The Agricultural Newsletter
from the Federal Reserve Bank of Chicago
Number 1900 *May 1998*

AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Our latest survey of agricultural banks in the Seventh Federal Reserve District found that farmland values continued to rise during the winter. The bankers reported that farmland values rose 2 percent during the first three months of 1998, while the year-over-year gain, as of April 1, averaged about one-tenth. The demand for new farm loans remained firm and the survey respondents reported a modest increase in available funding for farm loans. But loan repayments at agricultural banks deteriorated—compared with a year earlier—due to lower prices for most farm commodities.

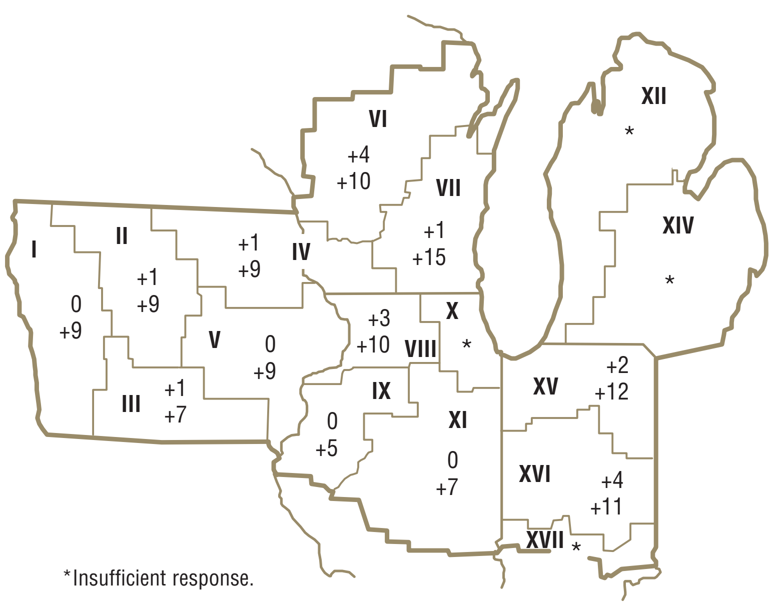
The trend in farmland values showed considerable variation among the five District states. Illinois and Iowa registered little change during the first quarter of 1998. Indiana and Wisconsin both showed a 3 percent rise, while the bankers in Michigan reported an increase of nearly 5 percent. The year-over-year change followed a similar pattern, with Illinois and Iowa showing the smallest increase and Michigan the largest. For the 12 month period ending in March, Illinois and Iowa registered gains of 7 percent and 9 percent, respectively. An increase of 12 percent was reported for both Indiana and Wisconsin, while Michigan registered a 15 percent rise.

The strength in farmland values seems unusual in light of the recent weakness in commodity prices and the outlook for farm income. Net cash income to the farm sector is expected to drop this year due to a decline in receipts from both crops and livestock. In particular, hog prices are down sharply from last year in response to extensive production gains. Furthermore, prices for corn and soybeans—two other predominantly midwestern agricultural enterprises—have shown little strength this year. The widely reported economic problems in Southeast Asia also contributed to lower exports of farm commodities in recent months. However, several factors that support farmland values are also in play. Milk prices have been quite strong this year. Government payments are fixed for the next few years, reducing uncertainty and allowing farmers greater freedom in responding to market signals when making their planting decisions. Lower costs for some inputs—especially feeds, feeder livestock, seed, and fuel—are expected to keep a lid on total cash expenses. And despite the recent downturn in farm exports, the General Agreement on Tariffs and Trade (GATT) has provided a framework to actively address trade barriers and make it more difficult for other nations to arbitrarily set up roadblocks to foreign sales of U.S. farm

Percent change in dollar value of "good" farmland

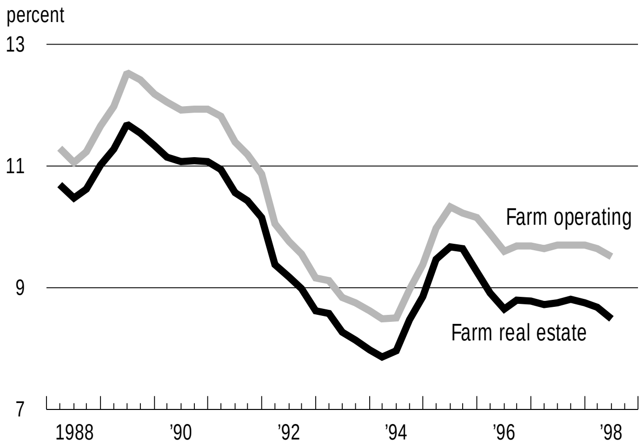
Top: January 1, 1998 to April 1, 1998
Bottom: April 1, 1997 to April 1, 1998

	January 1, 1998 to April 1, 1998	April 1, 1997 to April 1, 1998
Illinois	0	+7
Indiana	+3	+12
Iowa	0	+9
Michigan	+5	+15
Wisconsin	+3	+12
Seventh District	+2	+10



*Insufficient response.

