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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary

Farmland values jumped 15 percent in the third quarter of 2007 from the third quarter of 2006 in the Seventh Federal Reserve District. Compared with the second quarter of 2007, the value of "good" agricultural land increased 4 percent. With responses from 222 agricultural bankers, the survey, as of October 1, 2007, indicated vigorous interest by farmers in purchasing farmland, given brighter prospects for higher levels of farm income. More than half of the respondents anticipated rising farmland values in the fourth quarter of 2007.

Third quarter agricultural credit conditions were little changed from the second quarter of 2007, but looked better than a year ago, according to District bankers. Demand for non-real-estate loans strengthened from demand in the third quarter of 2006. Funds availability increased for District banks, while collateral requirements tightened slightly. District loan repayment rates rose, and loan renewals and extensions fell from the third quarter a year ago. Average interest rates on agricultural loans eased a bit since the start of July. The average loan-to-deposit ratio edged up from three months ago to 78.1 percent, 3 percent below the preferred ratio. Overall, District agricultural credit conditions have rarely seemed better in recent decades, leading some bankers to fear overcommitments by farmers, given elevated land values and stiff competition for acres to rent in 2008.

Farmland values

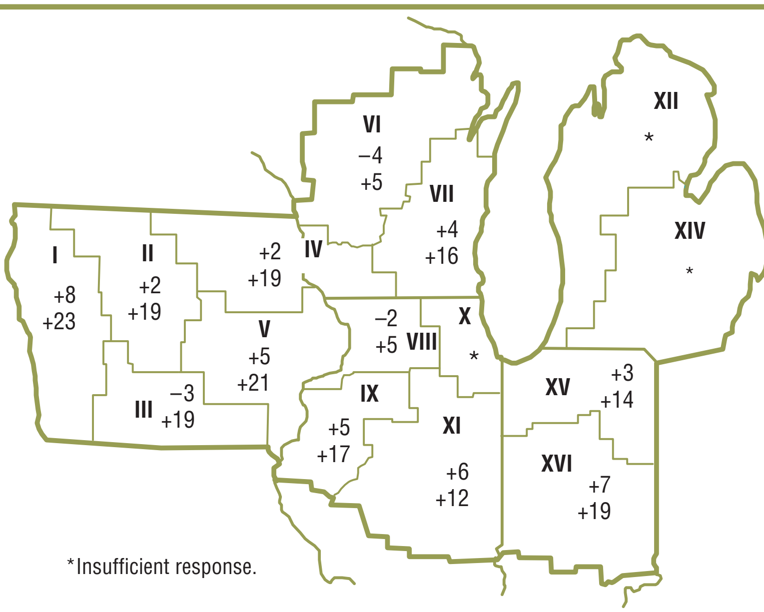
The year-over-year increase in the value of "good" agricultural land in the District surged to 15 percent for the third quarter (see map and table below). This year-over-year increase, the largest since 1979, outpaced prior gains in this decade (see chart 1). The results for District states ranged from 10 percent in Illinois, Michigan, and Wisconsin to 21 percent in Iowa. District land values increased 4 percent from the second quarter of 2007. The quarterly results for District states included gains of 4 percent in Illinois, 6 percent in Indiana, 3 percent in Iowa, and 8 percent in Michigan, with no gain in Wisconsin. Also, Wisconsin was the only state with a lower year-over-year increase in land values than last quarter.

Over half of the responding bankers expected farmland values to increase during the October to December period, with only 2 percent expecting declines. These results reflected a continuing change from a year ago, when expectations inclined toward stability. Wisconsin respondents exhibited the lowest expectations (45 percent) that farmland values will go up in the fourth quarter of 2007, as well as the highest expectations of declines (7 percent).

Percent change in dollar value of "good" farmland

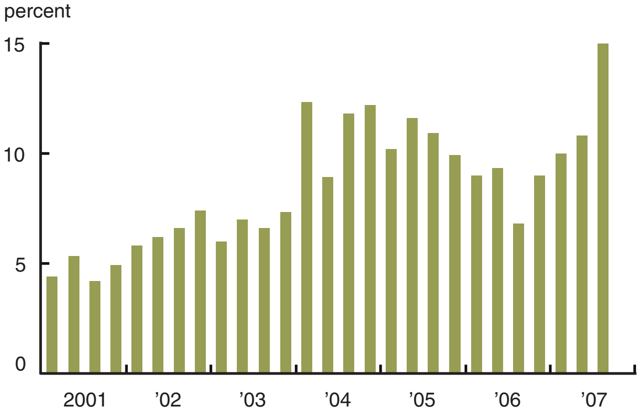
Top: July 1, 2007 to October 1, 2007
Bottom: October 1, 2006 to October 1, 2007

	July 1, 2007 to October 1, 2007	October 1, 2006 to October 1, 2007
Illinois	+4	+10
Indiana	+6	+17
Iowa	+3	+21
Michigan	+8	+10
Wisconsin	0	+10
Seventh District	+4	+15



*Insufficient response.

