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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary

A survey of more than 330 agricultural bankers in the five Seventh District states indicated that gains in farmland values slowed in the most recent quarter from those reported for the previous two quarters. An increase of less than 1% in the second quarter (April 1-July 1), compared with a 2% gain in the first quarter, represented the lowest rate of increase since the third quarter of 1999. On a year-over-year basis, farmland values were reported up 5% from the July 1,1999, survey. This was the largest year-to-year increase since an 8% gain reported in the second quarter of 1998.

Credit conditions reported by the surveyed banks indicated that, on average, loan demand had weakened relative to a year ago and that loan-to-deposit ratios continued to increase, as had been the case in recent years. Loan repayment rates continued to be sluggish. Although repayment rates showed some improvement from a year ago, they remained well below those reported in the mid-1990s. Bankers reported that interest rates on agricultural loans increased from the previous quarter, as has been the case in each survey beginning with the second quarter of 1999. The bankers also reported that the availability of funds, under current conditions, retracted sharply in the most recent quarter, relative to a year ago.

Farmland values

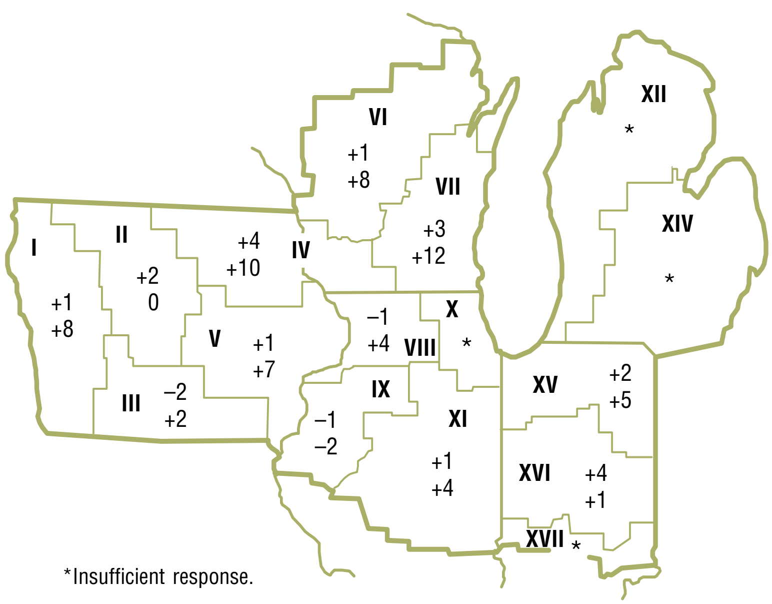
A divergence in the pattern of change in farmland values reappeared in the latest survey. During the two previous surveys, quarter-to-quarter changes in farmland values in Illinois and Iowa turned to fairly strong positive numbers from the negatives reported for most of 1998 and 1999. However, during the most recent quarter, farmland values in Illinois remained unchanged, on average, and in Iowa the gains slowed to 1%. From a regional perspective, within these two states the weakness in farmland values tended to be concentrated in the western and southern regions of Iowa (areas hardest hit by early-season dry weather and crop uncertainty) and the western and southwestern regions of Illinois (where concerns about early season crop conditions also may have been a factor).

Nonetheless, on a year-over-year basis, farmland values in Illinois and Iowa were up 3% and 4%, respectively. By comparison, farmland prices in Indiana were reported strong in the most recent quarter, up 3% from the first quarter of 2000 and up 3% from a year ago. Bankers in Wisconsin reported that farmland prices were up 2% in the second quarter, with a year-over-year gain of 10%. Wisconsin's quarterly and year-over-year gains continued in line with what survey respondents have reported for the last five years. Responses from the Michigan survey were insufficient to report; however, they seemed to suggest that

Percent change in dollar value of "good" farmland

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

	April 1, 2000 to July 1, 2000	July 1, 1999 to July 1, 2000
Illinois	0	+3
Indiana	+3	+3
Iowa	+1	+4
Michigan	*	*
Wisconsin	+2	+10
Seventh District	+1	+5



*Insufficient response.

increases in farmland values reported in recent years (similar in magnitude to the reports from Wisconsin) had slowed in the second quarter of 2000.

Weakness in farmland values in some areas of the District, especially in the heart of the corn belt, is not surprising given continued commodity price weakness in corn, soybeans, and some fruit crops—all important commodities to the farm economies of one or more regions of the Seventh District. Weak milk prices in the first quarter turned modestly stronger in the second quarter and may have helped support farmland values in Wisconsin, where dairy is an especially important contributor to agricultural incomes.

