The Agricultural Newsletter
from the Federal Reserve Bank of Chicago
Number 1919 *February 2003*

AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary

The 2002 annual increase of 7 percent in the value of "good" agricultural land for the Seventh Federal Reserve District was the largest increase since 1997. The quarterly increase in farmland values remained 2 percent, on average, for the District, based on a survey of 370 agricultural bankers as of January 1, 2003. More bankers projected farmland values to rise over the next three months and fewer expected farmland values to go down.

Agricultural credit conditions have changed for the better from a year ago according to District bankers. The improvement in the availability of funds was the highest since 1993. Moreover, the index of loan repayment rates reached a level not seen since 1997. Demand for loans inched up in the fourth quarter to the level of a year ago. There was even a smaller proportion of banks that required increased collateral. Renewals and extensions of loans continued to be higher in the fourth quarter than a year earlier, but the pace slowed from the third quarter. Interest rates on agricultural loans dropped across the District again, the tenth quarterly drop in a row. Loan-to-deposit ratios fell below the levels of the last two quarters, but still were above the level of a year ago. Thus, several positive signals indicate improvement in the District's agricultural credit conditions, alleviating some concern about financial stress in the agricultural economy. Yet, there is still broad concern about the financial health of farms in the District, especially for those in areas with low yields in 2002 and those with dairy operations.

Farmland values

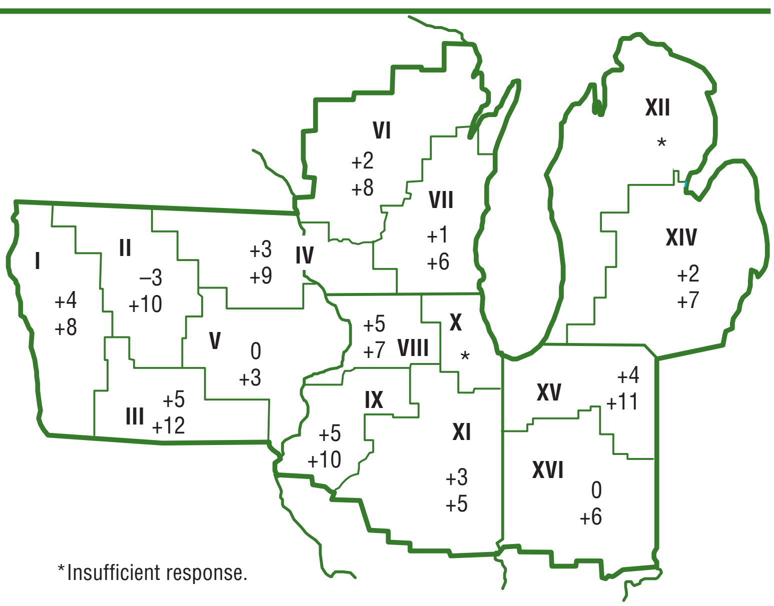
The value of "good" agricultural land increased in all the states of the District in the fourth quarter of 2002 (see table and map below). From October 1 to January 1, Illinois led the states with a 4 percent increase in farmland values, after lagging behind the other states in the third quarter. The rate of change in Michigan's farmland values trailed the other states with a 1 percent increase (quarter-to-quarter). Farmland values in Indiana, Iowa, and Wisconsin exhibited growth of 2 percent for the quarter, a surprise given the varied agricultural performance each experienced last year.

For last year district farmland values were up on average 7 percent, the best year-over-year results since 1997 (see chart 1). State increases only ranged from 8 percent gains in Indiana and Iowa down to a 6 percent gain in Michigan. Thirty-two percent of Seventh District bankers expect farmland values to rise, with only 2 percent seeing a fall during

Percent change in dollar value of "good" farmland

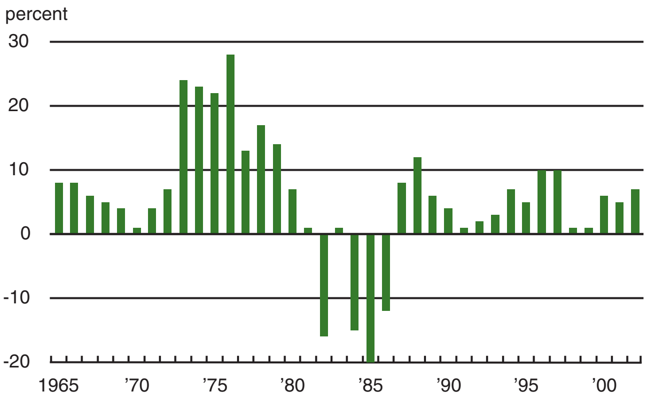
Top: October 1, 2002 to January 1, 2003
Bottom: January 1, 2002 to January 1, 2003

	October 1, 2002 to January 1, 2003	January 1, 2002 to January 1, 2003
Illinois	+4	+7
Indiana	+2	+8
Iowa	+2	+8
Michigan	+1	+6
Wisconsin	+2	+7
Seventh District	+2	+7



*Insufficient response.

