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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary

The July survey of agricultural banks in the Seventh District, conducted by the Chicago Fed, indicated that average farmland values increased just over 1 percent from the end of March 2002 to the end of June. Data provided by more than 340 bankers showed that the year-over-year increase in the value of "good" farmland was close to 6 percent, on average. As is typical, the District average obscured substantial differences in the reported changes in farmland values across the five states of the District (see map and table below).

Credit conditions have remained fairly stable since the last survey. The proportion of bankers reporting an increase in collateral requirements on loans was somewhat lower than at the end of the first quarter, and about the same as a year ago. Respondents also observed that demand for agricultural loans was down slightly, while the availability of funds edged up from last quarter. Compared with the first quarter of 2002, fewer banks reported lower rates of loan repayment, though not as few as a year ago. A summary measure of the incidence of farmer requests for loan renewals or extensions indicates a decline in such requests from last quarter and a year ago. Still, the proportion of farm loans that respondents viewed as having "major" or "severe" repayment problems was virtually unchanged from the last two times the survey asked this question (the second and fourth quarters of 2001). Interest rates on farm-related loans reverted to their downward trend, providing some additional relief to those with variable-rate loans or those able to refinance fixed rate loans.

Farmland values

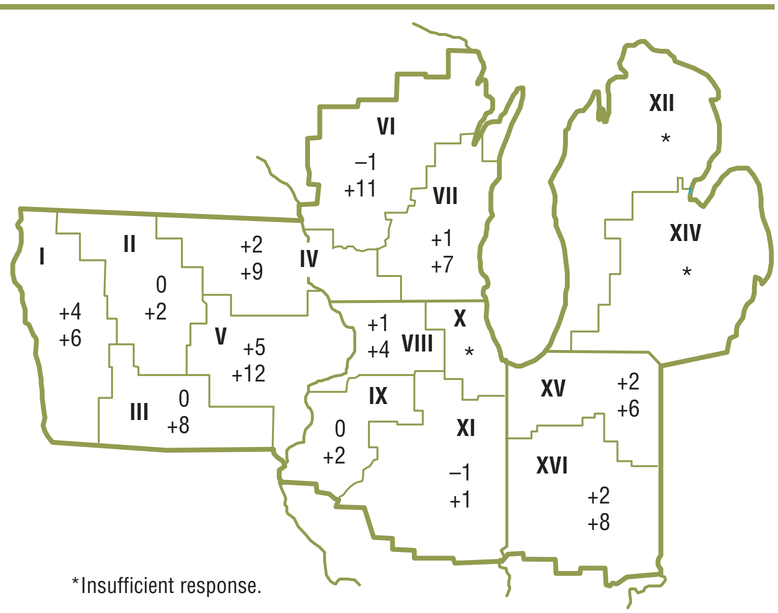
Average district farmland values continued to increase through the second quarter of 2002. However, the rate of change remained varied across the region.

Respondents in Illinois, Michigan, and Wisconsin reported no change, on average, in "good" farmland prices from the end of the first quarter to the end of the second quarter. Mixed crop conditions in Illinois may have led to no change in the state average. Sharply lower milk prices this year, hurting dairy farmers, likely contributed to the flat farmland values in Wisconsin. On a year-over-year basis, Michigan and Wisconsin respondents indicated prices had increased about 6 percent and 9 percent, respectively. Respondents in Illinois reported an increase of only 2 percent, year-over-year. In comparison, the increase in farmland values in Indiana and Iowa was broader in the second quarter of 2002, as opposed to the previous survey. A 2 percent rise, on a quarterly basis, in farmland values was reported for these states (see table). The year-over-year increase in

Percent change in dollar value of "good" farmland

Top: April 1, 2002 to July 1, 2002
Bottom: July 1, 2001 to July 1, 2002

	April 1, 2002 to July 1, 2002	July 1, 2001 to July 1, 2002
Illinois	0	+2
Indiana	+2	+8
Iowa	+2	+7
Michigan	0	+6
Wisconsin	0	+9
Seventh District	+1	+6



*Insufficient response.

farmland values was 8 percent in Indiana and 7 percent in Iowa. Positive crop conditions—notably in Iowa, the most favorable of the Seventh District states this year—probably boosted farmland values. But, poor crop conditions in Indiana, the least favorable of the Seventh District states, didn't dampen farmland values. Most likely, continued demand from non-farm development was a key factor.

The impact on farmland values of relative agricultural conditions in the District states was also reflected in bankers' expectations for land prices in the third quarter of 2002. The proportion of Seventh District bankers who expected increases in farmland values was well above the proportion who expected declines—in all states. In fact, 21 percent of Seventh District bankers expected farmland values would increase while only 4 percent thought they would decline, with the remainder expecting stable farmland values. A primary factor in these expectations is probably the supporting impact of the Farm Security and Rural Investment Act of 2002.

Credit conditions in the District

Credit conditions reported in the latest survey mirrored those reported by the bankers during the past year, being favorable—for the most part.

