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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary

The 2003 annual increase of 7 percent in the value of “good” agricultural land for the Seventh Federal Reserve District matched the rise of last year, the biggest increase since 1997. Based on a survey of 284 agricultural bankers as of January 1, 2004, the quarterly gain in farmland values for the District was once again 2 percent, on average. Over half the bankers expected farmland values to increase over the next three months and very few expected farmland values to fall.

Agricultural credit conditions improved noticeably from both last quarter and a year ago, according to District bankers. Loan repayment rates actually rose relative to a year earlier, which had not happened since 1997. Both the demand for loans and renewal or extensions in the fourth quarter were essentially the same as the level of a year ago. Only 10 percent of banks required increased collateral when compared with the fourth quarter of last year. There was continued improvement in the availability of funds, though the pace was the lowest of the past year. Interest rates on agricultural loans moved down again, but real estate loan rates were not quite as low as six months ago. Loan-to-deposit ratios fell to the lowest level since 1999. Overall, these improvements brightened the District’s agricultural credit conditions, pushing back concerns about the financial situation in the agricultural economy for at least a quarter.

Farmland values

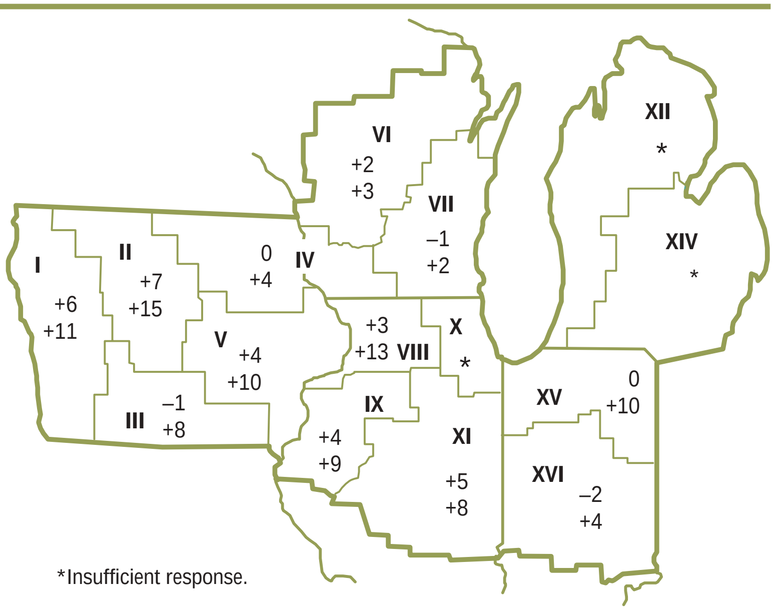
Even as the value of “good” agricultural land increased in all the states of the District last year, not all states experienced increases in the fourth quarter of 2003 (see table and map below). From October 1, 2003, to January 1, 2004, Illinois led the District with a 5 percent increase in farmland values, followed closely by Iowa at 4 percent. The change in farmland values for Indiana and Wisconsin trailed the other states with a 1 percent decrease and no change (quarter-to-quarter), respectively. While low prices in the dairy industry have hurt Wisconsin land values recently, there does not seem to be an easy explanation for Indiana’s down quarter.

Last year’s District farmland values rose on average 7 percent, equaling the results of 2002 (see chart 1). State increases ranged from a 10 percent gain in Iowa down to 3 percent gains in Michigan and Wisconsin, where the annual change was the smallest in a decade. Fifty-two

Percent change in dollar value of “good” farmland

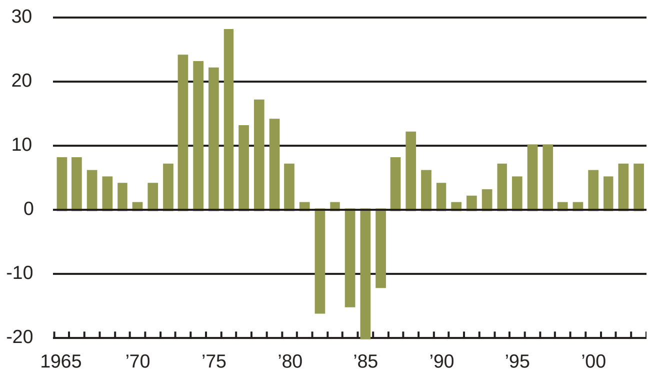
Top: October 1, 2003 to January 1, 2004
Bottom: January 1, 2003 to January 1, 2004

	October 1, 2003 to January 1, 2004	January 1, 2003 to January 1, 2004
Illinois	+5	+9
Indiana	–1	+6
Iowa	+4	+10
Michigan	+3	+3
Wisconsin	0	+3
Seventh District	+2	+7



*Insufficient response.

