FEDERAL RESERVE BANK OF CHICAGO

AGRICULTURAL LETTER

ISSN 0002 - 1512

July 24, 1981 | Number 1556

DISTRICT FARMLAND VALUES edged higher in the second quarter, but the increase was modest. A recent survey of 550 agricultural banks shows the value of good farmland in the Seventh Federal Reserve District rose about 1.3 percent in the three months ending June 30. Compared to a year ago, land values are up nearly 14 percent. Nearly three-fourths of the annual increase, however, occurred during the second half of 1980. Since the beginning of this year, the rate of increase in District farmland values has been slowing as the land market continues to be affected by low farm earnings and high interest rates.

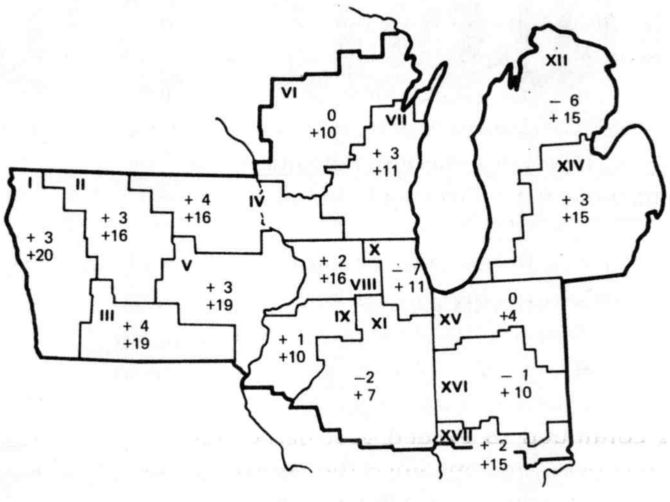
Among the five District states, the second-quarter trends in farmland values varied considerably (see map on page 2). Values were surprisingly strong in Iowa, the only District state that registered a faster rate of increase in the second quarter than in the first three months of the year. Bankers from Iowa reported a second-quarter increase in land values of nearly 4 percent, capping a year that has produced a rise of almost 19 percent for that state. In contrast, farmland values in the District portion of Illinois declined 1 percent in the second quarter, while those in Indiana were unchanged. Compared to a year ago, land values are up nearly a tenth in both Illinois and Indiana. In District portions of Michigan and Wisconsin, farmland values rose about 1 percent in the second quarter and as of midyear were up 15 percent and 11 percent, respectively, from a year ago.

Low farm income and high interest rates are probably the major factors behind the modest gains in farmland values since the end of last year. Low farm income—reflecting both low commodity prices relative to production costs and losses suffered by farmers that experienced the bulk of the weather damage to crops last summer and this spring—impact land markets in several ways. From the supply side farmers financially vulnerable to the downturn in earnings are more likely to sell some land. From the demand side low farm earnings lead to less aggressive bidding because of the implications of low short-term returns to any new acquisitions of land and because of the impact—not easily measured—on investors' expectations of the long-term returns from land. Moreover, since other farmers tend to be the predominate buyers of land, low farm earnings and/or recent losses from farming tend to deplete the available equity funds that expanding farmers have to invest in new land purchases.

High interest rates also affect the land market in several ways. The supply of land available for sale tends to be higher as potential sellers consider the opportunity to invest funds from the sale of land in other high yielding assets, including the alternative of financing the sale of their own land through a land contract. At the same time high interest rates tend to dampen the demand for farmland. Potential land buyers face sharply higher debt-servicing costs from leveraged land purchases, making rentals of land a more attractive option—at least for the short term—to expansion-minded farmers. In addition, high interest rates provide potential land buyers alternatives for placing investible funds in assets more liquid than land that now offer a return that is at least comparable to the total returns—including appreciation—historically available from owning land. Moreover, disruptions in financial markets from inverted yield curves have sharply curtailed the amount of new mortgage lending by life insurance companies and commercial banks. And the high and far more volatile interest rates of recent years confront potential buyers with additional risks if they use debt to finance new acquisitions of land. The historical practice of long-term, fixed-rate mortgages from life insurance companies has been virtually replaced by intermediate-term contracts or contracts that permit more frequent adjustments of interest rates. New borrowers face the uncertainty of future debt service requirements, in contrast to the old contracts whereby a favorable rate had been "locked-in" if rates subsequently rose and the option of refinancing was available if rates subsequently declined. Increased interest rate volatility has led to similar added risks to land buyers financing with federal land banks—despite the FLB's longstanding practice of variable-rate lending—or financing from any source that requires a balloon payment in a relatively short period of time.

