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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Summary
Drought became the biggest story line over the summer for Midwest agriculture, and indeed, it contributed to less rapid increases in farmland values during the second quarter of 2012. The year-over-year gain in agricultural land values was 15 percent in the second quarter of 2012 for the Seventh Federal Reserve District. The rise in the value of "good" farmland was 1 percent in the second quarter relative to the first quarter of 2012, based on a survey of 205 agricultural bankers. With 22 percent of the respondents anticipating higher farmland values for the third quarter of 2012 and only 4 percent anticipating lower ones, the drought did not seem to have stifled all the momentum of rising agricultural land values.

Even with spreading concern about the drought's impact, agricultural credit conditions strengthened overall in the second quarter of 2012 compared with a year earlier. Repayment rates for non-real-estate farm loans were above the level of a year ago, with 94 percent of agricultural loans seen by survey respondents as having no significant repayment problems. Moreover, there were fewer loan renewals and extensions. The index of funds availability for lending rose to a new high. There was no break in the decline in interest rates on agricultural operating loans and mortgages, which set new lows once again. Yet, the demand for non-real-estate loans was feeble compared with a year ago, continuing a recent trend. The average loan-to-deposit ratio for the District crept up to 68.1 percent in the second quarter of 2012, but remained over 10 percentage points below the average level desired by respondents.

CONFERENCE ANNOUNCEMENT
Farmland Leases: Tales, Types, and Trends

On November 27, 2012, the Federal Reserve Bank of Chicago will hold a conference to examine trends in farmland leasing and analyze various types of leases, within the context of recent increases in farmland values and this year's drought. For more details, including the agenda, and to register, go to www.chicagofed.org/webpages/events/2012/agriculture_conference.cfm.

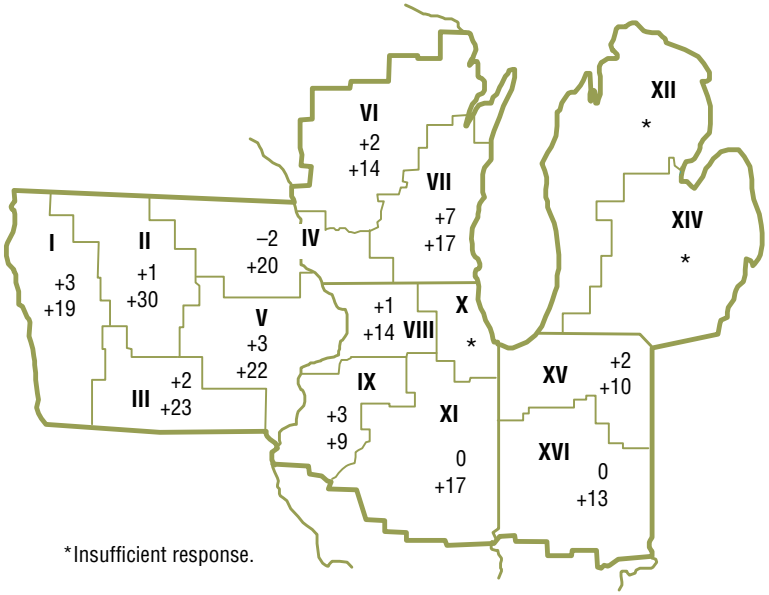
Farmland values

The year-over-year increase in the value of District farmland for the second quarter of 2012 was 15 percent, easing down from the year-over-year increases of the past five quarters (see table and map below). The second quarter's year-over-year gain seems modest only in the context of exploding farmland values over the past few years (see chart 1). Iowa had a year-over-year gain of 24 percent in

Percent change in dollar value of "good" farmland

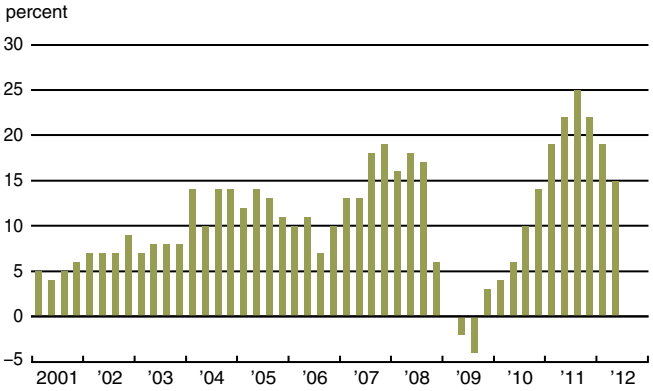
Top: April 1, 2012 to July 1, 2012
Bottom: July 1, 2011 to July 1, 2012

	April 1, 2012 to July 1, 2012	July 1, 2011 to July 1, 2012
Illinois	+1	+15
Indiana	+1	+12
Iowa	+2	+24
Michigan	*	*
Wisconsin	+2	+13
Seventh District	+1	+15



*Insufficient response.

