



Chicago Fed Insights, August 2024

AgLetter Insights: Tightening Conditions Characterize Regional Agriculture in Second Quarter

By Chicago Fed Staff Writer

Agriculture Regional Economy

Economic conditions for agriculture continued to tighten in the Federal Reserve Bank of Chicago's five-state District, with farmland value increases slowing again and credit challenges growing. But this tightening follows some very strong years, explains David Oppedahl, lead author of the Chicago Fed's AgLetter and policy advisor at the Bank.

In this Q&A about the AgLetter's August 2024 issue, which covers this year's second quarter, Oppedahl talks about why midwestern farmers are in generally strong positions, explains what "beef-on-dairy" is, and shares the working title for the 2024 edition of the Chicago Fed's Midwest Agriculture Conference.

Q: So what do you think is the big headline coming out of the second quarter survey?

A: Nominal farmland values continue to have a slowdown in their increases for the District. Plus, when you adjust for inflation, farmland values actually moved down 1% relative to the previous year's second quarter. They've been kind of edging down from the double-digit increases that for a couple of years they had, and now this was the first time in 15 quarters since we had an increase of 2% or less. The agricultural credit conditions are weaker as well, so it's looking like a more challenging time lies ahead.

Q: Is there anything in particular that your respondents think accounts for these slowing increases in farmland value?

A: The primary factor has been the lower income levels when you adjust for costs, and basically the revenues have been falling quite a bit, especially for corn and soybeans. Livestock prices have risen some from last year, so there is a little recovery there. But for the District as a whole, the revenue decline is likely to be pretty big because of the decreases in corn and soybean prices.

Q: So the relationship is that direct: If prices—or revenues—for farm output are falling, then the farmland value also falls?

A: No, it's not an exact causation kind of relationship, but that's the general tenor that our respondents report to us. And certainly, purchasing farmland is a long-term buy. It's not something that you're expecting to flip tomorrow. And so you have to plan for the longer term. Certainly higher interest rates last year have come into play, too. That's probably slowed some of the borrowing to purchase farmland, but at the same time, we have seen farm mortgage rates kind of plateau.

Q: Reading the *AgLetter*, I noticed that a large majority of respondents said District farmland was overvalued and that not a single respondent said they thought it was undervalued.

A: Correct. The overvaluation idea has been there for a while in terms of the responses. And it is one of those things we've been following now for a couple of years, but it's still relatively new in terms of the questions we ask. So I don't put that much weight on it, but it does give us a sense of how people are thinking.

It's not surprising in this period where we've had a rapid run-up in farmland values that they're seen as probably overvalued. But at the same time, you have various interpretations of the decline in crop prices and how those are related.

So, yeah, when crop prices are down a lot, the bankers are like, “Whoa, purchasers should be adjusting instead of keeping the prices of farmland going higher.” But then you have not that much available land, and you still have a lot of funds that farmers had built up in recent years. They don't necessarily want to park it in a bank, even though you can actually earn something in a CD now versus previous to the interest rate increases.

Q: You mention in the *AgLetter* that farmland values in Wisconsin continue to grow. Why is that?

A: That can be partly traced to the fact that milk prices have recovered some. And so dairy operations probably have better balance sheets, enabling them to purchase land. It also seems like there's been a number of outside bidders that have been coming in and have been able to purchase farm ground that is at a higher price than what the local people might have been able to pay. Those kinds of trends are coming together there to keep farmland values in Wisconsin rising more than in the rest of the District.

Q: The outside interest in that land—is that something you've been able to document, or is that more anecdotal?

A: It's more anecdotal. We do sometimes ask a question about that, but not this quarter. But we did have some comments about outside bidders for farmland. And there's just a limited supply of ground available. So the number of buyers has, relative to that supply, been enough to keep the Wisconsin land prices rising faster.

Q: Agricultural credit conditions are getting weaker?

