FRB CHICAGO

AGRICULTURAL LETTER

FEDERAL RESERVE BANK OF CHICAGO

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Farmland values down again in second quarter

Farmland values in the Seventh Federal Reserve District continued to decline in the second quarter. A mid-year survey of nearly 550 District agricultural banks indicated that the value of good farmland was down 4.6 percent from three months earlier and down 20 percent from a year earlier. The second quarter decline, although substantial, was below the 6 percent rate of decline in the previous quarter and the more than 5.5 percent decline in the final 3 months of 1984. Nevertheless, it extends the downtrend that has prevailed since the summer of 1981. Since then, District farmland values have declined 36 percent.

As has been the pattern for several quarters, rates of decline in farmland values vary considerably among the five District states. Bankers from the District portion of Illinois reported the sharpest rate of decline for the most recent quarter, down more than 6.5 percent. Bankers from Iowa, which for several quarters had reported the steepest downtrend, reported a 5 percent drop in the most recent quarter. Bankers from the District portion of Michigan reported a second quarter decline of 4 percent, while those in Indiana and Wisconsin reported a decline of 3 percent. Compared to a year ago, the declines in land values range from 12 percent in Michigan to nearly 26 percent in Iowa. Compared to earlier peaks, the declines range from roughly 20 percent in Michigan and Wisconsin to more than 45 percent in Iowa.

The pronounced decline in farmland values probably attracts more attention than any other aspect of the current financial stress in agriculture. This phenomenon is understandable because the erosion in land values has been associated with a substantial drop in equity among farmers and other landowners. The problems that arise from a loss in equity are most acute for highly leveraged farmers who simultaneously have struggled with depressed earnings that for many have proved insufficient to meet their debt repayment commitments. In such situations, the tendency is to seek additional collateral to secure the debt and/or to liquidate some of the farmers' collateral or other assets in order to pay the debt burden down to a level that can be supported by the lower earnings. Liquidating assets at current depressed values translates an "unrealized" loss in equity to an abrupt "realized" loss in equity, in some cases for both the borrower and the lender.

But even for farmers not highly leveraged and for the farm sector overall, the decline in farmland values has resulted in a huge loss in equity. Pending revisions in U.S. Department of Agriculture estimates are likely to show that the value of farm real estate assets in the nation's farm sector has declined nearly a fifth since the 1981 peak. (The revisions will incorporate recent adjustments, back to 1979, in per acre land values and the amount of land in farms.) Assuming that nonreal estate asset values—which account for about a fourth of all farm assets—will not be revised significantly, it appears that the value of all farm sector assets has declined about a sixth from the earlier peak. In conjunction with only a modest decline in outstanding farm debt, the erosion in asset values likely translates into a drop of nearly a fourth in farm sector equity since the 1981 peak. When adjusted for inflation, farm sector equity is off a third from the earlier peak and at the lowest level since about 1973. In light of this comparison, it could be argued that the agricultural sector has lost most, if not all, of the gains in real wealth that it accumulated during the boom years of the 1970s.