1. Year-over-year changes by quarter in District farmland values



In the other states, at least half forecast increases in land values during the next three months.

Demand among farmers to acquire farmland should heighten this fall and winter, whereas demand among non-farm investors should remain steady. District bankers strongly predicted higher rather than lower interest in land purchases among farmers (63 percent versus 6 percent). Only about a third of the Wisconsin bankers expected higher demand by farmers, although that was still 14 percent more than those who expected lower demand. About 40 percent of the respondents foresaw interest in farmland by non-farm investors going up; about 20 percent anticipated it going down over the next three to six months. With 46 percent of the respondents anticipating higher volumes of farmland transfers from the previous fall and winter and 10 percent anticipating lower volumes of transfers, there should be more farmland sales from the swell in demand by farmers. Farmland transfer activity in Indiana and Iowa may be higher than in the rest of the District, while Wisconsin may not see any bump in its activity.

Substantially higher corn and soybean prices than a year ago helped raise expectations for net cash farm earnings in the District and shed light on the heightened demand for land by farmers. For the primary types of District operations, more respondents expected increases in net cash farm earnings versus decreases over the next three to six months compared with earnings of a year earlier: 89 percent to 3 percent for crops, 52 percent to 7 percent for dairy, and 33 percent to 24 percent for cattle and hogs. Bucking typical patterns, prices for corn and soybeans increased during harvest for a second year in a row. With U.S. soybean production forecast to fall 19 percent from 2006 to 2.59 billion bushels (estimates from the U.S. Department of Agriculture), higher soybean prices would not be surprising. However, a record U.S. corn harvest of 13.2 billion bushels, an increase of 25 percent from 2006, would usually be expected to bring lower corn prices. Yet, higher demand for ethanol production and exports have helped support corn prices this fall. Corn will also be competing with soybeans for acres to plant next spring. Even with higher feed costs, livestock producers should also see gains in net cash farm earnings according to the responding bankers.

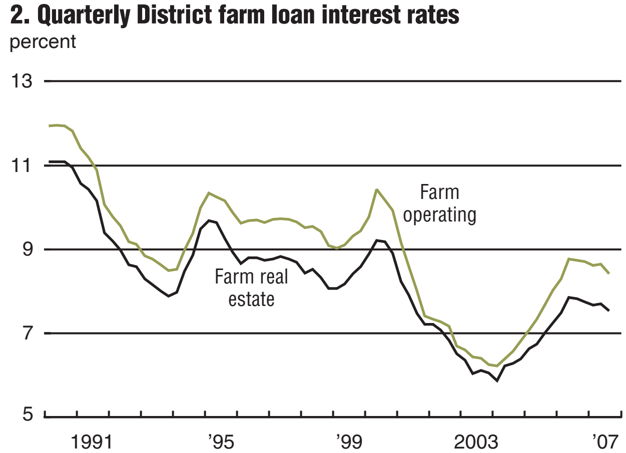
Agricultural exports have provided an important boost to farm income in key categories for the District. In fiscal year 2007 the value of U.S. exports increased 44 percent for corn, 34 percent for soybeans, 38 percent for dairy products, and 28 percent for red meats (data from the U.S. Department of Agriculture). Overall, U.S. agricultural exports increased in value by 19 percent from fiscal year 2006. The slide in the value of the U.S. dollar has lowered relative prices for foreign importers, making U.S. exports more attractive to buyers in many countries. So, income in the farm sector should continue to benefit from favorable conditions for U.S. agricultural exports.

Credit conditions

In a turnaround from a year ago, credit conditions improved in the third quarter of 2007. Demand for non-real-estate loans grew for the fifteenth consecutive quarter at surveyed banks. With 33 percent of the bankers reporting higher demand for non-real-estate loans from a year earlier and 15 percent reporting a decline in demand, the index of loan demand was 118 (see table on the next page). Half of Iowa's bankers reported higher non-real-estate loan demand, whereas Michigan and Wisconsin had more reports of lower demand than reports of higher demand.

Funds availability kept growing during July through September for the fourth consecutive quarter. With 24 percent of the bankers reporting they had more funds available during the third quarter of 2007 than they had a year earlier and 6 percent reporting they had less, the index of funds availability was 118. Collateral requirements at District banks were tighter than last quarter, with 8 percent demanding increased amounts of collateral.

