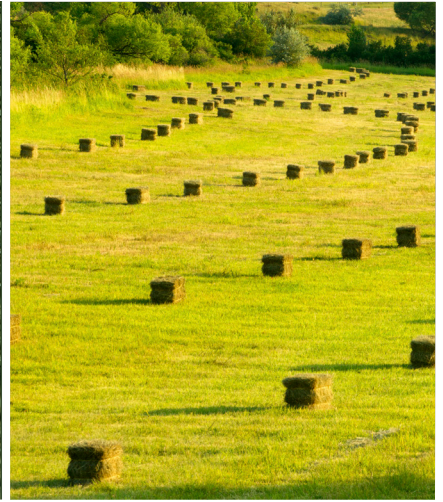


SURVEY of TENTH DISTRICT

Agricultural Credit Conditions



2nd QUARTER 2012

FEDERAL RESERVE BANK of KANSAS CITY

Farm Income Expectations Shrivel Amid Drought

*By Jason Henderson, Omaha Branch Executive, and
Maria Akers, Associate Economist*

After early spring rains, emerging drought conditions wilted District farm income expectations during the second quarter. At the beginning of the quarter, precipitation in the southern portions of the District led to a rebound in winter wheat production and farm incomes. Yet, by the end of the quarter, intensifying drought conditions were cutting bankers' expectations for farm income during the third quarter.

Bankers reported that livestock producers were bearing the biggest burden from the drought. Higher feed costs and lower cattle prices from forced herd liquidations were cutting livestock profits. Several survey respondents noted that high crop prices would support crop incomes for producers able to harvest a crop and those that have crop insurance.

Despite the weaker outlook for farm income, loan repayment rates were expected to hold near year-ago levels. Better than expected winter wheat yields and rising land lease revenues for mineral rights supported loan

repayments. Bankers commented that several years of strong farm income also bolstered farm balance sheets and improved debt-repayment capacity.

Although operating loan demand was sluggish in the second quarter, bankers expected loan demand to strengthen in the third quarter as drought boosted production costs. Poor pastures prompted many cow/calf producers to pay higher forage costs. Rising corn prices were also increasing the costs for cattle feedlot, hog, dairy, and poultry enterprises. Bankers indicated ample funds were available for farm loans and interest rates

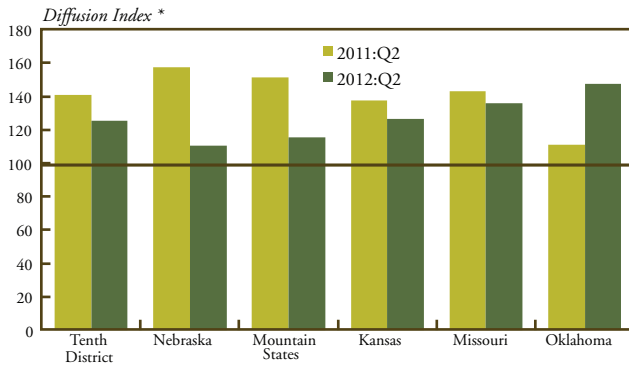
*...by the end of the quarter,
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farm income ...*

edged down further.

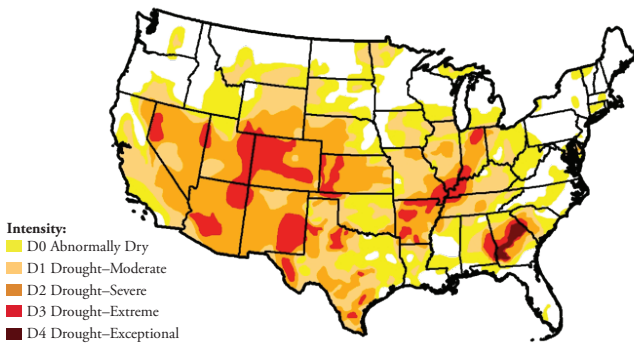
District farmland values rose less rapidly in the second quarter and remained well above year-ago levels. Nonirrigated cropland values rose solidly and irrigated cropland values held steady. Looking forward, more than three-quarters of survey respondents expected farmland values to hold at current levels during the rest of the growing season.



