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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary

Farmland values in the Seventh District inched upward during the third quarter of 2000, according to a survey of 368 agricultural bankers. An increase of 1%, on average, in the third quarter (July 1-October 1) compared with a similarly modest gain in the second quarter. On a year-to-year basis, however, farmland values were reported up 7% from the October 1, 1999, survey. This constituted the largest year-to-year increase since the 8% gain in the second quarter of 1998.

Bankers reported that, on average, loan demand in the third quarter of 2000 was a little weaker than a year ago, but that loan-to-deposit ratios continued to increase. Repayment patterns for non-real-estate loans stabilized with 70% of the respondents noting that repayment rates were about the same as a year ago. Bankers reported some moderation in recent rapid increases in interest rates on agricultural loans. Operating loan rates backed off slightly, although rates on real estate increased somewhat, relative to the July 1, 2000, survey.

Farmland values

The October 1 survey confirmed the result of the July 1, 2000, survey that showed a slowing in the quarter-to-quarter appreciation of farmland values in Seventh District states, following a brief acceleration in land prices in the fourth quarter of 1999 and the first quarter of 2000. Furthermore, a divergence in the pattern of change in farmland values across the five states that reappeared in the second quarter became more pronounced in the latest survey.

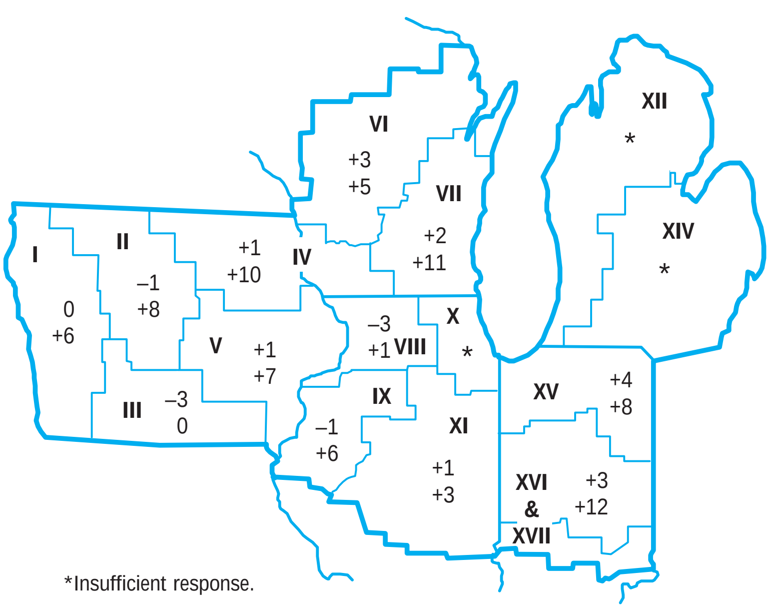
During the fourth quarter 1999 and first quarter 2000 surveys, quarter-to-quarter changes in farmland values in Illinois and Iowa turned to comparatively strong positive numbers from the declines reported for most of 1998 and 1999. However, the second quarter 2000 survey indicated that farmland values in Illinois "weakened," quarter-to-quarter, to "unchanged," on average, and in Iowa the gains slowed to 1%. In the most recent survey, quarter-to-quarter farmland values in Illinois remained unchanged and Iowa farmland values slipped to "no change." Quarter-to-quarter gains continued in the 2% to 3% range for Indiana, Michigan, and Wisconsin. On a year-over-year basis farmland values gains were comparatively strong in District states, ranging from 4% in Illinois to 10% in Indiana.

Many bankers noted that weakness in farmland values in some areas of the District, especially in the heart of the Corn Belt, was attributable to continued low prices for corn and soybeans. In addition, low milk prices were cited frequently by respondents in dairy producing areas as contributing to weak demand for land by farmers.

Percent change in dollar value of "good" farmland

Top: July 1, 2000 to October 1, 2000
Bottom: October 1, 1999 to October 1, 2000

	July 1, 2000 to October 1, 2000	October 1, 1999 to October 1, 2000
Illinois	0	+4
Indiana	+3	+10
Iowa	0	+6
Michigan	+2	+8
Wisconsin	+2	+8
Seventh District	+1	+7



*Insufficient response.

At the same time, numerous respondents observed that there was considerable demand for farmland for residential/commercial use near population centers and recreational use near population centers and elsewhere.

