FEDERAL RESERVE BANK OF CHICAGO

AGRICULTURAL LETTER

ISSN 0002 - 1512

May 16, 1980 Number 1525

DISTRICT FARMLAND VALUES recorded a rare decline in the first quarter. Reports from about 525 agricultural banks indicate the value of good farmland in the district declined 2 percent during the three months ended in March. That is only the second time since 1960 that quarterly surveys have detected a downturn in district farmland values. Farmland values still average 9 percent higher than a year ago. An unusually large proportion of the bankers expect the decline to continue this quarter, however.

The downturn was evident in four of the five district states. Bankers in the district portion of Wisconsin were the exception, reporting a surprisingly strong increase of 3 percent. In the other four states, bankers reported first-quarter declines ranging from 1 percent in Michigan to 4 percent in Iowa. (See map on back.)

The contrast between Wisconsin and other district states partly reflects differences in the type of agricultural production. Dairying accounts for about three-fifths of all cash receipts from farm marketings in Wisconsin. Larger production and higher milk prices have held returns to dairy farmers at high levels. But returns on cash crops, fed cattle, and hogs—the commodities that account for the bulk of agriculture in the other district states—were substantially lower in the first quarter. The lower earnings and tight credit markets contributed to much less aggressive bidding on farmland.

Preliminary estimates by the USDA show net farm income declined to a seasonally adjusted annual rate of $28.4 billion in the first quarter. That compares with $32.4 billion in the fourth quarter and $36.0 billion a year ago. In real terms, the preliminary estimates show first-quarter net farm income was the lowest since the summer of 1977. That was the only other quarter since 1960 that district farmland values declined.

Tight credit markets probably added a two-pronged impact that contributed to the first-quarter downturn in land values. The demand for mortgage financing was reduced by high mortgage rates and their implications for debt servicing costs. District bankers were charging on average 16.2 percent on farm real estate mortgages April 1. In comparison, farm mortgage rates averaged 13.0 percent three months earlier and 10.5 percent a year earlier. Because of the rise in mortgage rates and land values over the past year, the annual principal and interest payment associated with a mortgage on a recent land purchase would be two-thirds higher than a year ago, assuming a given maturity and percentage downpayment. In many cases, the higher debt servicing costs would exhaust the prospective gross receipts from the land purchased.

For some lenders, the tight credit markets may have resulted in a smaller supply of mortgage funds. Rural banks curtailed farm mortgage lending substantially last year and the trend probably continued in the first quarter. New farm mortgage commitments made by life insurance companies during January and February were less than half what they had been a year before. Loans closed by federal land banks in the first quarter exceeded the year-earlier level by more than 40 percent. But the bulk of that large increase probably reflects commitments made in late 1979 rather than new commitments.

The outlook for farmland values, in the eyes of district agricultural banks, is for a futher decline. Districtwide, 46 percent of the bankers that responded to the recent survey expected further declines this quarter. Only 4 percent projected an increase and 50 percent expected land values to be unchanged. Overall, these were the most pessimistic projections recorded in the 20-year history of these surveys.

While there was a great deal of pessimism at the time of the latest survey, trends in rural credit markets have reversed substantially. Most evident is the sharp decline that has pulled short-term interest rates back down to levels more typical six to 12 months ago. Although still high, the declines make mortgage servicing costs more palatable than a short while ago.

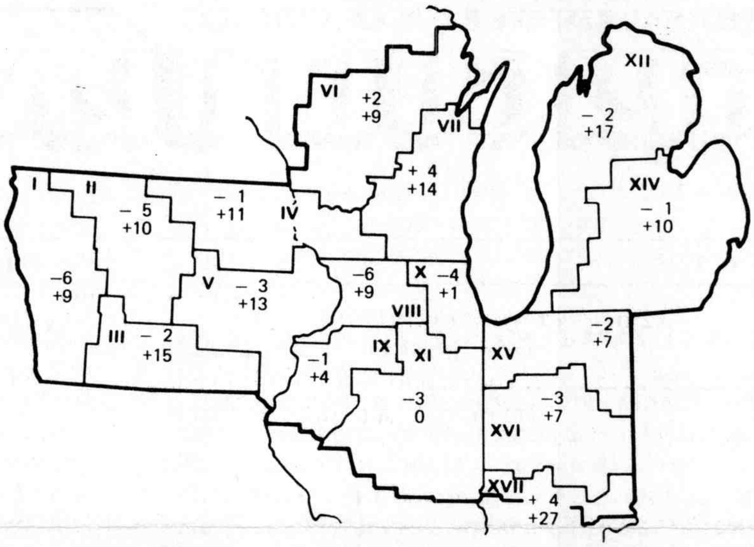
Although conditions in credit markets have improved, short-run farm profit prospects remain quite bleak. Losses to hog producers and cattle feeders have been substantial and may continue to mount for the next few months. Crop farmers are facing a tight cash-flow squeeze because of the large supplies from last year's harvest that are overhanging the market. But prices could improve if the government isolates substantial old crop supplies from the market or if new crop prospects are threatened by adverse weather.

Gary L. Benjamin

Percent change in dollar value of "good" farmland

Top: January 1, 1980 to April 1, 1980
Bottom: April 1, 1979 to April 1, 1980

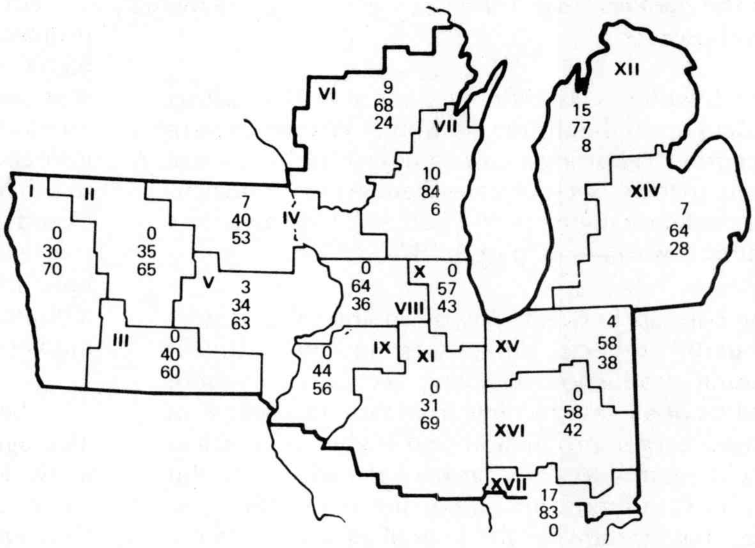
	January 1, 1980 to April 1, 1980	April 1, 1979 to April 1, 1980
Illinois	−3	+ 2
Indiana	−2	+10
Iowa	− 4	+11
Michigan	−1	+13
Wisconsin	+ 3	+12
Seventh District	−2	+ 9



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

Top: Up
Center: Stable
Bottom: Down

	Up	Stable	Down
Illinois	0	41	59
Indiana	2	60	38
Iowa	0	33	67
Michigan	10	68	22
Wisconsin	11	75	14
Seventh District	4	50	46



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