Farm derived income doesn't tell the whole story

Considerable diversity in the condition of various sectors of the agricultural industry continued through the first half of the year. Indeed, a number of banker respondents noted concerns about the weakness in commodity prices and expressed reservations about the future financial health of the farm sector if such prices persist. Nonetheless, the USDA's most recent forecast for crop production indicated an expected record output for corn and soybeans this year. And, despite low prices for these commodities, the USDA's latest farm income forecast indicates that this record output will contribute to a modest increase in cash farm receipts from these crops during the current year, albeit from the low levels of 1999.

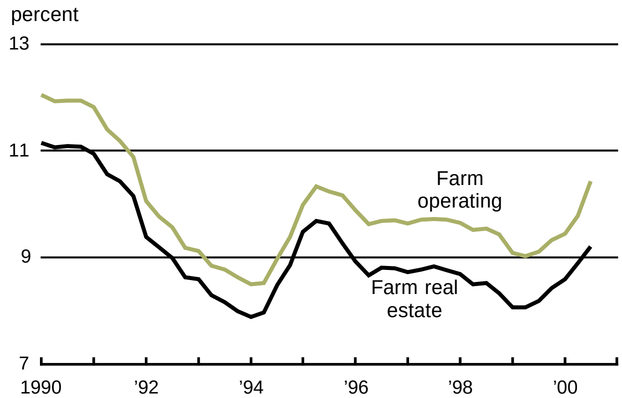
At the same time, taking a broader perspective, some agricultural operations have benefited from low grain prices—hog, fed beef, and dairy operations, in particular, may see lower costs for some feed inputs, thus improving profit margins (or reducing loss margins). Higher prices for hogs, relative to a year ago, are forecast to result in a substantial increase in cash receipts from these operations in the current year. On the other hand, cash receipts from sales by dairy and fruit farmers are expected to drop substantially from a year ago.

Given these conditions, it comes as a surprise to some that in the aggregate, net farm income is expected to increase 6% from the 1999 level to $46.1 billion in 2000—the largest since $48.6 billion in 1997. "Emergency" farm assistance legislation recently signed into law (in response to low and/or falling commodity prices) will result in an increase in direct government payments to agriculture during 2000 (this is the third consecutive year in which "emergency" legislation has increased direct government payments to agriculture). Direct payments are estimated by the USDA to total $22.7 billion for the current year, as compared with $15.8 billion in 1999, and a much lower $7.5 billion as recently as 1997. Should the farm output and direct government payments estimates hold, government payments relative to total farm sector receipts from crops and livestock will rise to an equivalent of 11.7% in 2000. This would compare with 10.9% in 1999 and 3.6% in 1997.

Credit conditions in the District

While net farm income is expected to increase this year, credit conditions reported by District bankers suggest that farmers and bankers may be responding to the low prices for agricultural commodities by pulling back on borrowing/lending activity in order to reduce the risk of overextension. Increased demand for non-real-estate loans (relative to a year ago) was reported by 32% of the respondent bankers. This percentage was down slightly from that reported in the first quarter. At the same time, a reduced proportion of the bankers noted an increase in non-real-estate loan demand. As a result, the loan demand index for non-real-estate farm loans in the second quarter stood at 109. In the first quarter it stood at 121 and in the second quarter of 1999 the index was 115.

Quarterly District farm loan rates



In some sense, bankers might consider the weakness in loan demand fortuitous. On average, bankers reported a substantial reduction in the availability of funds (given current financial market conditions). Fewer bankers reported increased availability and more reported decreased availability—the number of banks reporting no change from a year ago also declined. As a result, the funds availability index in the second quarter stood at 76, as compared with 95 in the first quarter.

Bankers reported that interest rates on farm loans rose again in the second quarter of 1999. Average operating loan rates increased to 10.43%, up 65 basis points from the first quarter average and the largest quarter-to-quarter increase since the early 1980s. Average loan rates for farm real estate loans rose to 9.21%, a 32 basis point increase, and the largest quarter-to-quarter increase since the fourth quarter of 1994. It is interesting to note that the rate spread between farm operating and farm real estate loans increased to 122 basis points, the largest since before 1982. This may, in part, reflect an increase in the risk premium placed on what may be considered the less well secured operating loan category.

Despite the expected increase in net farm income this year, bankers indicated that farm loan repayments remain under some stress, although less so than during 1999. Only 3% of the respondents observed a more rapid rate of loan repayment, relative to a year ago. While this rate was about the same as those reported during most of 1998 and 1999 it was well below the 10% of the bankers who reported more rapid repayment in the fourth quarter of 1999 and first quarter of 2000. However, in the most recent survey, substantially fewer banker respondents reported a slowing in

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

[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.

loan repayment; two-thirds of the bankers reported no change in the repayment rate relative to a year ago.