Low commodity prices

Low commodity prices were commonly cited as contributing to adverse pressure on farmers' balance sheets. Nonetheless, according to U.S. Department of Agriculture (USDA) estimates, net income for the nation's farmers is expected to total $45.6 billion in 2000, up about 5% from 1999, which would be the highest level since 1997. And, as many bankers observed, payments to farmers through government support and emergency aid programs were key to the ability of many farmers to remain current on the service of their financial obligations. Indeed, while net farm income (nationally) is estimated to be up $2.2 billion in 2000, government payments to farmers are estimated to be up $2.7 billion.

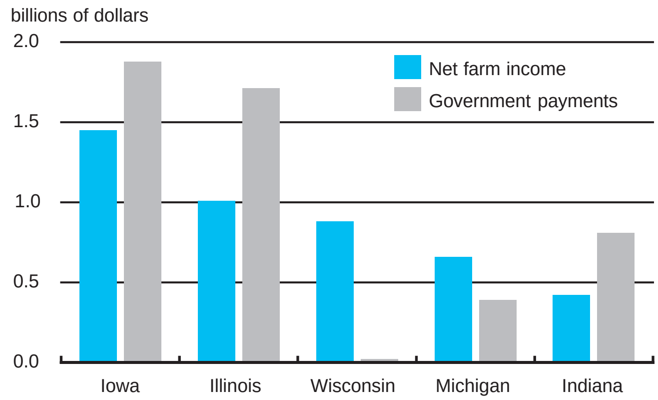
Recent data from the USDA support the gravity of this concern. As shown in the chart, in 1999 payments from government programs to farmers in Seventh District states exceeded estimated net farm income in three of the five states. For the five states in sum, government payments were equivalent to 109% of net farm income and ranged from a high of 193% in Indiana to a low of 1% in Wisconsin. As a number of bankers observed, many farmers are surviving on the land because of government payments, off-farm income, the diminution of their capital stock, or some combination of the three. They are concerned about the long-term viability of this environment for farmers and, implicitly, for rural banking operations.

Credit conditions in the District

Credit conditions reported by agricultural bankers in the District suggest that low prices for agricultural commodities may be causing farmers and bankers to become more conservative in their borrowing and lending activity in order to moderate the risk of over-extension. For example, only 25% of the banker respondents reported increased demand for non-real-estate loans (relative to a year ago) compared with 32% in the second quarter. At the same time, the proportion of bankers that reported a reduction in non-real-estate loan demand also declined from that reported in the second quarter—from 23% to 19%. Thus, the bankers that observed "no change" in non-real-estate loan demand, relative to a year earlier, rose to 56% from 45% in the second quarter.

Interestingly, the above-noted increase in the "no change" category from a year ago (relative to the second quarter) carried through to other credit condition measures. Most importantly, measures of loan repayment and loan renewals or extensions appeared to be more positively oriented in the latest survey. In particular, only 26% reported that loan repayment rates declined, compared with 31% in the second quarter. In addition, the proportion of bankers who reported a higher incidence of loan renewals

Net farm income and government payments, 1999



or extensions declined to 27% in the third quarter from 35% in the second quarter.

While data from the reporting bankers suggested some improvement in credit conditions for the District overall, nevertheless, the responses indicated substantial diversity in credit conditions across the five states. Informal comments from many respondents appeared to reflect continued distress from low milk prices in the dairy industry. Given the relative importance of the dairy industry to Wisconsin agriculture it is not surprising that credit conditions, as reflected by the "loan repayment" and "loan renewals or extensions" measures reported by Wisconsin bankers, showed the least favorable conditions of the five District states. Forty seven percent of the Wisconsin bankers reported lower loan repayment rates, compared with a range for the other states of 16% in Indiana to 27% in Illinois. Similarly, the percentage of bankers facing a higher incidence of loan renewals or extensions was 37% for Wisconsin, compared with a range of 15% in Michigan to 29% in Illinois. To some degree this may reflect the relatively lower farm income support from government payments to Wisconsin farmers—see chart.

District bankers reported a break in the recent upward trend in interest rates on farm loans. On average, operating loan rates declined 26 basis points to 10.17%, as of the October 1 survey, following five consecutive quarters of increased rates. However, the average loan rate for farm real estate loans increased for the sixth consecutive quarter, up 21 basis points to 9.42%. Consequently, the rate spread between farm operating and farm real estate loans narrowed sharply to 75 basis points in the October 1 survey from 122 basis points in the July 1 survey.