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



its farmland values, marking yet again the highest increase among District states. However, Wisconsin was the only state that matched its year-over-year increase for the first quarter of 2012. The rise in the value of "good" farmland was 1 percent in the second quarter relative to the first quarter of 2012; this was the smallest quarterly increase in the past two years. Several survey respondents remarked that demand for higher-quality farmland still outpaced the supply of such ground.

Responding bankers predicted that as the drought continues to spread across much of the District during the third quarter, farmland values would likely level off but not face much downward pressure from the drought's effects. Only 4 percent of respondents forecasted farmland values to decline in the third quarter of 2012, whereas 22 percent of respondents forecasted farmland values to rise in the third quarter. With over 70 percent of the respondents expecting stable agricultural land values for the third quarter of 2012, the consensus was for farmland markets to move sideways.

Even so, the drought threatens to reduce the District's output of corn and soybeans dramatically. In 1988 (the last time such an extensive drought took hold of the District), corn and soybean yields dropped from the previous year by about 40 percent and 30 percent, respectively. Newer seed traits and better farming practices should limit the damage from the current drought. The U.S. Department of Agriculture (USDA) estimated that the nation's 2012 harvest of corn for grain will be 13 percent smaller than the 2011 harvest. It also estimated that the five District states' 2012 harvest of corn for grain will be 22 percent less than the previous year's harvest. Soybean production was estimated to decline 12 percent for the nation and 19 percent for the five District states. The USDA raised price interval estimates for the 2012–13 crop year to $7.50 to $8.90 per bushel for corn and $15.00 to $17.00 per bushel for soybeans. Based on the midpoints of these projected price ranges, the District's corn and soybean crops in the current year would fall in value 20 percent and 7.3 percent, respectively, from 2011 if yield declines turned out to be similar to those of 1988—presumably a worst-case scenario.

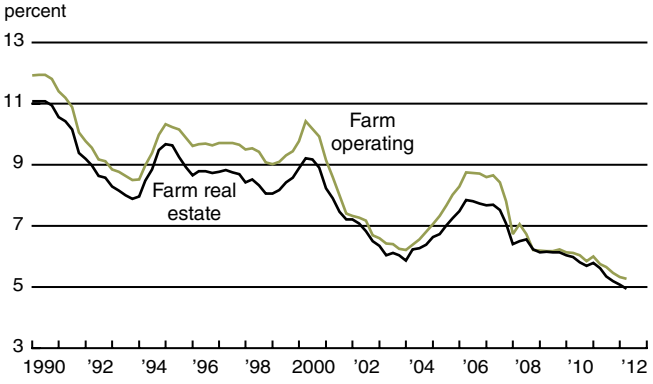
Besides higher crop prices, crop insurance payments will partially offset the drought's impact on farm income. Only 22 percent of U.S. corn acres were not insured at all in 2011. Moreover, the USDA has declared most of the District as disaster areas, releasing additional funds and enabling lower rates on some loans. This disaster relief, plus any additional programs passed by the U.S. Congress, would particularly assist livestock operations. Dairy, hog, poultry, and cattle operations do not have the extensive insurance coverage of corn and soybeans; and prices related to livestock have not experienced increases on par with those of corn and soybean prices. Livestock operations have had to absorb substantially higher feed costs. Hence, livestock operators face much more challenging circumstances than corn and soybean producers. Overall, the District has already incurred severe losses in farm income for 2012—the extent of which will be determined during the harvest. Coming after several years of farm income that were better than average, the drought should not reverse the gains in farmland values, but there could be a pause while expectations about future earnings from crop production adjust to the short-term effects of this summer's drought.

Credit conditions

While the drought was deemed by some respondents to hurt farm finances in upcoming periods, agricultural credit conditions in the District for the second quarter of 2012 avoided deterioration. Funds availability once again improved from a year ago, with 65 percent of survey respondents reporting that their banks had more funds available and 1 percent reporting they had less. The index of funds availability edged higher to 164, setting another record for the survey. One respondent commented that "farmers have become depositors, not borrowers."

