FRB CHICAGO

AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO
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Downtrend in Land Values Steepens

A recent survey of about 525 agricultural banks indicates that farmland values in the Chicago Federal Reserve District, on average, declined 5.6 percent in the three months ending with December. The decline was the steepest for any quarter since the downtrend in land values began in 1981. Moreover, it climaxed in a decline of 15 percent for all of 1984 and a decline of 29 percent from the 1981 peak. Many agricultural bankers believe that the slide in land values will continue.

Bankers from each of the five District states reported declines in farmland values for the fourth quarter. However, the rates of decline varied widely among District states (see map on page 2.) Iowa bankers once again reported the steepest declines, more than 8 percent in the the fourth quarter and 22 percent for all of last year. Bankers from the District portion of Illinois reported a fourth quarter decline of 7 percent and a drop of 16 percent for all of 1984. Indiana bankers indicated declines of 6 percent for the fourth quarter and nearly 12 percent for the year ending with December. Michigan and Wisconsin continued to report the slowest rate of decline in farmland values, averaging less than 2 percent in the fourth quarter and less than 7 percent for all of last year.

Declines relative to earlier peaks also vary widely among the five District states. The sharpest drop has occurred in Iowa, nearly 38 percent. In Illinois and Indiana, land values are off approximately 30 percent from their early 1981 peaks. By comparison, the declines in Michigan and Wisconsin have been roughly 15 percent. These declines have reduced farmland values in Illinois, Indiana, and Iowa to levels that prevailed in late 1976 and early 1977. In Michigan and Wisconsin, land values are those that prevailed in the summer of 1979.

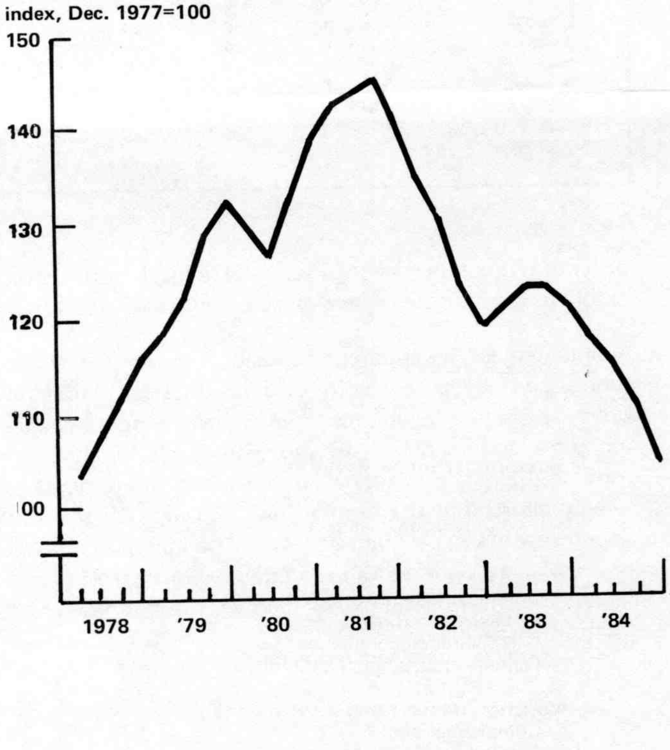
The consequences of the steep decline in farmland values can be considerable for landowners. Since real estate accounts for roughly three-fourths of all farm assets, owners of farmland have suffered a substantial paper loss in their net worth. In 1981 when land values were at their peak, the farm sector in the five District states had roughly $260 billion in assets and $40 billion in debt, leaving a net worth of nearly $220 billion. As of the beginning of 1984, USDA estimates show that farm sector asset values in the five states had shrunk to nearly $210 billion while debt had risen to more than $47 billion, leaving equity at less than $165 billion. Last year's decline in farmland values may have trimmed another $20 billion or so off the equity in farm sector assets in the five District states. If such is the case, it implies an overall loss of a third, or nearly $75 billion, in farm sector equity since 1980.

Despite the huge loss, equity per farm still remains fairly substantial. Rough adjustments to update USDA numbers suggest that equity per farm in District states averages about $325,000. That average, however, masks a wide range of situations for individual farmers and landowners. A small, but growing, proportion have little or no equity in their farm assets following the sharp decline in land values in recent years.