Looking ahead

In addition to responding to current loan demand conditions, bankers were asked to report on their expectations for several categories of farm loan demand during the fourth quarter of 2000 (relative to a year earlier). Their pattern of responses with regard to near-term outlook for non-real-estate loan volume tended to mirror their responses during the third quarter, but they also indicated increased

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	9.42

[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.

stability in loan demand. For example, an unusually high (historically) 60% of the respondents indicated that they expected demand during the October to December period to remain the same as in the fourth quarter of 1999. In addition, an unusually low 24% of the bankers thought they would face a seasonal increase in demand for non-real-estate loans, while 16% expected a decrease in demand. Within this broad category of lending the most volatile type of lending appeared to be for farm machinery—a category that is closely associated with the farm-derived income cycle. Only 9% of the bankers reporting expected an increase in lending for farm machinery in the fourth quarter while 43% expected a decrease. By comparison, for example, in the third quarter of 1997, prior to the current agricultural downturn, 36% of banker respondents expected an increase in machinery lending in the next quarter while only 12% foresaw a decrease.

The proportion of bankers expecting increased demand for operating loans in the next quarter was only slightly lower (35%) than in the second quarter. However, these proportions are substantially below those reported during the early stages of the current cycle in 1998 and early 1999 (56% in both the fourth quarter of 1998 and the first quarter of 1999).

Bankers were also asked to evaluate the outlook for farm income, by enterprise, and to assess farm asset stability during the next three to six months, as compared to the fall and winter period of 1999-2000.

Not surprisingly, given current price levels, a large proportion of the respondents expected farmers' cash receipts from field crops and dairy to be down, 55% and 61%, respectively. Only 12% and 5% of bankers, respectively, expected receipts from crops and dairy to increase. Given the more favorable prices for fed beef and hogs, the bankers were evenly split in their outlook for earnings by cattle and hog farmers at one-third each for up, down, and unchanged.

Finally, bankers remained concerned about the financial situation of farm customers. When asked about the expected incidence of forced liquidation of assets, relative to a year ago, 39% of the bankers foresaw an increase. A year ago, 56% of the respondents thought asset liquidation would increase. Also, in the October 1, 1999, survey 60% or more of the respondents in Illinois, Indiana, and Iowa expected increased liquidations. However, in the October 1, 2000, survey, only Wisconsin bankers approached that level, with 58% expecting an increase in liquidations. In the remaining four states, between 30% and 42% of the bankers expected an increase in the incidence of asset liquidation.

Jack L. Hervey
Senior economist

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Federal Reserve Bank of Chicago
P.O. Box 834
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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)*	October	92	–6.1	1	–7
Crops *(index, 1990–92=100)*	October	89	–9.2	1	–11
Corn *($ per bu.)*	October	1.74	8.1	3	–9
Hay *($ per ton)*	October	85.20	3.0	12	2
Soybeans *($ per bu.)*	October	4.36	–4.6	–2	–16
Wheat *($ per bu.)*	October	2.70	10.7	5	–3
Livestock and products *(index, 1990–92=100)*	October	96	–2.0	0	–2
Barrows and gilts *($ per cwt.)*	October	43.20	2.6	24	53
Steers and heifers *($ per cwt.)*	October	69.80	1.7	0	14
Milk *($ per cwt.)*	October	12.60	–1.6	–15	–29
Eggs *(¢ per doz.)*	October	68.5	13.6	30	3
Consumer prices *(index, 1982–84=100)*	October	174	0.2	3	6
Food	October	169	0.1	2	4
Production or stocks					
Corn stocks *(mil. bu.)*	September 1	1,715	N.A.	–4	31
Soybean stocks *(mil. bu.)*	September 1	288	N.A.	–17	44
Wheat stocks *(mil. bu.)*	September 1	2,366	N.A.	–3	–1
Beef production *(bil. lb.)*	September	2.28	–6.6	0	4
Pork production *(bil. lb.)*	September	1.55	–5.4	–4	–2
Milk production* *(bil. lb.)*	October	11.9	3.4	3	7
Receipts from farm marketings *(mil. dol.)*	July	15,479	5.7	2	–2
Crops**	July	6,680	10.3	3	–11
Livestock	July	8,404	6.5	5	3
Government payments	.July	396	–43.4	–39	N.A.
Agricultural exports *(mil. dol.)*	August	4,259	11.1	8	15
Corn *(mil. bu.)*	August	188	23.0	2	37
Soybeans *(mil. bu.)*	August	58	16.2	2	120
Wheat *(mil. bu.)*	August	107	23.1	–4	8
Farm machinery sales *(units)*					
Tractors, over 40 HP	October	7,597	50.3	26	16
40 to 100 HP	October	5,289	37.9	35	16
100 HP or more	October	2,308	89.6	9	16
Combines	October	846	14.5	–6	2

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

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Federal Reserve Bank of Chicago
Public Information Center
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