A: They were softer than a year ago, with repayment rates slowing down and the need for more loans to get extensions and renewals. So it's a period that's a little bit more of a challenge, but at the same time, it's been so strong in terms of credit conditions in recent years. For instance, loans without repayment problems were at their highest percentage in the survey's history just last year. And so for conditions to be coming down just a little bit off of that this year still indicates that even though they're weaker, they're in a pretty good situation. And farm balance sheets have been strong overall, though now there will be weaker working capital. Hopefully, we're in a state where it won't be that hard for farm operations to manage through any challenges.

Q: You mentioned lower working capital, and you quote an Iowa banker saying that is a strong predictor of challenges ahead for agriculture. Can you elaborate?

A: Without the working capital, you're not able to have normal operations. And so you have to borrow more. And if you're not having the income to support that borrowing, then you can get into some financial squeezes.

The factor that's favorable for our agricultural operations in the District is that so many of them have a strong financial position. And then others can free up some working capital in various ways, possibly by selling a small area of land. That's been a common approach in the previous decade.

I think this Iowa banker was just indicating that there are going to be challenges. We're coming off of some really strong years for net farm income. But now it will take better financial management for farm operations going forward.

Q: Pricing seems to be a challenge for the big commodity crops.

A: There's a lot of downward momentum to the corn and soybean prices. And if you look at the situation in terms of this year's crop, it's probably going to be a very big one. Maybe not a record in terms of total output, but the yields are likely to be records given that we're into August now and it's been a pretty good year in terms of moisture and other variables. If we have a really strong harvest, that'll probably put some additional downward pressure on prices.

Q: To an outsider, that seems a little bit of a paradox. You've got one respondent saying the area had almost perfect growing conditions. But as that plays out, that's going to put downward pressure on the prices farmers are able to get.

A: Yeah, that's usually the dynamic of the market, isn't it? That you have more quantity, then prices are going to be moving down. But how quickly that occurs, of course, is part of what's at play. For any individual farmer, they can't control the prices, but they can control how much land they plant and how well they farm it.

So they try to maximize their output, and when you gather everybody that's maximizing output together, you end up with quite a big crop—as long as there's not an area that has a major weather hiccup. This year, our entire District had been out of the drought conditions that had plagued us in the previous couple of years.

Q: There are a fair number of downward trends based on the farmland value surveys, but how would you characterize the overall picture? It doesn't sound like it's overly doom-and-gloom.

A: No. There are still threads of positive news within the agricultural sector. It's a period where we've had a couple of really, really strong years for incomes. And so it's just the natural cycle that you come down off of those kinds of periods. Where we're at right now is still fairly good in terms of the current year. But then these downward trends continue, and so there are concerns around how long they might continue.

Crop prices are still higher than they were in, say, 2020, but at the same time, will they move back down toward what they were in the period before that, which turned out to be a real slog for the agricultural sector? It's unclear. So that's where we're at: We're still in pretty decent shape, but it's concerning to producers that the price trends are headed down instead of stabilizing.

Q: We've talked about lowlights. Are there are any highlights?

A: The one very bright spot has been the beef cattle sector, where prices have kept moving higher. And one trend that's interesting to note in our District has been that a lot of dairy operations have started to focus on having what they call "beef-on-dairy," where you use a different kind of genetics to be able to have better beef production. In essence, the input of genetic technology allows more marketable beef characteristics to be introduced into calves that are born on dairies.

So they're taking advantage of some of the new technology out there to be able to come up with a profit opportunity. And that's something hopefully we'll be able to examine somewhat at the Chicago Fed's [Midwest Agriculture Conference](#) on December 3.

Q: And if I recall, looking at ag inputs was the broad idea for this year's conference. Is that still the plan?

A: Right, the role of inputs and how they've been changing in various ways, including the beef-on-dairy phenomenon. But then feed prices, too. And then also some fertilizer and crop input trends that are brewing, and some of the changes in terms of who's able to sell and buy inputs using the internet (and other digital tools) to help facilitate those transactions.

Q: Do you have a title yet, or a working title?

A: The Changing Landscape for Agricultural Inputs. That's the working title.

To learn more

Please see the most recent [AgLetter](#), covering the second quarter of 2024, and the [data on farmland values](#) in the Seventh Federal Reserve District.

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