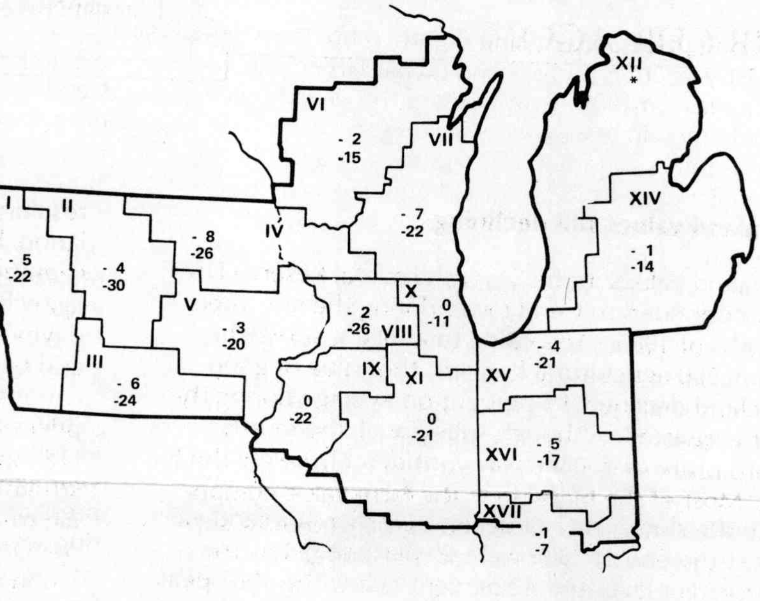
Declining interest rates in general have been a positive development for the land market. In this vein, farm mortgage interest rates charged by District agricultural banks at the end of 1985 averaged about 12 1/4 percent, down from 12 1/2 percent three months ago and 13 1/3 percent a year ago.

With respect to near-term trends in farm land values, slightly over half (54 percent) of the bankers who responded to the recent survey expect that land values will trend still lower in the first quarter. Another 44 percent of the bankers expect land values to be stable while the remaining 2 percent project an upturn in the first quarter. On balance, these proportions are somewhat less pessimistic than in the four preceding surveys when, on average, bankers were split about 60/40 in projecting further declines over stable trends. In the most recent survey, the proportion of bankers expecting stability were highest in the District portions of Illinois and Indiana, 60 and 51 percent, respectively. Michigan bankers were about evenly split between a leveling-off and a decline. Conversely, roughly two-thirds of the bankers from Iowa and Wisconsin projected further declines with most of the remainder projecting a leveling-off.

On balance, the downtrend in land values seems to be continuing. During the current winter months, when transactions in farm real estate are at a seasonal high, land values may well trend lower as the pressures on severely stressed farmers to liquidate fixed assets continue to dominate the market. Yet there is some hope that the land market may be approaching a bot-

Percent change in dollar value of "good" farmland

Top: October 1, 1985 to January 1, 1986
Bottom: January 1, 1985 to January 1, 1986

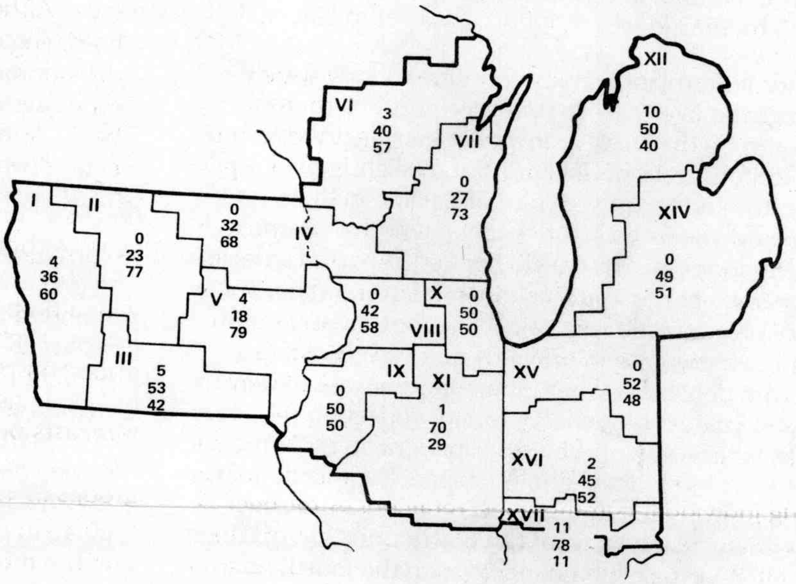


*Insufficient response.

	October 1, 1985 to January 1, 1986	January 1, 1985 to January 1, 1986
Illinois	0	-21
Indiana	-4	-17
Iowa	-5	-25
Michigan	-2	-13
Wisconsin	-5	-18
Seventh District	-3	-20

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

Top: Up
Center: Stable
Bottom: Down



	Up	Stable	Down
Illinois	1	60	40
Indiana	3	51	46
Iowa	3	31	66
Michigan	2	49	49
Wisconsin	1	32	67
Seventh District	2	44	54

tom. In this regard, the apparent leveling-off of land values in Illinois in the fourth quarter and the growing proportion of bankers in Illinois and Indiana who anticipate stable land values in the current quarter are encouraging signs. Whether the land market is actually close to bottoming-out, however, will depend to a large extent on the mood of potential land buyers. Despite the deep financial stress that now exists in agriculture, most analysts believe that there exists a substantial pool of farmers and others that have the interest and the financial resources to acquire land once they are convinced that the economics of land acquisition is favorable and that the land market may be approaching a bottom. In light of the substantial declines that have already occurred in land values, and despite the uncertainty of the Gramm-Rudman legislation with respect to government outlays for future farm income and price support programs, the recent farm program legislation may prove to be an important factor in rekindling farmland demand.