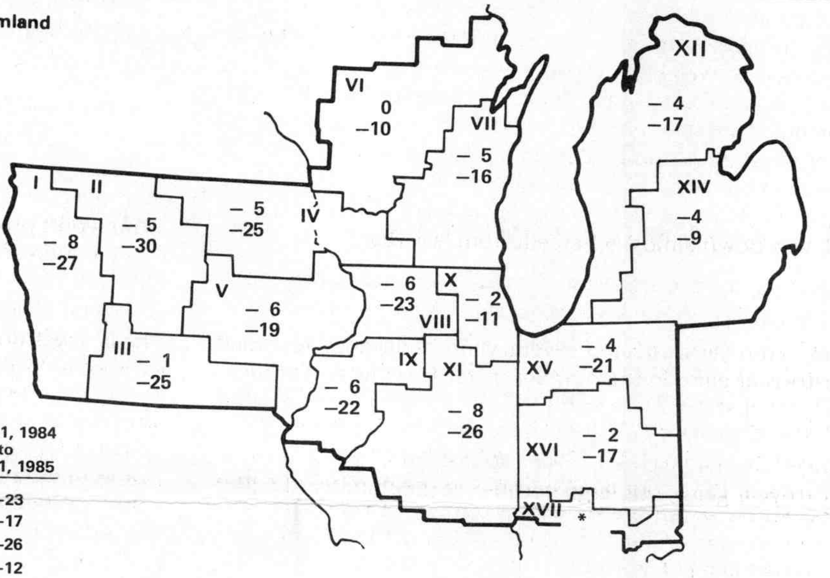
While down sharply, equity in the agricultural sector is still rather substantial. The pending U.S. Department of Agriculture estimates are likely to show that equity in the farm sector exceeds $700 billion. On average, that is equivalent to about $310,000 for each of the roughly 2.3 million farms nationwide. The average, however, encompasses a broad array of farms, ranging from a large number of very small, typically part-time, farms to a comparatively small number of very large farms. In addition, that equity is distributed among operating farmers and nonoperating farm landlords.

Prospects for a recovery in land values in the near-term are not very encouraging. An overhang of farm real estate available for sale by farmers most affected by the financial stress in agriculture continues to weigh heavily on the land market. Moreover, farm income prospects for the near-term are not encouraging for those interested in buying farmland. Agricultural commodity prices remain very depressed. Livestock prices are well below year-ago levels and far below most earlier forecasts, despite measures suggesting that meat production over the next several months will lag year-ago levels. For many producers, especially cattle feeders, the current prices are well below break-even levels. Crop prices have also trended lower in recent weeks as 1985 harvest prospects portend production well in excess of the slackening demand picture. Crop prices have also been influenced by the ongoing congressional debate on new multi-year legislation for farm programs. The tone of that debate suggests that some reduction in loan support prices for grains is likely in 1986. While lowering support prices would better enable U.S. agriculture to compete in world markets, it probably will not enhance short-run prospects for farm earnings and for income returns to farmland.

The bankers who responded to the most recent survey generally expect that the downtrend in farmland values will continue this summer. Overall, 55 percent of the bankers felt that farmland values would trend lower in the third quarter. Another 44 percent of the bankers were expecting land values to stabilize, while less than 1 percent were anticipating

Percent change in dollar value of "good" farmland

Top: April 1, 1985 to July 1, 1985
Bottom: July 1, 1984 to July 1, 1985

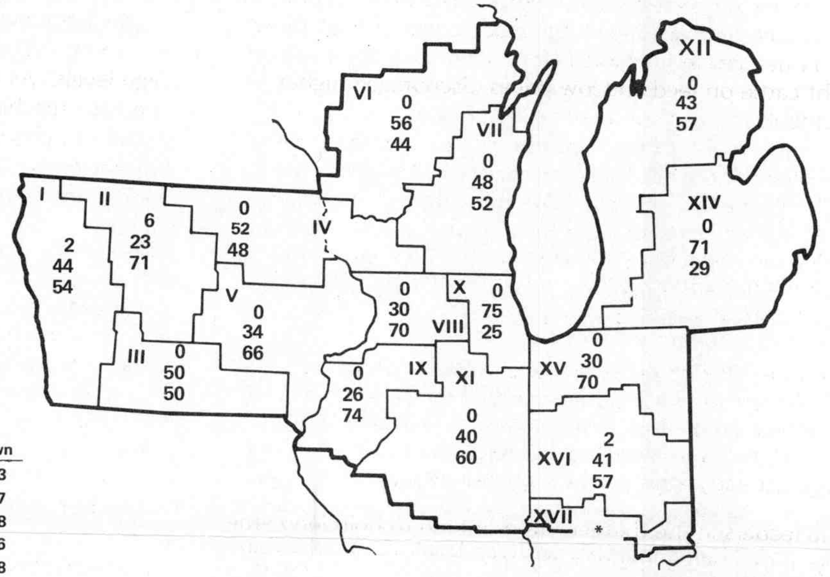


	April 1, 1985 to July 1, 1985	July 1, 1984 to July 1, 1985
Illinois	−7	−23
Indiana	−3	−17
Iowa	−5	−26
Michigan	−4	−12
Wisconsin	−3	−14
Seventh District	−5	−20

*Insufficient response.