Quarterly District farm loan rates



products. Finally, anecdotal reports suggest that some investors have moved funds out of financial assets and into real assets such as farmland.

Reflecting these developments, the survey results indicate that gains in the demand to purchase farmland simply outstripped the corresponding increase in the number of farms on the market. Over 55 percent of the responding bankers indicated there had been a year-over-year increase in the demand for farmland, while only 4 percent noted a decline. Demand was up in all District states, but especially in Indiana and Wisconsin. Nearly two-thirds of the bankers in these two states believed there had been an increase. On the supply side of the market, only 38 percent reported an increase in the number of farms for sale, while 16 percent observed a decline. The number of bankers reporting an increase in the amount of farmland for sale was highest in Illinois (50 percent) and lowest in Iowa (25 percent). Furthermore, the bankers indicated that nonfarm investors played a larger role—relative to farmers—in farmland purchases during the fall and winter. This was especially true in Indiana, Michigan, and Wisconsin.

The near-term outlook for farmland values is fairly optimistic. About one-third of the bankers expect farmland values to rise in the second quarter, while nearly all the rest anticipate a sideways trend. But the pattern of responses varied considerably across District states and was similar to that regarding the first-quarter change in farmland values. The bankers in Michigan and Wisconsin showed the most optimism, with about 60 percent in each state expecting an increase in the second quarter. Nearly 40 percent of the Indiana respondents expect an increase. A much smaller share of the Illinois and Iowa bankers—15 percent and 28 percent, respectively—anticipate further gains during the second quarter.

The bankers reported that cash rental agreements remain the preferred method of leasing farmland throughout the District, accounting for two-thirds of all rented ground. Thirty percent is rented on a crop-share basis. However, there is some variation among states. Cash rental arrangements account for 85 percent of the rented ground in Wisconsin, 75 percent in Michigan, and two-thirds in Indiana and Iowa. In Illinois, the proportion of land leased under cash rent agreements was only slightly larger than that leased under crop-share agreements (50 percent versus 45 percent). Like farmland values, cash rents were up from a year earlier, though not to the same extent. The reported increase averaged 5 percent for the District, ranging from 4 percent in Illinois and Michigan to 9 percent in Wisconsin.

Turning to credit conditions in the Seventh District, the survey responses showed that the demand for new farm loans was up throughout the District, with the loan demand index rising to 134 (see table). This measure is a composite of the 42 percent of the respondents that indicated loan demand was up from a year ago and the 8 percent that noted a decline. About half thought that loan demand was unchanged from a year earlier. The increase is likely due to a couple of factors. First, the year-over-year declines in livestock and grain prices that have persisted since last fall prevented some farmers from repaying loans as originally agreed, resulting in higher renewal balances. Moreover, some operators have been forced to place a greater reliance on borrowed funds to purchase new crop inputs. Second, a recent report from the U.S. Department of Agriculture indicated a substantial increase in the number of hogs on farms in Illinois, Indiana, and Iowa (and to a lesser extent, Michigan), which would increase producers' needs for working capital. As with the previous survey, the gains in loan demand appeared to be concentrated in Illinois and Iowa.

The bankers' ability to fund agricultural loan requests showed lackluster improvement during the first quarter. One-fourth of the respondents stated that fund availability had improved, while a tenth thought there had been a decline. A sizeable group believed there was little change from a year earlier. Furthermore, the funding situation appeared to be somewhat tighter in Michigan than in the other District states.

Bank liquidity, on average, was little changed from three months earlier. The average loan-to-deposit ratio at District agricultural banks on April 1 was reported at 70.6 percent. Moreover, 45 percent of the bankers indicated they are still below the desired ratio. Among the individual District states, the average loan-to-deposit ratio ranged from a low of 66.1 percent in Illinois to 77.2 percent in Michigan. Continued upward pressure on the loan-to-deposit ratio in the second quarter is likely due to seasonal increases in farm lending and the year-over-year gain reported in farm loan demand.

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)
1995							
Jan-Mar	122	96	98	64.8	10.33	10.26	9.68
Apr-June	124	104	93	66.1	10.24	10.20	9.64
July-Sept	123	104	98	67.3	10.16	10.14	9.27
Oct-Dec	111	123	119	64.9	9.89	9.88	8.93
1996							
Jan-Mar	125	125	117	65.0	9.62	9.63	8.66
Apr-June	116	114	108	65.8	9.69	9.69	8.81
July-Sept	122	113	112	68.2	9.70	9.68	8.80
Oct-Dec	122	110	94	67.6	9.64	9.61	8.73
1997							
Jan-Mar	134	110	105	67.6	9.71	9.65	8.77
Apr-June	134	97	94	69.7	9.72	9.68	8.83
July-Sept	131	97	93	70.2	9.71	9.69	8.76
Oct-Dec	120	109	95	70.7	9.65	9.63	8.69
1998							
Jan-Mar	134	113	84	70.6	9.52	9.51	8.50

[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.