1. Annual percentage change in Seventh District farmland values



the next three months. Even in Wisconsin there were more respondents that predict farmland values to rise than fall. In Iowa 43 percent of the bankers that responded anticipated an increase in farmland values, continuing to reflect the outstanding crop yields last year.

While the gains in nominal farmland values have been impressive, a comparison to the index of farmland values adjusted for inflation reveals that "real" farmland values are still well below the peak of 1979 (see chart 2). The inflation-adjusted annual increase in farmland values of 6 percent for 2002 almost pushed the index to the level of 1984. However, relative to other investments experiencing negative returns farmland continues to be an attractive part of many investment portfolios, which has helped maintain the upward movement in farmland values.

Credit conditions

Taken as a whole credit conditions in the District appear to be the best in several years. Only 6 percent of the respondents reported lower fund availability, whereas 36 percent reported they had more funds available during October, November, and December than a year earlier. Every state in the District showed improved funds availability. The index of fund availability was 130, the highest value since 1993 (see table on page 3).

There was a slight elevation in the demand for non-real estate loans over the level of a quarter ago, as the index of loan demand moved up to 101, the same as last year in the fourth quarter. Twenty-five percent of the bankers reported an increase in the demand for non-real estate loans, while 23 percent reported a decline. Iowa, followed by Illinois and Indiana, led the way in higher non-real estate loan demand. But, Michigan and Wisconsin experienced a drop in demand for non-real estate loans last quarter. Additionally, Wisconsin bankers reported the highest level of increased loan renewals and extensions (37 percent), balanced somewhat by 24 percent of Iowa bankers reporting fewer renewals and extensions. For the District there were more renewals and extensions, with 25 percent of the bankers noting an increase and 14 percent noting a decrease.

Respondents indicated that non-real estate farm loan repayment rates had improved from last quarter, buoyed by higher prices last year, particularly for corn and soybeans. About 16 percent of the bankers reported higher rates of loan repayment, while 29 percent reported lower rates. The index of loan repayment rates rose to 88, the best value since 1997. About 6 percent of the volume of the agricultural loan portfolios held by the respondents was deemed to have major or severe repayment problems. Wisconsin experienced the lowest levels of loan repayments, with 51 percent of lenders reporting lower rates. Meanwhile, Iowa and Michigan had more banks report higher rates of loan repayment than lower rates compared with a year ago.

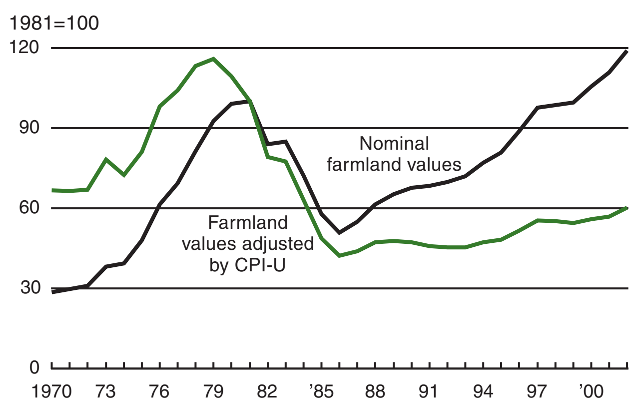
District banks continued to tighten collateral requirements, with 18 percent requiring a higher level of collateral in the past three months, down from 24 percent a year ago. The respondents indicated there was less tightening in credit standards for agricultural loans from October to December 2002 compared with the previous year. But, easing was not evident either. Around 3 percent of customers with operating credit are not likely to qualify for new credit this year from the reporting banks, a bit higher than last year.

Farm loan interest rates declined to the lowest level in the last thirty years. As of January 1, the District average for interest rates on new operating loans was 6.70 percent, almost 375 basis points lower than the cyclical peak of two years ago. Averaging 6.51 percent, interest rates for farm mortgages had fallen over 265 basis points from the most recent peak. The spread narrowed somewhat relative to the third quarter.

Looking forward

Comparing the first quarter of 2003 with the first quarter a year ago, 23 percent of the respondents indicated that they

2. Indexes of District farmland values



Note: Derived from Federal Reserve Bank of Chicago Farmland Value Surveys and BLS consumer price index series (annual average).