For landowners with little or no farm debt, the loss in net worth may have relatively little consequence for their individual farming operations, although the loss would still represent a very disheartening blow to their financial nest egg. But for farmers who rely heavily on farm debt, the erosion in equity, unless offset by favorable earnings, can lead to a substantial reduction in their borrowing capacity. A number of farmers will undoubtedly face such a situation in attempting to secure new financing in 1985. Reflecting this, District agricultural bankers who responded to a special survey in November indicated that about 4 percent of 1984 farm borrowers would not be eligible for operating credit in 1985.

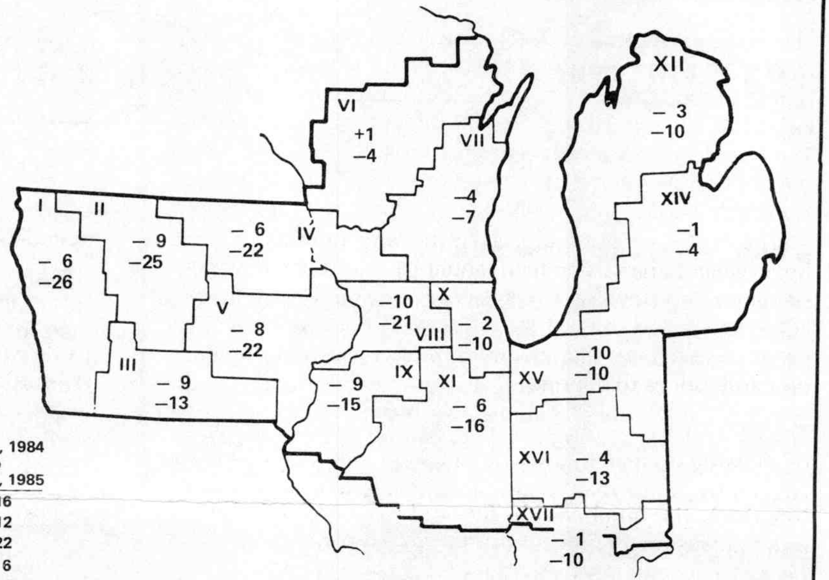
The sharp declines that have already occurred suggest that land values may have retreated to levels that offer higher rates of income return than was required by land buyers over the past several years. Reflecting this, isolated reports note that some recent farm real estate transactions have offered positive cash flow prospects for the purchaser. But whether the improved relationship between land values and income returns will soon arrest the current downtrend is doubtful for several reasons. For instance, the growing number of financially-strapped farmers who need to liquidate assets in

District farmland prices retreat to a 7-year low



Percent change in dollar value of "good" farmland

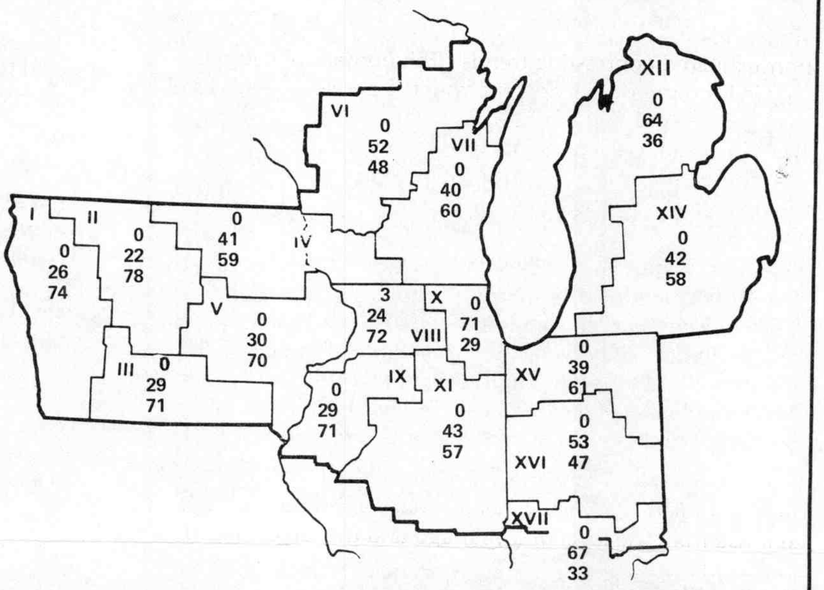
Top: October 1, 1984 to January 1, 1985
Bottom: January 1, 1984 to January 1, 1985