Chart 1
Tenth District Farm Income by State

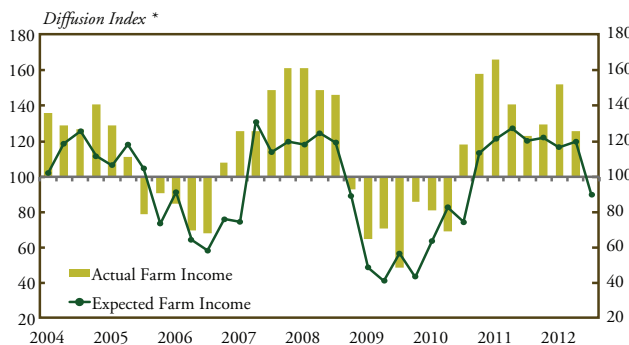


Map 1
U.S. Drought Monitor
June 26, 2012



Source: National Drought Mitigation Center

Chart 2
Tenth District Farm Income



Favorable spring weather kept District farm income above year-ago levels during the second quarter. Early spring rains in the southern Great Plains led to better-than-expected winter wheat yields in Kansas and Oklahoma. The bigger wheat crop in 2012 contributed to stronger farm income during the quarter (Chart 1). In addition, rising land lease revenues from mineral rights contributed to rising income in energy-intensive areas.

By the end of June, intensifying drought conditions cut bankers' expectations for farm income this fall (Map 1). The expectations index for farm income fell sharply as more bankers expected farm income to decline with deteriorating crop conditions and soaring feed costs (Chart 2). With pastures in poor condition, many cow/calf operators weaned calves early and either paid high prices for supplemental feed or liquidated herds. Several survey respondents noted livestock sales had risen sharply, boosting farm income in the short term but reducing cow inventories in the longer run. Cattle feedlot operators and hog, dairy, and poultry enterprises struggled with rising feed costs.

Bankers were concerned by how quickly nonirrigated crops were deteriorating. In addition, farmers were irrigating crops earlier than normal, and below normal mountain snowpack was limiting irrigation in some regions of the District. Although high crop prices may help offset lower yields, many bankers expected crop incomes to depend more heavily on crop insurance this year.

** Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than 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.*



Chart 3
Tenth District Expected Farm Income and Capital Spending

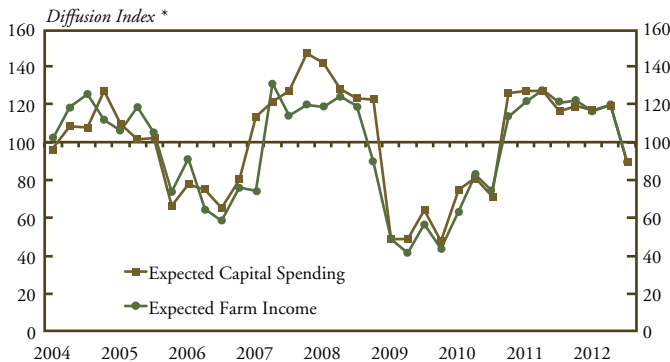


Chart 4
Tenth District Farm Interest Rates

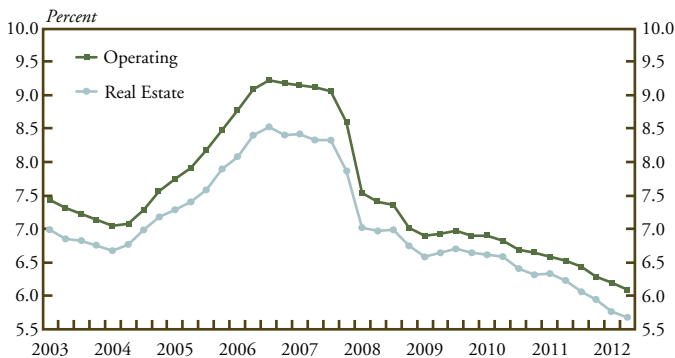
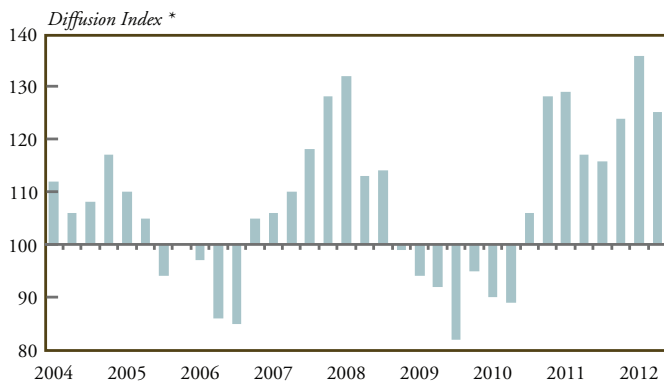


Chart 5
Tenth District Farm Loan Repayment Rates



Bankers expected drought-reduced income to limit capital spending, but boost operating loan demand. After sluggish operating loan demand in the second quarter, rising fuel and feed expenses were expected to increase operating loan demand in the coming months. In contrast, intermediate-term loan demand for farm machinery and equipment was expected to fall with weaker farm income and capital spending (Chart 3). In addition, capital spending during the past year limited the demand for further equipment upgrades by some agricultural enterprises.

Bankers reported plenty of funds were available to satisfy a potential rise in farm operating loan volumes. In addition, financing costs fell as farm interest rates dipped to new lows. The average interest rate on farm operating loans fell to 6.1 percent and the average interest rate on farm real estate loans was 5.7 percent in the second quarter (Chart 4). Collateral requirements for farm loans eased further and very few banks referred borrowers to nonbank credit agencies.

Farm loan repayment rates held at high levels and fewer banks reported requests for loan renewals or extensions in the second quarter (Chart 5). In fact, most banks had few nonperforming farm loans, and those with delinquencies indicated that most repayment issues could be managed without major loan restructuring or forced sale of assets. Looking forward, more than three-quarters of survey respondents anticipated loan repayment rates would match year-ago levels despite weaker farm income expectations. Several years of strong farm profits, crop insurance payments and land lease revenues were some of the factors bankers felt would support loan repayment rates.

**Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than 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.*



Chart 6
Expected Trend in Tenth District Farmland Values

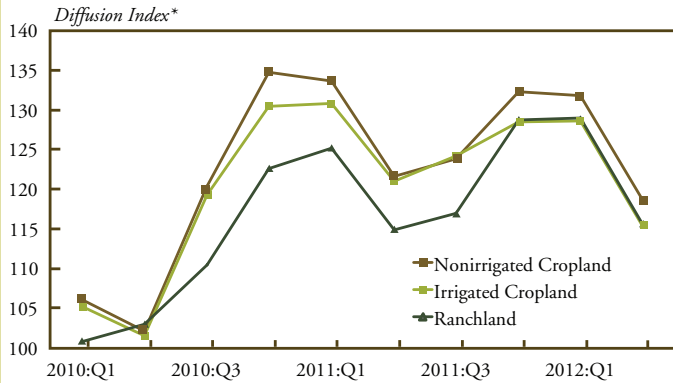


Chart 7
Tenth District Farmland Values—Annual Gains

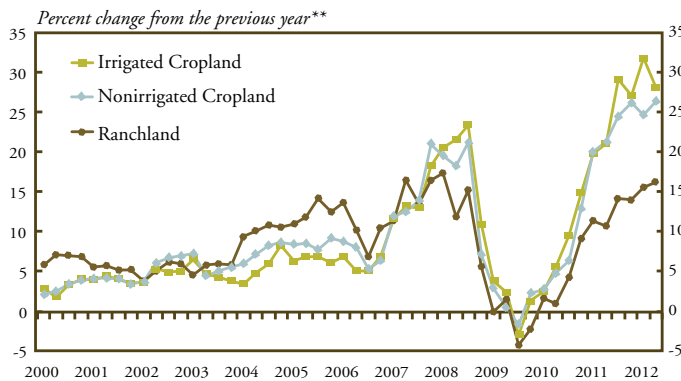


Table 1
Tenth District Farmland Value Gains
Percent change from the previous year**