Gary L. Benjamin

Moderate rise in food prices expected again this year

Retail food prices, after rising slightly more than 2 percent last year, may show a somewhat larger year-to-year increase in 1986. Any increase this year, however, will likely remain moderate, with only a small rise in the farm prices of raw food commodities and continued small increases in food marketing costs limiting upward pressure on retail food costs. As a result, USDA forecasts point to a 2 to 4 percent gain from a year ago in the prices consumers pay for food.

Following a year-to-year drop of about 7 percent in 1985, the farm value component of consumer prices for domestically produced foods is expected to climb 2 to 4 percent this year, accounting for most of the upward pressure likely to be exerted on food prices in 1986. Most of the increase in the farm value component is attributable to expected tighter red meat supplies that will boost livestock prices. Supplies of most other raw food commodities remain in ample supply and prices for many items may fall, partially offsetting higher red meat prices.

While the farm value component of food prices may rise in 1986, the cost of marketing food is expected to hold near the low level of a year ago. About three-fourths of the food marketing bill reflects the costs of labor, packaging, transportation, and energy consumed in the processing and distribution of food products beyond the farm gate. Labor costs, which account for about 45 percent of all food marketing costs, are expected to rise only 1 to 2 percent in 1986, following no change last year. Packaging costs, accounting for about 15 percent of the total, are expected to rise at a rate similar to last year, holding in the 3 to 4 percent range. Energy and transportation costs associated with the marketing of food products are not expected to change significantly in 1986.

Among individual commodities, retail prices for beef and pork are expected to register the largest increases. After falling about 1 percent in 1985, meat prices at the retail level are forecast to rise 3 to 5 percent this year. The higher retail prices for both beef and pork will be generated by expected declines in output. Beef production is forecast to decline 4.3 percent while pork production is likely to be down 2.6 percent from the year-earlier level.

Another increase in poultry production will partially offset the drop in red meat supplies, and temper the rise in meat prices. After increasing about 5 percent in 1985, poultry output is forecast to rise at a similar rate in 1986. Despite the sharp rise in production, poultry prices fell only about 1 percent last year and are expected to show a similarly moderate decline this year as poultry products continue to compete very effectively with red meats.

Among other major livestock products, the expected trends in retail prices for 1986 are mixed. Dairy product prices are expected to be unchanged to down 2 percent in 1986, following last year's 1.9 percent rise. However, egg prices are forecast to rise 3 to 5 percent this year, an abrupt reversal from the 18.5 percent drop recorded in 1985. Last year's large decline in egg prices reflected the industry's recovery from the avian influenza outbreak in 1984 that resulted in severe supply disruptions that year. In 1986, egg supplies are expected to decline almost 1 percent from last year.

While vegetable supplies are expected to be plentiful in 1986, supplies of some fruits may be down from a year ago. A record potato crop in 1985 is expected to pressure prices substantially lower this year and, barring severe freeze damage, fresh vegetable supplies will be plentiful in 1986 as well. As a result, retail prices for fresh vegetables are expected to be down 3 to 5 percent this year. In addition, large supplies of processed vegetables other than tomatoes will temper prices. Although production of citrus is up from the damaged crop of a year ago, supplies of some of these fruits will remain tight. In addition, small apple and pear crops will put pressure on fresh fruit prices in 1986.

Retail prices of fats and oils, following a 3 percent increase in 1985, are expected to rise at a similar rate this year. Although the large soybean crop will be partially offsetting, smaller supplies of animal fats associated with a drop in slaughter will tighten supplies and boost prices. Highly processed cereal and bakery product prices, despite large supplies of raw commodity inputs, will likely rise due to higher marketing costs. USDA forecasts point to 2 to 4 percent year-to-year gains in retail prices for foods in both of these commodity groups in 1986.

Peter J. Heffernan

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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)*	September	12,425	21.8	1	-4
Crops	September	6,471	37.2	4	3
Livestock	September	5,851	7.3	-2	2
Government payments	September	103	243.3	-10	-88
Real estate farm debt outstanding *($ billions)*					
Commercial banks	September 30	11.0	4.1†	8	21
Federal Land Banks	September 30	46.4	-3.5†	-6	-5
Life insurance companies	October 31	12.0	0.0	-5	-6
Farmers Home Administration	September 30	10.7	0.6†	6	11
Nonreal estate farm debt outstanding *($ billions)*					
Commercial banks	September 30	39.3	-1.6†	-6	1
Production Credit Associations	September 30	16.0	-4.0†	-19	-22
Farmers Home Administration	September 30	18.8	1.3†	12	18
Commodity Credit Corporation	September 30	10.0	14.9†	54	-18
Farm loans made *($ millions)*					
Life insurance companies	October	156	104.7	269	67
Interest rates on farm loans *(percent)*					
7th District agricultural banks					
Operating loans	January 1	12.72	-0.7†	-7	-7
Real estate loans	January 1	12.28	-1.6†	-8	-8
Commodity Credit Corporation	January	7.75	-1.6	-18	-23
Agricultural exports *($ millions)*	November	2,786	18.9	-21	-20
Corn *(mil. bu.)*	November	211	67.8	-13	7
Soybeans *(mil. bu.)*	November	80	43.8	-15	15
Wheat *(mil. bu.)*	November	87	-2.1	-13	-19
Farm machinery salesᵖ *(units)*					
Tractors, over 40 HP	December	4,365	16.1	-9	-9
40 to 139 HP	December	3,071	16.2	-12	-9
140 HP or more	December	1,294	15.9	-1	-8
Combines	December	919	-19.1	4	-24

† Prior period is three months earlier.
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