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

Top: Up
Center: Stable
Bottom: Down



	Up	Stable	Down
Illinois	0	37	63
Indiana	1	42	57
Iowa	2	40	58
Michigan	0	64	36
Wisconsin	0	52	48
Seventh District	1	44	55

*Insufficient response.

an upturn in land values this summer. As has been the case for several surveys, the bankers expecting continued declines in land values tended to be more concentrated in Illinois, Indiana, and Iowa.

Gary L. Benjamin

Heavy-weight backlog holds cattle prices down

Prospects for third-quarter cattle prices dimmed in late July as prices for choice steers at Omaha dipped below $50 per hundredweight. The continued downtrend in prices stems largely from the backlog of heavy-weight cattle that built up during the second quarter as lower feed costs facilitated producers' holding of cattle in anticipation of higher prices. The backlog of cattle was confirmed by the USDA's latest quarterly Cattle on Feed report showing numbers of heavy-weight animals substantially above year-ago levels. However, the smaller inventories of lighter-weight cattle noted in the report foreshadow improving price prospects for late this summer or early fall. Moreover, the latest semi-annual report on U.S. inventories of all cattle indicates a substantial decline in beef cattle production capacity, improving the longer range outlook for profitability of cattle operations.

The number of cattle in feedlots was down slightly from last year according to the USDA's July 1 survey of feedlots in the thirteen largest cattle feeding states. The thirteen states account for about 85 percent of all cattle in feedlots nationwide. Comparisons with year-earlier inventories, however, vary widely by weight and type. Heavier-weight cattle—those likely to be marketed in the third quarter—numbered almost 6 percent more than a year ago while the inventory of all lighter weights was down 7 percent. Similarly, the number of heifers on feed was up 7 percent while the inventory of steers, which accounts for about 60 percent of the total on feed, was down almost 5 percent from last year.

Changes in the inventory of cattle on feed also varied considerably by geographic region. Most major cattle feeding states in the Midwest, after several years of declines, recorded year-to-year gains in the number of cattle on feed. For the two District states included in the survey, feedlot inventories in Illinois were up 5 percent, while those in Iowa were unchanged from a year ago. Plains states continued to show year-to-year gains, but large declines in the number of cattle on feed were reported for western states and Texas.

The net movement of cattle into feedlots during the second quarter was down almost 5 percent from last year. Data for the seven states that are surveyed monthly suggest that much of the decline came late in the quarter. After lagging 3 percent below a year ago during the first two months of the quarter, net placements in the seven states dropped more than 12 percent in June as the mounting backlog of heavy-weight cattle on feed and low prices discouraged higher placements.

Fed-cattle marketings from feedlots in the 13 major states during the second quarter were about 2.5 percent higher than in the same period last year. Despite the increase, commercial slaughter of all cattle for the three-month period was down more than 3 percent from last year, paced by a sharp decline in cow slaughter. However, the proportional increase in slaughter animals coming from feedlots and their substantially higher dressed weights contributed to a year-to-year increase of almost 2 percent in beef production during the second quarter. The increase in slaughter weights stemmed from this year's lower feed costs and expectations of stronger cattle prices, which encouraged longer feeding.