Percent change in dollar value of "good" farmland

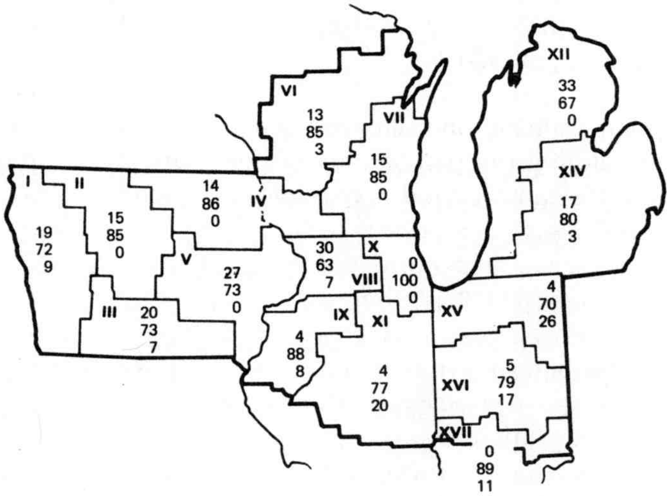
Top: April 1, 1981 to July 1, 1981
Bottom: July 1, 1980 to July 1, 1981



	April 1, 1981 to July 1, 1981	July 1, 1980 to July 1, 1981
Illinois	− 1	+ 9
Indiana	0	+ 9
Iowa	+ 4	+19
Michigan	+ 1	+15
Wisconsin	+ 1	+11
Seventh District	+ 1	+14

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

Top: Up
Center: Stable
Bottom: Down



	Up	Stable	Down
Illinois	9	77	14
Indiana	4	77	19
Iowa	20	77	3
Michigan	21	77	2
Wisconsin	14	85	1
Seventh District	14	79	8

Future trends in land values are clouded by the uncertainties regarding trends in interest rates and farm income. While farm income prospects have improved with the recent strengthening in livestock prices and a modest recovery in crop prices, further increases will likely be needed before the farm income picture can be considered conducive to a strong land market overall. In some areas of the District, land markets in the short run may be particularly affected by the lingering impact of last summer's drought or by the wide-ranging weather conditions of this spring that resulted in extensive hail damage, flooding, and prevented plantings.

Bankers are reserved in their expectations for further short-term gains in land values. Of those responding to the recent survey, only 14 percent expected farmland values to rise during the summer quarter while 8 percent foresaw a decline. The remainder expected land values to be stable. Although not as pessimistic as during the downturn in land values during the first half of 1980, these proportions are clearly less optimistic than in the three preceding quarterly surveys. In the April 1 survey, for instance, more than a fourth of the bankers foresaw further increases in land values while only 3 percent expected a decline. Interestingly, the most pessimistic bankers are in District portions of Illinois and Indiana where land markets appear to have been the weakest in the past quarter.

Gary L. Benjamin

MILK PRODUCTION, at 67.5 million pounds, was up 3.5 percent in the first half of 1981 over the same period a year ago. An increase in output per cow and a small gain in the number of dairy cows contributed to the rise. The increase in production, coupled with lagging disappearance, has greatly increased government support purchases of dairy products and placed the issue of dairy support levels in a major debate in the pending legislation to replace the expiring farm bill.

Output per cow in the first half was up 2.6 percent from the same period a year ago and up 6 percent from 1979. The gain reflected continued improvement in dairy herd productivity and relatively heavy feeding of grains and concentrates. In addition, the number of dairy cows continued to exceed year-earlier levels, a trend that has been evident since the spring of 1980. Fewer cullings and an increase in the number of replacement heifers that entered the milking herd contributed to this expansion. Though the number of dairy cows has been virtually unchanged in recent months, the number reported in June—10.9 million—was nevertheless nearly 1 percent above a year ago.

Preliminary estimates indicate that cash receipts to dairy farmers during the past six months were up 12 percent over the same period a year ago. Expanded marketings and higher milk prices contributed to the substantially higher cash receipts. Milk prices received by farmers averaged $13.75 per hundredweight during the past six months, an 8 percent increase over the same period the year before. While milk prices are above year-ago levels, prices received by dairy farmers have declined since January in step with seasonally higher production. In June dairy farmers received an average of $13.40 per hundredweight for all milk sold, down 70 cents from January. Dairy ration prices have declined somewhat since the first of the year but are still a fifth higher than last year. As a result, net returns to dairy farmers have not likely improved any in 1981.

The support price for manufacturing grade milk remains at $12.80 per hundredweight, the level established last October. (The April 1 semiannual adjustment was eliminated by legislation.) However, substantial purchases of manufactured dairy products by the government were still necessary in recent months in order to maintain this support price—as production exceeded commercial disappearance. Commercial disappearance of milk and dairy products through May of this year was 1 percent below the same period a year ago. However, the sluggishness in commercial disappearance occurred mostly in the first quarter as disappearance exceeded year-ago levels in April and May.