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)*
1998							
Jan-Mar	134	113	84	68.9	9.52	9.51	8.50
Apr-June	127	102	74	72.7	9.54	9.55	8.52
July-Sept	117	104	60	72.0	9.43	9.41	8.33
Oct-Dec	113	121	57	70.3	9.09	9.07	8.06
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
July-Sept	99	124	76	75.7	7.21	7.26	6.84
Oct-Dec	101	130	88	73.2	6.70	6.78	6.51

[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.

expect an increase in non-real estate loan volume, while 19 percent expect a decrease in volume. Bankers foresee increases in operating loans (36 percent) and Farm Service Agency (FSA) guaranteed loans (29 percent). Even after a poor harvest, Indiana was the only state where more bankers expect an increase in farm machinery loan volume than a decrease during January, February, and March compared to a year ago. A majority (58 percent) of the respondents indicated that they expected loan volumes would remain the same as a year ago in the period from January to March. Only 22 percent of the bankers look for higher real estate loan volume, which is greater than the 15 percent that look for lower volume. However, in Wisconsin at least a third anticipate lower volumes for both real estate and non-real estate loans, with a similar percentage anticipating a rise in operating loans.

Capital expenditures by farmers in the year ahead look to be weak, though about half of the respondents foresee no change in the level of capital expenditures from last year. The worst prospects are for expenditures on buildings and facilities with only 7 percent of the bankers seeing higher levels of spending and 42 percent anticipating lower levels. Expenditures on land purchases or improvements were projected by 20 percent to be higher than last year and by 27 percent to be lower.

There is likely to be an expansion in the number of acres planted to corn or soybeans containing genetically modified organisms (GMOs) this spring in the District, as over a quarter of the bankers anticipated a rise in the use of GMO seed. The vast majority of respondents are willing to finance farmer purchases of GMO seed (only 4 percent were not willing), as the drive for efficiency and higher yields leads farmers to embrace the benefits of biotechnology.

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AgLetter (ISSN 1080-8639) is published quarterly by the Research Department of the Federal Reserve Bank of Chicago. It is prepared by Jack L. Hervey, senior economist, and members of the Bank's Research Department, and is distributed free of charge by the Bank's Public Information Center. The information used in the preparation of this publication is obtained from sources considered reliable, but its use does not constitute an endorsement of its accuracy or intent by the Federal Reserve Bank of Chicago.
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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 (*index, 1990-92=100*)	January	99	1.0	4	2
Crops (*index, 1990-92=100*)	January	102	–1.9	9	9
Corn (*$ per bu.*)	January	2.27	–2.2	15	15
Hay (*$ per ton*)	January	92.90	0.3	1	9
Soybeans (*$ per bu.*)	January	5.38	–1.5	27	15
Wheat (*$ per bu.*)	January	3.66	–9.9	28	29
Livestock and products (*index, 1990-92=100*)	January	95	4.4	–2	–5
Barrow and gilts (*$ per cwt.*)	January	32.30	5.2	–16	–14
Steers and heifers (*$ per cwt.*)	January	77.60	3.3	9	–2
Milk (*$ per cwt.*)	January	11.8	–0.8	–12	–9
Eggs (*¢ per doz.*)	January	68.9	1.3	11	3
Consumer prices (*index, 1982-84=100*)	January	182	0.4	3	4
Food	January	176	0.1	1	4
Production or stocks					
Corn stocks (*mil. bu.*)	December 1	7,633	N.A.	–8	–11
Soybean stocks (*mil. bu.*)	December 1	2,114	N.A.	–7	–6
Wheat stocks (*mil. bu.*)	December 1	1,321	N.A.	–19	–27
Beef production (*bil. lb.*)	January	2.29	8.8	–2	4
Pork Production (*bil. lb.*)	January	1.75	2.0	2	3
Milk production* (*bil. lb.*)	January	12.5	2.1	2	4
Receipts from farm marketings (*mil. dol.*)	November	19,182	–12.5	–4	–6
Crops**	November	11,369	–16.1	3	–5
Livestock	November	7,813	–6.8	–14	–6
Government payments	November	N.A.	N.A.	N.A.	N.A.
Agricultural exports (*mil. dol.*)	November	5,184	10.4	–1	9
Corn (*mil. bu.*)	November	137	6.7	–2	–7
Soybeans (*mil. bu.*)	November	137	5.5	–13	11
Wheat (*mil. bu.*)	November	79	–3.4	–23	–11
Farm machinery (*units*)					
Tractors, over 40 HP	January	4,014	–27.4	–5	–7
40 to 100 HP	January	2,905	–27.0	–4	1
100 HP or more	January	1,109	–28.4	–7	–22
Combines	January	178	–73.1	–3	–57

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