1. Annual percentage change in Seventh District farmland values



percent of Seventh District bankers expected farmland values to rise, with only 1 percent projecting a fall during the next three months. In all states there were more respondents that predicted farmland values to rise than fall. In Illinois and Iowa, 60 percent of the bankers that responded anticipated an increase in farmland values. Factors cited by respondents as reasons for increased farmland values included demand for hobby farms, development, and nonfarm investors, all competing for the relatively small amount of available land.

Credit conditions

Credit conditions in the District were the best in many years. Especially improving the credit picture, non-real estate farm loan repayment rates rose, boosted by higher corn and soybean prices in particular. Almost 20 percent of the bankers reported higher rates of loan repayment, while 15 percent reported lower rates. The index of loan repayment rates climbed to 104, the highest since 1997 (see table on page 3). Iowa, closely followed by Illinois, had the highest percentage of banks report higher rates of loan repayment compared with a year ago. Even in Wisconsin there was improvement, as loan repayments seemed to stabilize after the problems of the past several years. Moreover, just 4.5 percent of the volume of the agricultural loan portfolios held by the respondents was deemed to have major or severe repayment problems, a small decline from six months ago.

Fifteen percent of bankers reported higher renewals and extensions of loans relative to a year earlier, compared with 25 percent last year. With 14 percent of the bankers noting a decrease, the net number of renewals and extensions was close to that of a year ago. Indiana and Wisconsin bankers reported movement toward higher levels of loan renewals and extensions, whereas Iowa bankers reported lower levels of renewals and extensions.

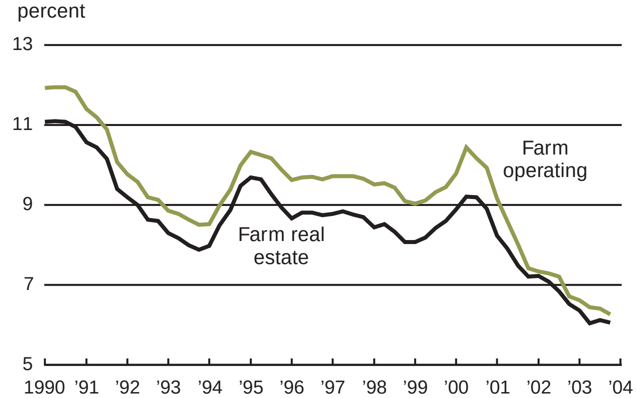
The demand for non-real estate loans dipped in the fourth quarter from the level of a year ago, as the index of loan demand moved down to 97. While 19 percent of the bankers reported an increase in the demand for non-real estate loans, 22 percent reported a decline. Iowa was the only state with higher non-real estate loan demand. Indiana, Michigan, and Wisconsin had lower demand for non-real estate loans last quarter.

Bankers across the District reported they had more funds available during October, November, and December than a year earlier. Almost a third of the respondents reported higher fund availability and only 4 percent lower. The index of fund availability was down slightly to 127, capping the third consecutive year of improvement.

However, it was again more difficult for borrowers to obtain some of the available funds. Collateral requirements continued to tighten at District banks as 10 percent of banks required a higher level of collateral in the past three months (though down from 18 percent a year ago). The respondents indicated there was less tightening in credit standards for agricultural loans from October to December 2003 (30 percent versus 46 percent in 2002). Even so, 2 percent of customers with operating credit are not likely to qualify for new credit this year from the reporting banks, a percentage point lower than the previous year.

Interest rates on agricultural loans fell in all categories (see chart 2). As of January 1, 2004, the District average for interest rates on new operating loans was 6.26 percent, a 417 basis point drop from the cyclical peak of three years ago. At an average of 6.05 percent, interest rates for farm mortgages were down again, almost to the level of six months ago following an increase last quarter. The interest rate spread in the fourth quarter was the narrowest of the year.