Cattle feeders in the thirteen states intend to hold fed-cattle marketings 5 percent above year-ago levels during the third quarter. Inventories of heavy-weight cattle on feed, up almost 6 percent on July 1, are consistent with the intended increase in fed-cattle marketings. However, most of the heavier-weight cattle were probably marketed in July, accounting for much of the recent declines in cattle prices. As this backlog of heavy cattle is reduced, fed-cattle slaughter is likely to drop below year-ago levels this summer or early fall, lending some strength to prices. Commercial slaughter of all cattle this summer may hold near year-earlier levels as continued declines in slaughter of cows and range-fed steers and heifers offset the rise in fed-cattle marketings. Total beef production, however, may be up slightly.

During the final three months of 1985 and next year, however, indicators point to declining cattle slaughter. The number of light-weight cattle on feed, down about 7 percent from last year, suggests that fed-cattle marketings will register a year-to-year decline during the fourth quarter. In addition, a mid-year estimate of the U.S. inventory of all cattle foreshadows tightening feeder cattle supplies and lower cattle slaughter in 1986.

At 116.3 million head, the July 1 estimate of all cattle and calves in the U.S. was down more than 4 percent from a year earlier. The cutback reflects a smaller calf crop as well as extensive culling of the beef cow herd and replacement heifers. The report projected that this year's calf crop would be down 3 percent and the smallest since 1961. Moreover, it revealed that the inventory of beef cows that have calved was down 7 percent from a year ago while that for beef replacement heifers was down 11 percent from a year ago. The combined inventory of beef cows and replacement heifers was down more than 13 percent from the cyclical high of four years ago, indicative of a substantial decline in production capacity for the U.S. cattle industry. While these declines have contributed to the depressed cattle prices through the first half of the year by boosting slaughter, they signal improving prospects for 1986.

With cattle prices hovering below $50 per hundredweight in early August as feedlots continue to market the excess of heavy-weight cattle, earlier projections of an average price of $60 per hundredweight for the third quarter appear unlikely. However, after the backlog of the heaviest animals on feed is marketed, fed-cattle slaughter may drop below year-ago levels. As a result, prices can be expected to strengthen, perhaps reaching the low $60 per hundredweight range by fall, but will likely average only in the mid to upper $50s for the third quarter. During the final three months of 1985, cattle prices will likely hold in the low $60 per hundredweight range.

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)*	July	127	-0.8	-12	-3
Crops *(1977=100)*	July	123	0.8	-15	-1
Corn *($per bu.)*	July	2.63	0	-20	-16
Oats *($per bu.)*	July	1.37	-13.8	-20	-6
Soybeans *($per bu.)*	July	5.52	-1.8	-21	-12
Wheat *($per bu.)*	July	2.95	-4.5	-10	-12
Livestock and products *(1977=100)*	July	132	-1.5	-9	-4
Barrows and gilts *($per cwt.)*	July	48.00	5.5	-11	6
Steers and heifers *($per cwt.)*	July	54.20	-4.2	-13	-10
Milk *($per cwt.)*	July	12.10	0	-7	-8
Eggs *(¢per doz.)*	July	52.8	-0.8	-12	-9
Prices paid by farmers *(1977=100)*	July	164	0	0	3
Production items	July	150	-0.7	-3	-1
Feed	July	116	-0.9	-15	-12
Feeder livestock	July	147	-5.2	-2	-5
Fuels and energy	July	204	0	1	-1
Producer Prices *(1967=100)*	June	294	-0.1	1	3
Agricultural machinery and equipment	June	340	0.1	1	4
Fertilizer materials	June	231	-0.4	-4	1
Agricultural chemicals	June	459	0.5	2	0
Consumer prices *(1967=100)*	June	322	0.3	4	8
Food	June	309	0.1	2	6
Production or stocks					
Corn stocks *(mil. bu.)*	June	2,832	N.A.	32	-43
Soybean stocks *(mil. bu.)*	June	609	N.A.	29	-23
Beef production *(bil. lbs.)*	June	1.89	-9.3	-5	-4
Pork production *(bil. lbs.)*	June	1.13	-15.3	-3	-11
Milk production *(bil. lbs.)*	June	12.4	-2.8	6	1

N.A. Not applicable

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