	October 1, 1984 to January 1, 1985	January 1, 1984 to January 1, 1985
Illinois	−7	−16
Indiana	−6	−12
Iowa	−8	−22
Michigan	−2	− 6
Wisconsin	−1	− 7
Seventh District	−6	−15

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

Top: Up
Center: Stable
Bottom: Down



	Up	Stable	Down
Illinois	1	38	61
Indiana	0	49	51
Iowa	0	29	71
Michigan	0	48	52
Wisconsin	0	44	56
Seventh District	0	39	60

order to reduce their debt to acceptable levels adds considerably to the amount of land available for sale.

Simultaneously, an apparent disposition on the part of potential land buyers to wait for evidence that land prices have bottomed before buying results in an inordinately weak demand for land relative to the supply available. Such an attitude on the part of potential land investors has undoubtedly been reinforced by the Administration's proposals to reduce government farm program benefits. At a minimum, those proposals cast considerable uncertainty about prospective income returns on land ownership over the next few years.

Within this environment, it is clear that agricultural bankers are quite pessimistic about current trends in farmland values. Only 1 of the 525 bankers who responded to the recent survey thought that farmland values would rise in the current quarter. Of the remainder, 60 percent felt that farmland values would decline and 40 percent thought land values would stabilize in the first quarter. With the exception of late 1982, that represents the largest proportion of bankers in the 25-year history of these surveys to project a downtrend in farmland values. Iowa bankers were the most pessimistic, with 71 percent forecasting a continued downtrend.

Gary L. Benjamin

Feedlot cattle up at yearend

The number of cattle on feed registered a year-to-year gain during the fourth quarter of 1984. USDA's January 1 quarterly survey of feedlots in the thirteen major cattle feeding states indicated a 7 percent rise in the number of cattle on feed. The year-to-year increase reflects a jump in placements that outstripped the rise in marketings and other disappearance. Fed-cattle marketings will likely hold above year-ago levels for the next several months given the large number of heavyweight animals on feed January 1. However, lower cow slaughter and slower movement of forage-fed cattle to market are expected to hold second quarter slaughter and beef production below year-ago levels, placing upward pressure on cattle prices this spring.

The USDA report, which generally accounts for 85 percent of all cattle on feed in the United States, indicates that about two-thirds of the year-to-year inventory gain is attributable to a rise in the number of heifers and cows on feed. The number was up 14 percent from a year ago, while the number of steers and steer calves on feed January 1 was up 4 percent. The gains were concentrated in the heavier weight categories, while inventories of steers under 700 pounds and heifers under 500 pounds were below year-ago levels.

The two Seventh District states included in the quarterly report exhibited contrasting trends. The number of cattle on feed in Illinois was up 6 percent from the previous year's level, while Iowa registered the largest decline among the thirteen. The 12 percent decline of inventories in Iowa is more in line with the pattern the five District states have followed since the mid-1960s. At that time, District states accounted for about a third of the inventory of cattle on feed in the U.S. Since that time, feedlot inventories in the District have steadily fallen as total U.S. inventories have grown. While the decline has been shared across the District, with the five states now accounting for about 18 percent of all cattle on feed, the drop in Iowa's inventories has been most pronounced. Iowa's ranking among all cattle-producing states has fallen from first to fifth over the 20-year period.

The movement of cattle onto feedlots in the thirteen states this fall totaled 7.56 million head. That represented a 4 percent rise from the level of a year ago and the largest fourth quarter placement of cattle since 1978. Data from the seven largest cattle-feeding states, which are surveyed monthly, suggest that the rise in cattle placements occurred early in the fourth quarter. Placements in these states through the first two months of the period were 8 percent above the year-ago pace, while December placements of cattle into feedlots registered a 7.5 percent year-to-year decline.