Examining specific measures of credit conditions as of July 1 relative to a year earlier, 22 percent of respondents indicated they had increased loan collateral requirements, a drop from the last survey. There was substantial variation in this response, however, ranging from 33 percent in Illinois to 11 percent in Indiana. The notably smaller proportion of bankers requiring increased collateral in Illinois, Indiana, and Iowa represented a change from three months earlier, when 40 percent of Illinois and 20 percent of Indiana bankers reported an increase in collateral requirements.

The respondents also provided their assessments, relative to a year ago, of the rate of loan repayment (see table on page 3) and farmers' requests for loan renewals or extensions. Based on the loan repayment index (see footnote 2 of table on page 3), the repayment rate for the District overall improved in the second quarter relative to the first quarter. However, the index, which was at 71, also indicated that a larger percentage of bankers reported a reduction in the rate of loan repayment relative to a year ago than those who saw an increase. The index measure for loan renewals and extensions told a similar story. A larger proportion of bankers reported increases in requests for loan renewals or extensions than those who reported a decrease. This index stood at 126 in the latest survey for the District overall, an improvement from responses in the surveys for the first quarter and the second quarter of 2001. There was again a wide dispersal across states in both of these measures. Of particular note, however, was the change recorded in the responses of Iowa bankers, where both repayment rates (increased) and renewal/extension rates (decreased) showed substantial relative improvement from last quarter. This was likely in response to higher corn and soybean prices coupled with Iowa's relatively good productivity prospects, leading to improved balance sheets for Iowa farmers.

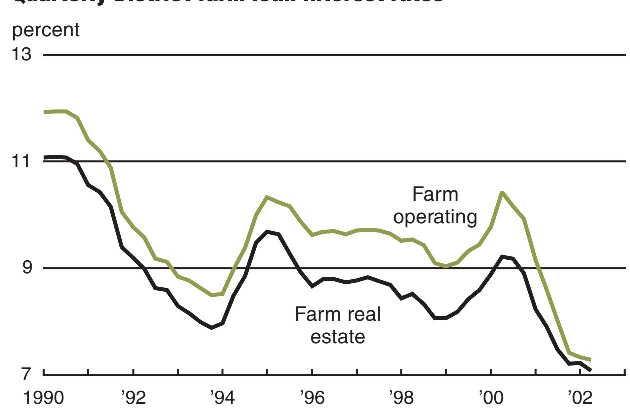
The bankers' responses to a question regarding the volume of farm loans with repayment problems is another measure of financial stress in the industry. For the District on average, respondents noted that 6 percent of their loan volume was in the "major" or "severe" problem categories. This proportion remained quite stable over the past year.

Finally, interest rates resumed their decline on farm-related loans. After peaking in the second quarter of 2000, real estate loan rates declined 213 basis points to 7.08 percent, on average, by the end of the second quarter of 2002. Over the same period, farm operating loan rates dropped 315 basis points to 7.28 percent. The relatively larger decline in rates on operating loans resulted in a substantial reduction in the interest rate differential between operating and real estate loans. This spread decreased from 122 basis points in the second quarter of 2000 to only 20 basis points at the end of the second quarter of 2002. With the interest rate spread at 20 basis points or below in 2002, this year has seen the smallest differential since 1983. The narrowing spread may reflect a reduction in the risk premium, possibly due to the stability provided by the Farm Security and Rural Investment Act of 2002, on what might be viewed as a farm operating loan portfolio without the same level of security as real estate loans.

Looking forward

With indications of some weakening in loan demand evident in the second quarter, the prospects for the third quarter are of interest. When asked to report their near-term (third-quarter 2002 relative to third-quarter 2001) expectations for non-real-estate loan demand, the bankers' responses were pretty balanced. Nineteen percent of the respondents expected

Quarterly District farm loan interest rates



Credit conditions at Seventh District agricultural banks

	Loan demand	Fund availability	Loan repayment rates	Average loan-to-deposit ratio[1]	Interest rates on farm loans: Operating loans[1]	Feeder cattle[1]	Real estate[1]
	(index)[2]	(index)[2]	(index)[2]	(percent)	(percent)	(percent)	(percent)
1999							
Jan-Mar	120	119	40	69.9	9.03	9.01	8.06
Apr-June	115	107	50	71.7	9.11	9.08	8.18
July-Sept	109	94	63	72.7	9.32	9.28	8.42
Oct-Dec	107	104	72	72.7	9.44	9.41	8.59
2000							
Jan-Mar	121	95	77	72.9	9.78	9.72	8.89
Apr-June	109	76	72	75.5	10.43	10.14	9.21
July-Sept	106	82	77	76.9	10.17	10.14	9.18
Oct-Dec.	105	92	81	74.9	9.92	9.90	8.90
2001							
Jan-Mar	118	101	67	75.0	9.16	9.17	8.23
Apr-June	106	109	73	75.1	8.60	8.58	7.91
July-Sept	91	127	86	74.9	8.01	8.07	7.47
Oct-Dec	101	129	75	72.8	7.41	7.51	7.21
2002							
Jan-Mar	108	118	66	72.7	7.33	7.48	7.22
Apr-June	105	120	71	75.1	7.28	7.35	7.08

[1]At end of period.
[2]Bankers responded to each item by indicating whether conditions during the current quarter were higher, lower, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100.

an increase in loan volume and 18 percent expected a decline, giving a loan demand expectation index of 101.