Some reduction in financial stress also was indicated in bankers' responses to a survey question on loan repayment classification. They were asked to assign their farm loans to four repayment categories: 1. No significant repayment problems; 2. Minor repayment problems; 3. Major repayment problems (that require more collateral or a long-term workout); and 4. Severe problems (likely to result in losses or forced sale of the borrower's real assets). Respondents indicated that 84% of their portfolios presented no significant problems, while 11% had minor problems, 4% involved major problems, and 1% represented severe problems. A year ago the breakdown on these responses were 78%, 14%, 6%, and 2%, respectively.

Looking ahead

A further indication of a weakening in loan demand was evident in banker respondents' outlook for loan volume in the third quarter of 2000 (relative to a year earlier). When asked to indicate their near-term expectation for non-real-estate loan volume their responses resulted in a loan-demand expectations index of 100. In the first-quarter 2000 survey this index stood at 117.

Weakness in expectations for non-real-estate lending was especially evident for farm machinery loans, where the outlook continued to deteriorate. The index for farm machinery loan expectations (for the third quarter of 2000) stood at 61 in the second quarter, thus indicating that a substantially larger proportion of the bankers expect a decrease than expect an increase in farm machinery loans (again, this expectation is relative to the volume of such loans in the third quarter of 1999).

Bankers' expectations for activity in operating loans lend further credence to the notion of a weakening in demand for farm loans. In this case, the proportion of bankers anticipating increased demand continues to trend downward, while the proportion expecting a reduction in operating loans has remained relatively stable during the past several years.

Another indicator of credit conditions is reflected in lenders' reliance on loan guarantees. Bankers were asked to indicate if they expect to rely more heavily on the USDA's Farm Service Agency (FSA) farm loan guarantees during the next three months (i.e., July-September) than they did during the same period a year ago. Thirty-one percent of the respondent bankers indicated that they expect to increase their reliance on FSA guarantees during the third-quarter of 2000. This number was down, however, from 39% of respondents who answered similarly in the first quarter 2000 survey, and was well below the 56% response in the first quarter of 1999. The proportion of lenders expecting to reduce their utilization of the guarantees held at 8% in the most recent survey.

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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)*	July	98	–1.0	3	–4
Crops *(index, 1990–92=100)*	July	95	–4.0	0	–11
Corn *($ per bu.)*	July	1.55	–18.8	–11	–29
Hay *($ per ton)*	July	80.20	–2.8	2	–9
Soybeans *($ per bu.)*	July	4.48	–8.9	7	–27
Wheat *($ per bu.)*	July	2.34	–6.4	5	–9
Livestock and products *(index, 1990–92=100)*	July	101	1.0	6	5
Barrows and gilts *($ per cwt.)*	July	50.00	1.2	55	33
Steers and heifers *($ per cwt.)*	July	71.00	–0.7	9	16
Milk *($ per cwt.)*	July	12.70	4.1	–8	–11
Eggs *(¢ per doz.)*	July	57.2	–9.1	–4	–2
Consumer prices *(index, 1982–84=100)*	July	173	0.2	4	6
Food	July	168	0.5	3	5
Production or stocks					
Corn stocks *(mil. bu.)*	June 1	3,587	N.A.	–1	18
Soybean stocks *(mil. bu.)*	June 1	775	N.A.	–9	30
Wheat stocks *(mil. bu.)*	June 1	950	N.A.	0	32
Beef production *(bil. lb.)*	June	2.37	2.9	2	5
Pork production *(bil. lb.)*	June	1.54	–0.3	–3	6
Milk production* *(bil. lb.)*	July	12.2	0.9	5	8
Receipts from farm marketings *(mil. dol.)*	April	14,618	–9.6	5	2
Crops**	April	5,892	–9.4	–1	–17
Livestock	April	7,670	–12.0	2	6
Government payments	April	1,056	11.6	94	N.A.
Agricultural exports *(mil. dol.)*	May	4,022	2.7	10	2
Corn *(mil. bu.)*	May	144	–5.8	–5	27
Soybeans *(mil. bu.)*	May	46	–9.9	20	64
Wheat *(mil. bu.)*	May	90	16.2	3	29
Farm machinery sales *(units)*					
Tractors, over 40 HP	July	6,421	–10.1	14	–6
40 to 100 HP	July	5,228	–10.8	16	20
100 HP or more	July	1,193	–6.9	9	–53
Combines	July	509	16.2	43	–45

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

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