Net government purchases of manufactured dairy products rose to 9.1 billion pounds (milk equivalent) during the first half of 1981, exceeding the purchase level for all of 1980 and more than fifty percent higher than in the first half of last year. Government costs for the dairy support program, in turn, have risen to nearly $1.4 billion for the period January-June. For nine months of this marketing year, which began last October, government costs for the dairy support program have been $1.6 billion, well in excess of the $1.3 billion spent for the entire previous marketing year.

The current dairy support program expires this fall and some change is anticipated as a result of new legislation. The Administration is seeking provisions that would permit dairy support prices to be set as low as 70 percent of parity, and even lower if net government removals were high. The expiring legislation calls for a minimum of 80 percent of parity. Senate and House versions of the dairy legislation, however, generally provide for a minimum support of 75 percent of parity, although the Senate version would permit a 70 percent level whenever government expenditures reach a certain level. Whatever level is ultimately enacted, it is likely that the program will be altered so as to lower government costs.

The outlook for the second half of 1981 is shaded by the uncertainty over the support level this fall. But some trends are still anticipated. Gains in output per cow are expected to slow in the second half of 1981. With feed costs up, the milk-feed relationship has deteriorated, discouraging any heavier concentrate feeding. For the rest of 1981, year-to-year gains in output per cow may narrow from those in the first half.

Year-to-year gains in milk cow numbers may also narrow in the months ahead. If utility cow prices improve in the second half, some increase in culling rates may occur in view of higher costs and uncertainty over the support level. But the large number of replacement heifers available could be an offsetting factor. Overall, the USDA expects milk production in the second half may hold at least 2 percent over last year. Commercial disappearance may rise above year-ago levels in the second half, offsetting the sluggish first quarter. Rising meat prices may make dairy products relatively more attractive throughout the rest of the year. However, for the year overall commercial disappearance may only rise 1 percent above last year—resulting in a continued oversupply of milk.

Jeffrey Miller

Selected agricultural economic developments

Subject	Unit	Latest period	Value	Percent change from Prior period	Percent change from Year ago
Farm finance					
Total deposits at agricultural banks†	1972-73=100	June	232	− 0.2	+12
Total loans at agricultural banks†	1972-73=100	June	263	+ 0.8	+ 4
Production credit associations					
Loans outstanding					
United States	mil. dol.	June	22,126	+ 2.2	+10
Seventh District states	mil. dol.	June	4,543	+ 2.8	+ 9
Loans made					
United States	mil. dol.	June	2,738	− 2.3	+13
Seventh District states	mil. dol.	June	618	+ 2.0	+16
Federal land banks					
Loans outstanding					
United States	mil. dol.	June	40,280	+ 1.8	+20
Seventh District states	mil. dol.	June	9,627	+ 2.1	+22
New money loaned					
United States	mil. dol.	June	824	− 5.2	+31
Seventh District states	mil. dol.	June	219	+ 5.2	+30
Interest rates					
Feeder cattle loans††	percent	1st Quarter	16.94	+ 7.2	+11
Farm real estate loans††	percent	1st Quarter	15.56	+ 5.7	+ 7
Three-month Treasury bills	percent	7/16-7/22	15.17	+ 3.4	+89
Federal funds rate	percent	7/16-7/22	19.05	− 0.8	+112
Government bonds *(long-term)*	percent	7/9-7/15	13.38	+ 5.2	+32
Agricultural trade					
Agricultural exports	mil. dol.	May	3,567	− 4.9	+11
Agricultural imports	mil. dol.	May	1,529	+ 9.5	+ 6
Farm machinery sales[p]					
Farm tractors	units	June	8,216	− 5.8	−28
Combines	units	June	1,799	+53.1	+19
Balers	units	June	2,607	+110.9	− 4

†Member banks in Seventh District having a large proportion of agricultural loans in towns of less than 15,000 population.

††Average of rates reported by District agricultural banks at beginning and end of quarter.

[p]Preliminary.

AGRICULTURAL LETTER
FEDERAL RESERVE BANK OF CHICAGO
Public Information Center
P.O. Box 834
Chicago, Illinois 60690
Tel. no. (312) 322-5112

FEDERAL RESERVE BANK OF CHICAGO
AGRICULTURAL LETTER

FIRST-CLASS MAIL
U.S. POSTAGE
PAID
Chicago, Il.
Permit No. 1942

MR.MARTIN K.CHRISTIANSEN AGL
EXTENSION ECONOMIST AGR.POLICY
ROOM 217 CLASSROOM OFFICE BLDG
UNIVERSITY OF MINNESOTA
ST.PAUL,MINNESOTA 55101