2. Quarterly District farm loan interest rates



Credit conditions at Seventh District agricultural banks

	Loan demand	Funds availability	Loan repayment rates	Average loan-to-deposit ratio	Interest rates on farm loans: Operating loans[a]	Feeder cattle[a]	Real estate[a]
	(index)[b]	(index)[b]	(index)[b]	(percent)	(percent)	(percent)	(percent)
2005							
Jan–Mar	117	112	116	74.4	7.07	7.08	6.63
Apr–June	119	101	103	76.3	7.33	7.30	6.74
July–Sept	115	97	87	76.9	7.68	7.65	7.02
Oct–Dec	120	110	90	75.8	8.02	7.95	7.25
2006							
Jan–Mar	131	102	87	76.7	8.30	8.27	7.48
Apr–June	115	101	85	78.0	8.76	8.66	7.85
July–Sept	124	95	87	79.1	8.73	8.70	7.82
Oct–Dec	109	116	130	76.6	8.71	8.70	7.74
2007							
Jan–Mar	128	113	131	78.4	8.61	8.60	7.67
Apr–June	121	115	117	77.8	8.65	8.63	7.70
July–Sept	118	118	121	78.1	8.42	8.40	7.53

Note: Historical data on Seventh District agricultural credit conditions is available for download from the *AgLetter* homepage, www.chicagofed.org/economic_research_and_data/ag_letter.cfm.
[a]At end of period.
[b]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.

Non-real-estate farm loan repayment rates improved in 2007 from the third quarter of 2006. With 25 percent of the bankers reporting higher rates of loan repayment and 4 percent reporting lower rates, the index of loan repayment rates was 121. In addition, loan renewals and extensions were down from those in July, August, and September a year ago, with 5 percent of the bankers indicating an increase and 25 percent indicating a decrease. None of the states showed slippage in loan repayment rates, and none had higher levels of renewals and extensions. Illinois and Iowa had the highest percentages of banks report improvements in these measures.

Interest rates on agricultural loans were the lowest since the first quarter of 2006 (see chart 2 and table). As of October 1, the District average for interest rates on new operating loans fell to 8.42 percent. Interest rates on operating loans ranged from 8.12 percent in Illinois to 8.69 percent in Iowa. Interest rates for farm real estate loans slid to 7.53 percent. Iowa had the lowest rate for farm mortgages, 7.42 percent, and Wisconsin had the highest rate, 7.82 percent.

Looking forward

Credit conditions should improve further during the fall and winter, according to the respondents. More bankers (59 percent) expected the volume of farm loan repayments to rise over the next three to six months compared with a year ago than decline (3 percent), especially in Illinois and Iowa. Moreover, only 4 percent of the respondents anticipated an increase, versus 51 percent a decrease, in forced sales or liquidation of farm assets among financially stressed farmers this fall and winter.

For the fourth quarter of 2007, 35 percent of the bankers expected higher non-real-estate loan volume and 15 percent expected lower volume than in 2006. Respondents predicted increases in operating loans (27 percent more forecasted increases rather than decreases), farm machinery loans (46 percent), and grain storage construction loans (32 percent), while they predicted declines for Farm Service Agency guaranteed loans and livestock loans. More bankers forecast higher (23 percent) rather than lower (9 percent) real estate loan volume during October through December. Wisconsin was the only state where expectations for lower operating or real estate loan volume predominated.

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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)*	October	142	0.7	23	28
Crops *(index, 1990–92=100)*	October	149	4.9	31	46
Corn *($ per bu.)*	October	3.29	0.0	29	81
Hay *($ per ton)*	October	133.00	0.8	22	36
Soybeans *($ per bu.)*	October	8.58	4.9	55	51
Wheat *($ per bu.)*	October	8.02	18.8	75	134
Livestock and products *(index, 1990–92=100)*	October	132	−5.0	14	8
Barrow and gilts *($ per cwt.)*	October	43.30	−7.9	−8	−8
Steers and heifers *($ per cwt.)*	October	96.7	−1.4	3	1
Milk *($ per cwt.)*	October	21.2	−2.3	56	37
Eggs *(¢ per doz.)*	October	93.6	−12.5	73	83
Consumer prices *(index, 1982–84=100)*	October	209	0.2	4	5
Food	October	206	0.4	4	7
Production or stocks					
Corn stocks *(mil. bu.)*	September 1	1,304	N.A.	−34	−38
Soybean stocks *(mil. bu.)*	September 1	573	N.A.	28	124
Wheat stocks *(mil. bu.)*	September 1	1,717	N.A.	−2	−11
Beef production *(bil. lb.)*	October	2.44	16.5	9	17
Pork production *(bil. lb.)*	October	2.15	22.9	11	18
Milk production *(bil. lb.)**	October	14.2	3.4	4	6
Agricultural exports *(mil. dol.)*	September	7,693	2.2	43	66
Corn *(mil. bu.)*	September	213	10.2	9	61
Soybeans *(mil. bu.)*	September	61	17.3	−6	79
Wheat *(mil. bu.)*	August	155	89.1	94	79
Farm machinery *(units)*					
Tractors, over 40 HP	October	10,420	34.7	9	8
40 to 100 HP	October	7,126	20.5	1	4
100 HP or more	October	3,294	80.8	32	17
Combines	October	672	−31.3	6	23

N.A. Not applicable.
*23 selected states.
Sources: Author's calculations based on data from the U.S. Department of Agriculture, U.S. Bureau of Labor Statistics, and the Association of Equipment Manufacturers.