Most of the strength in non-real-estate lending was expected to occur in the operating loan category. Other categories of lending, such as feeder cattle loans, dairy loans, farm machinery loans, and loans for the construction of grain storage facilities were expected to be fairly weak in the third quarter—continuing a prolonged pattern. Bankers expect some deterioration in lending in most of these categories compared with last quarter and a year ago, but the deterioration may slow for farm machinery lending.

Lenders' reliance on loan guarantees is another indicator of credit conditions. Bankers reported they expect to rely more heavily on the USDA's Farm Service Agency (FSA) farm loan guarantees during the next three months (i.e., July-September) than they did during the same period a year ago. Their responses indicated a higher level of reliance on FSA guarantees than this time last year. As reported last quarter, 37 percent of the respondents indicated they would rely more heavily on FSA guarantees. The proportion of bankers expecting to reduce their utilization of the guarantees remained about 8 percent.

Lastly, District bankers expect a weakening in demand for farm real estate loans, relative to last quarter. Twelve percent of the respondents expect to see an increase in farm real estate loan demand in the third quarter of 2002, while 16 percent expect a decline. There has been a substantial increase in farm-related lending from non-bank sources in District states, though the trend has slowed since last year as banks seem able to generate more loans. Farm Credit System (FCS) lending for farm operating loans and farm mortgages was higher, up 38 percent and 49 percent, respectively, according to respondents—slightly lower than reported increases a year ago. Merchants, dealers, and other input suppliers continue to increase their agricultural lending, as 47 percent of respondents reported. On the other hand, life insurance companies continue to fade as agricultural lenders, with only 6 percent of respondents seeing higher loan volumes for life insurance companies, but 18 percent reporting lower loan volumes.

David B. Oppedahl and Jack L. Hervey

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Federal Reserve Bank of Chicago
P.O. Box 834
Chicago, IL 60690-0834
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SELECTED AGRICULTURAL ECONOMIC INDICATORS

	Latest period	Value	Percent change from: Prior period	Percent change from: Year ago	Percent change from: Two years ago
Prices received by farmers *(index, 1990–92=100)*	August	101	1.0	–8	–6
Crops *(index, 1990–92=100)*	August	116	4.5	6	21
Corn *($ per bu.)*	August	2.48	16.4	31	63
Hay *($ per ton)*	August	93.70	0.1	–4	16
Soybeans *($ per bu.)*	August	5.65	5.6	16	27
Wheat *($ per bu.)*	August	3.60	12.1	31	50
Livestock and products *(index, 1990–92=100)*	August	87	–2.2	–22	–9
Barrows and gilts *($ per cwt.)*	August	39.40	–2.0	–23	–11
Steers and heifers *($ per cwt.)*	August	66.30	–0.5	–10	–3
Milk *($ per cwt.)*	August	11.2	0.0	–32	–10
Eggs *(¢ per doz.)*	August	62.2	8.0	10	–6
Consumer prices *(index, 1982–84=100)*	August	181	0.3	2	5
Food	August	176	0.0	1	4
Production or stocks					
Corn stocks *(mil. bu.)*	June 1	3,594	N.A.	–8	0
Soybean stocks *(mil. bu.)*	June 1	684	N.A.	–3	–12
Wheat stocks *(mil. bu.)*	June 1	772	N.A.	–12	–19
Beef production *(bil. lb.)*	August	2.47	1.8	2	1
Pork production *(bil. lb.)*	August	1.64	5.1	2	0
Milk production* *(bil. lb.)*	August	12.2	–0.8	4	2
Receipts from farm marketings *(mil. dol.)*	June	13,722	–1.5	–8	–2
Crops**	June	6,551	2.8	1	9
Livestock	June	7,171	–5.0	–15	–10
Government payments	June	N.A.	N.A.	N.A.	N.A
Agricultural exports *(mil. dol.)*	July	4,105	0.7	4	7
Corn *(mil. bu.)*	July	167	0.2	–9	9
Soybeans *(mil. bu.)*	July	56	28.9	68	11
Wheat *(mil. bu.)*	June	65	5.7	5	–30
Farm machinery sales *(units)*					
Tractors, over 40 HP	August	5,505	–16.1	5	1
40 to 100 HP	August	4,787	–14.9	9	9
100 HP or more	August	718	–23.0	–13	–30
Combines	August	421	26.0	–36	–12

N.A. Not applicable
*20 selected states.
**Includes net CCC loans.