Another factor contributing to an increase in loan-to-deposit ratios was the deterioration in farm loan repayments. The measure of loan repayments came in at 84 during the first quarter, down from the 95 recorded three months earlier. One tenth of the respondents reported that farm loan repayments were up relative to a year ago, while 26 percent reported a decline. The decline in repayments was relatively greater in Illinois and Iowa. Furthermore, the bankers reported an increase in the number of loan extensions and renewals requested. In general, the poor repayment performance reflects lower prices for farm commodities. In particular, market hog prices averaged a year-over-year decline of about one-third during the first four months of this year.

The interest rate charged on new farm loans by District agricultural banks dropped slightly in the first quarter. The average rate charged on farm real estate loans as of April 1 was 8.50 percent, about 20 basis points below the previous quarter's level. The average operating loan rate declined about 13 basis points from three months earlier to 9.52 percent. Among the individual District states, the farm real estate loan rate ranged from a low of 8.34 percent in Illinois and Iowa to a high of 9.05 percent in Michigan. Illinois registered the lowest operating loan rate at 9.19 percent, while Michigan recorded the highest at 10.06 percent.

Looking ahead, the surveyed bankers expect farm lending to register a year-over-year gain during the spring. Nearly 40 percent anticipate an increase in the volume of nonreal estate loans, while 10 percent expect a decline. The other half do not foresee any change from a year ago. Most of the gains in nonreal estate lending will be spurred by a rise in the volume of operating loans. The proportion of bankers expecting an increase in operating loan volume was especially high in Illinois and Iowa (60 percent), relative to the other three District states (about 30 percent). In comparison, one-fourth of the surveyed bankers expect farm machinery and real estate loans to register gains from last year.

Mike A. Singer

Notice to Subscribers

Future issues of the AgLetter will be published quarterly and will focus on the farmland values and credit conditions survey. The next issue will be published in late August, 1998.

AgLetter (ISSN 1080-8639) is published monthly by the Research Department of the Federal Reserve Bank of Chicago. It is prepared by Mike A. Singer, 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)*	April	105	2.9	–1	–3
Crops *(index, 1990–92=100)*	April	116	4.5	0.0	–9
Corn *($ per bu.)*	April	2.36	–7.1	–16	–39
Hay *($ per ton)*	April	101	3.6	–10	14
Soybeans *($ per bu.)*	April	6.22	–2.8	–24	–16
Wheat *($ per bu.)*	April	3.23	–2.7	–21	–39
Livestock and products *(index, 1990–92=100)*	April	95	0.0	–4	2
Barrows and gilts *($ per cwt.)*	April	35.50	0.9	–35	–30
Steers and heifers *($ per cwt.)*	April	66.40	3.3	–2	14
Milk *($ per cwt.)*	April	14.10	–2.1	7	1
Eggs *(¢ per doz.)*	April	63.5	–9.2	–4	–16
Consumer prices *(index, 1982–84=100)*	April	162.5	0.2	1	4
Food	April	159.8	0.1	2	5
Production or stocks					
Corn stocks *(mil. bu.)*	March 1	4,937	N.A.	10	30
Soybean stocks *(mil. bu.)*	March 1	1,203	N.A.	14	1
Wheat stocks *(mil. bu.)*	March 1	1,166	N.A.	42	42
Beef production *(bil. lb.)*	March	2.08	5.3	6	2
Pork production *(bil. lb.)*	March	1.60	9.5	12	12
Milk production* *(bil. lb.)*	April	11.56	–1.3	1	3
Receipts from farm marketings *(mil. dol.)*	January	20,378	3.2	–3	11
Crops**	January	10,412	–5.9	–7	–4
Livestock	January	8,137	2.3	3	10
Government payments	January	1,829	N.A.	N.A.	N.A.
Agricultural exports *(mil. dol.)*	January	4,809	–8.3	–4	–13
Corn *(mil. bu.)*	January	141	17.0	–25	–24
Soybeans *(mil. bu.)*	January	120	–21.0	–1	34
Wheat *(mil. bu.)*	January	84	3.5	58	–18
Farm machinery sales *(units)*					
Tractors, over 40 HP	April	9,628	20.3	13	20
40 to 100 HP	April	5,443	16.0	21	26
100 HP or more	April	4,185	26.4	3	12
Combines	April	836	48.8	37	25

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

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