	Nonirrigated	Irrigated	Ranchland
Kansas	23.5	25.0	18.3
Missouri	18.6	n/a***	8.0
Nebraska	36.5	35.3	26.7
Oklahoma	15.0	10.9	10.6
Mountain States	19.8	28.2	16.2
District	26.4	28.2	16.2

** Percent changes are calculated using responses only from those banks reporting in both the past and the current quarter.

*** Not reported due to small sample size.

After surging at the beginning of the year, District farmland values rose less rapidly during the second quarter. District farmland values rose less than 3 percent during the second quarter, roughly half the rate of growth experienced at the beginning of the year. Nonirrigated cropland values rose solidly, while irrigated cropland values held steady and ranchland values edged up. The index of future farmland value gains declined sharply as more than three-quarters of survey respondents felt that farmland values would hold steady through the fall (Chart 6).

Despite the slower quarterly gains, District farmland values remained well above year-ago levels. During the second quarter, District irrigated and nonirrigated cropland prices remained more than 25 percent above year-ago levels (Chart 7). Ranchland values climbed higher with annual value gains averaging 16 percent. Bankers noted that strong demand for farmland raised interest in more marginal tracts of land with production potential. Although the number of farmland sales remained low during the growing season, some bankers expected the number of sales to rise after harvest.

Nebraska continued to lead District annual farmland value gains with cropland prices more than 35 percent above year-ago levels and ranchland values almost 27 percent higher (Table 1). However, annual farmland value gains in Nebraska were beginning to slow with less rapid land value growth during the second quarter. Oklahoma bankers reported the smallest year-over-year gains in farmland values as many areas of the state endured a second year of extreme drought.

**Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than 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.*



BANKER COMMENTS *from* the TENTH DISTRICT

“Current concern is drought, crop insurance will play a big part in helping farmers through the year.”
– Western Missouri

“Looking forward, crop yields due to ongoing drought may be affected, however, higher prices may hold income steady.”
– Eastern Nebraska

“The drought is having a major impact on fall crop production outlook and input costs are high. All operating loans will be analyzed to determine crop insurance guarantees and their impact on the loan’s profit potential.”
– Western Kansas

“Expenses will rise and income will be down due to drought.”
– South-Central Nebraska

“Lower crop prospects have kept some farms from sellin at higher prices.”
– North-Central Missouri

“Approximately one-third of irrigated acres have not been planted this year due to extreme low snowpack. Pastures are poor and ranchers are having to supplement with high-dollar feed.”
– Southeast Colorado

“Land values have increased in our area mostly due to oil and gas exploration and production putting a lot of money into our economy. Since investment returns are so low right now, people are buying land.”
– Western Oklahoma

“Drought has limited irrigation to under half of normal. Mineral leasing has been strong.” – Eastern Colorado

“Selling yearlings early, causing income to go up this time of year.”
– Eastern Wyoming

“Oil lease money and crop insurance continue to help prop up the local economy.”
– Western Kansas

“Severe drought conditions continue to reduce crop yields and are causing liquidation of livestock. Local sale barns are selling 10 times the number of cattle compared to last year.”
– Eastern Wyoming

Note: 241 banks responded to the second-quarter Survey of Agricultural Credit Conditions in the Tenth Federal Reserve District—an area that includes Colorado, Kansas, Nebraska, Oklahoma, Wyoming, the northern half of New Mexico and the western third of Missouri. Please refer questions to Jason Henderson, Omaha Branch executive, or Maria Akers, associate economist, at 1-800-333-1040, or Jason.Henderson@kc.frb.org or Maria.Akers@kc.frb.org. The views expressed in this article are those of the authors and do not necessarily reflect the views of the Federal Reserve Bank of Kansas City or the Federal Reserve System.

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