2. Quarterly District farm loan interest rates



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)*
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	9.18
Oct-Dec.	105	92	81	74.9	9.92	9.90	8.90
2001							
Jan-Mar	118	101	67	75.0	9.16	9.17	8.23
Apr-June	106	109	73	75.1	8.60	8.58	7.91
July-Sept	91	127	86	74.9	8.01	8.07	7.47
Oct-Dec	101	129	75	72.8	7.41	7.51	7.21
2002							
Jan-Mar	108	118	66	72.7	7.33	7.48	7.22
Apr-June	105	120	71	75.1	7.28	7.35	7.08
July-Sept	99	124	76	75.7	7.21	7.26	6.84
Oct-Dec	101	130	88	73.2	6.70	6.78	6.51
2003							
Jan-Mar	109	130	79	72.4	6.61	6.75	6.36
Apr-June	99	138	84	72.7	6.43	6.52	6.04
July-Sept	95	129	86	72.9	6.41	6.47	6.12
Oct-Dec	97	127	104	71.8	6.26	6.35	6.05

[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.

Looking forward

Respondents foresee increased loan volume in the year ahead, particularly for farm machinery loans. Comparing the first quarter of 2004 with the first quarter last year, 27 percent of the bankers indicated that they projected higher non-real estate loan volume, while 15 percent expected lower volume. More respondents expected increases in operating loans (35 percent) and Farm Service Agency (FSA) guaranteed loans (22 percent), rather than decreases (about 10 percent for both). Just over a quarter of the bankers looked for higher real estate loan volume, more than the 11 percent that looked for lower volume. Lower expected volumes for both feeder cattle and dairy loans reflected the impact of an incident of mad cow disease and diminished prices. Grain storage construction loans were also expected to drop in volume, even though storing crops has proven profitable this season. The biggest change in expectations was that farm machinery loan volume would rise, except in Wisconsin, during January, February, and March compared to a year ago.

Bankers anticipated that farmers would boost capital expenditures in the year ahead, though about half of the respondents foresaw no change in the level of capital expenditures from last year. The brightest prospects were for machinery and equipment with 45 percent of the bankers looking for higher spending, as well as 37 percent for higher spending on trucks and automobiles. For buildings and facilities, only 18 percent were seeing higher expenditures and 19 percent lower levels. Expenditures on land purchases or improvements were projected by 27 percent to be higher than last year and by 14 percent to be lower.

There continued to be expectations of expanded use of biotechnology, as 36 percent of respondents for corn and 28 percent for soybeans expected the number of acres planted with genetically modified organisms (GMOs) to increase this year. Only 5 percent of the bankers anticipated a decline in the use of GMO seed. There was no change in the willingness of banks to finance GMO seed purchases (only 3 percent were not willing).

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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*)	January	111	–1.8	11	17
Crops (*index, 1990-92=100*)	January	115	0.0	12	22
Corn *($ per bu.)*	January	2.46	6.0	6	25
Hay *($ per ton)*	January	79.30	–2.5	–13	–14
Soybeans *($ per bu.)*	January	7.82	9.1	42	85
Wheat *($ per bu.)*	January	3.73	1.1	–4	30
Livestock and products (*index, 1990-92=100*)	January	107	–4.5	11	11
Barrow and gilts *($ per cwt.)*	January	36.10	4.3	8	–6
Steers and heifers *($ per cwt.)*	January	81.20	–15.2	4	14
Milk *($ per cwt.)*	January	13.1	–4.4	12	–4
Eggs (*¢ per doz.*)	January	92.6	6.7	46	48
Consumer prices (*index, 1982-84=100*)	January	185	0.5	2	5
Food	January	184	0.1	4	5
Production or stocks					
Corn stocks (*mil. bu.*)	December 1	7,945	N.A.	4	–4
Soybean stocks (*mil. bu.*)	December 1	1,686	N.A.	–20	–26
Wheat stocks (*mil. bu.*)	December 1	1,521	N.A.	15	–6
Beef production (*bil. lb.*)	January	1.92	–2.6	–16	–18
Pork production *(bil. lb.)*	January	1.76	–5.6	1	3
Milk production* *(bil. lb.)*	January	12.5	1.5	–1	1
Receipts from farm marketings *(mil. dol.)*	November	22,248	–2.6	19	11
Crops**	November	12,529	–4.8	23	14
Livestock	November	9,719	0.4	15	7
Agricultural exports *(mil. dol.)*	December	6,048	–3.2	22	29
Corn *(mil. bu.)*	December	194	16.4	20	36
Soybeans *(mil. bu.)*	November	187	12.0	22	18
Wheat *(mil. bu.)*	November	78	–23.9	–1	–24
Farm machinery *(units)*					
Tractors, over 40 HP	January	5,801	–16.0	47	38
40 to 100 HP	January	3,776	–28.7	32	25
100 HP or more	January	2,025	25.6	86	69
Combines	January	253	–55.3	44	38

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