Fourth quarter fed-cattle marketings in the thirteen states rose slightly from a year ago to the highest level since 1978. At 5.5 million head, fed-cattle marketings were up 1 percent from 1983's level but well below operators' fourth quarter marketing intentions reported in October. Commercial slaughter of all cattle during the final three months of the year was up only marginally, however, reflecting a slowdown in the movement of forage-fed cattle to market. Moreover, cow slaughter, at high levels through most of 1984 as producers sharply trimmed the breeding herd, slowed appreciably during the fourth quarter. More than 20 percent above 1983 levels for much of the year, cow slaughter for all of 1984 registered a year-to-year gain of about 12 percent.

Operators' expected marketings during the first quarter of 1985, including an allowance for additional placements that will be marketed before April, points to a 6 percent increase from a year ago. The January 1 inventory of heavyweight cattle on feed represents a somewhat larger proportion of intended first quarter 1985 marketings than has been the case in recent years. This suggests that the tight supplies of feeder cattle may limit placements for marketing during the first three months of 1985. Moreover, reduced supplies of feeder cattle will likely firm prices, slowing the movement of forage-fed cattle to market. With a drop in forage-fed cattle slaughter largely offsetting the increase in marketings from feedlots, first quarter commercial beef production is expected to rise only moderately from the year-ago level.

During the second quarter of 1985, cattle slaughter and beef production are expected to fall below year-ago levels. Current inventories of lightweight animals on feed show a 4.5 percent gain from a year ago, implying a year-to-year increase in second quarter fed-cattle slaughter. However, a sharp drop in cow slaughter from last year's high level, along with improving forage conditions and prices that will likely reduce the movement of forage-fed cattle to market, is expected to more than offset the rise in fed-cattle slaughter. As a result, second quarter beef production is expected to lag last year's level by about 8 percent.

After trending higher over the last several months, cattle prices have weakened slightly in recent weeks. Prices for choice steers at Omaha steadily rose from about \$60 per hundredweight in October to well over \$65 per hundredweight in early January, averaging above year-ago levels during the period. In subsequent weeks, however, choice steer prices receded about \$1, and averaged \$3 to \$4 per hundredweight lower than a year ago. USDA projections suggest that first quarter prices may hold at or below last year's level of \$67.58 per hundredweight. During the second quarter, USDA projections point to average choice steer prices at Omaha ranging from \$65 to \$71, compared to \$66 per hundredweight last year.

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	11,634	4.2	-10	-5
Crops*	September	5,846	11.1	-7	-6
Livestock	September	5,685	-0.8	-1	-5
Government payments	September	103	-40.8	-88	-10
Real estate farm debt outstanding *($ billions)*					
Commercial banks	September 30	10.2	2.1†	12	20
Federal Land Banks	November 30	48.2	-0.1	0	2
Life insurance companies	October 31	12.6	-0.3	-1	-2
Farmers Home Administration	September 30	10.2	0.9†	6	9
Nonreal estate farm debt outstanding *($ billions)*					
Commercial banks	September 30	41.7	0.9†	7	13
Production Credit Associations	November 30	17.7	-4.0	-6	-14
Farmers Home Administration	September 30	16.8	0.6†	6	5
Commodity Credit Corporation	September 30	6.47	-0.8†	-47	-38
Farms loans made *($ millions)*					
Production Credit Associations	November	1,882	-2.7	-12	-19
Federal Land Banks	November	197	-6.8	-14	-36
Life insurance companies	October	42	41.9	-55	37
Interest rates on farm loans *(percent)*					
7th District agricultural banks					
Operating loans	January 1	13.64	-5.6†	0	-5
Real estate loans	January 1	13.36	-4.6†	0	-6
Commodity Credit Corporation	February	9.13	-3.9	-9	6
Agricultural exports *($ millions)*	November	3,528	23.3	1	16
Corn *(mil. bu.)*	November	246	58.2	25	44
Soybeans *(mil. bu.)*	November	93	128.4	35	0
Wheat *(mil. bu.)*	November	100	-29.1	-7	0
Farm machinery sales[P] *(units)*					
Tractors, over 40 HP	December	4,811	-7.9	0	-13
40 to 139 HP	December	3,507	0.2	4	-11
140 HP or more	December	1,304	-24.2	-8	-17
Combines	December	889	-50.6	-26	-61

* Includes net CCC loans.
† Prior period is three months earlier.
[P] Preliminary

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