In this regard, 1986 was the last time that the index of non-real-estate agricultural loan demand recorded a value lower than its current reading (69). With 13 percent of the respondents noting higher demand and 44 percent noting lower demand compared with a year ago, this situation was slightly weaker than in the first quarter of 2012. The District average for loan-to-deposit ratios rose

2. Quarterly Seventh 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]	Interest rates on farm loans: Feeder cattle[a]	Interest rates on farm loans: Real estate[a]
	(index)[b]	*(index)*[b]	*(index)*[b]	*(percent)*	*(percent)*	*(percent)*	*(percent)*
2010							
Jan–Mar	109	127	79	73.7	6.13	6.25	6.04
Apr–June	98	122	85	74.5	6.12	6.25	5.99
July–Sept	90	138	114	73.2	6.05	6.14	5.81
Oct–Dec	101	142	142	71.8	5.85	6.02	5.70
2011							
Jan–Mar	81	149	146	69.8	6.01	5.93	5.80
Apr–June	79	145	133	70.3	5.75	5.91	5.62
July–Sept	81	149	133	69.0	5.66	5.79	5.36
Oct–Dec	87	153	150	68.7	5.47	5.65	5.20
2012							
Jan–Mar	72	163	154	66.5	5.34	5.54	5.08
Apr–June	69	164	139	68.1	5.27	5.41	4.94

[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 percentage of bankers that responded "lower" from the percentage that responded "higher" and adding 100.
Note: Historical data on Seventh District agricultural credit conditions are available for download from the *AgLetter* webpage, www.chicagofed.org/webpages/publications/agletter/index.cfm.

to 68.1 percent, still below the level of a year ago. The ratio desired by the banks was 78.8 percent; and 79 percent of the banks had ratios underneath it. Respondents stated their banks were a bit more restrictive with regard to collateral requirements for loans in the second quarter of 2012 relative to the second quarter of 2011; more specifically, 9 percent of the banks required more collateral and none required less.

Repayment rates for non-real-estate farm loans were better during the second quarter of 2012 than a year ago. The index of loan repayment rates moved down to 139, with 42 percent of respondents observing higher rates of loan repayment and 3 percent observing lower rates. Agricultural loans with "major" or "severe" repayment problems were under 2 percent of District loan volume. Wisconsin was the only District state that had over 4 percent of loan volume with troubled status. Renewals and extensions of non-real-estate agricultural loans improved as well in the second quarter of 2012 relative to the same quarter of 2011, as 4 percent of those surveyed noticed increases and 27 percent noticed decreases.

Agricultural interest rates moved down again, setting new lows for the fifth quarter in a row (see chart 2). As of July 1, 2012, the District averages for interest rates on new farm operating and real estate loans were 5.27 percent and 4.94 percent, respectively.

Agricultural lending remained quite competitive. According to responding bankers, the amount of farm operating loans by banks decreased in the first half of 2012 compared with typical levels. However, District banks had higher volumes of farm mortgages than typical except those in Illinois. Amounts of operating loans and mortgages originated by lenders of the Farm Credit System were higher than normal in the first six months of 2012. Likewise, merchants, dealers, and other input suppliers lent more than usual to the agriculture sector in the January through June period of 2012. However, life insurance companies lent less than usual over the same period.

Looking forward

The drought put a damper on prospects for agriculture in the District. A few responding bankers thought repayment problems would creep up because of the drought.

Respondents anticipated the District's overall non-real-estate agricultural loan volumes to decline in the third quarter of 2012 compared with the same quarter of 2011. However, such volumes in Indiana and Wisconsin were expected to increase. For the July through September period of 2012, farm mortgage volumes were forecasted to grow slightly more than in the same period of 2011.

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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	193	6.0	5	39
Crops *(index, 1990–92=100)*	July	233	9.4	10	56
Corn *($ per bu.)*	July	7.36	15.5	16	111
Hay *($ per ton)*	July	184	0.5	8	66
Soybeans *($ per bu.)*	July	15.60	12.2	18	59
Wheat *($ per bu.)*	July	8.31	24.0	17	85
Livestock and products *(index, 1990–92=100)*	July	151	–0.7	–3	14
Barrows & gilts *($ per cwt.)*	July	74.70	5.2	3	27
Steers & heifers *($ per cwt.)*	July	119.00	–4.0	3	24
Milk *($ per cwt.)*	July	16.60	2.5	–24	4
Eggs *($ per doz.)*	July	0.97	6.9	11	37
Consumer prices *(index, 1982–84=100)*	June	229	0.0	2	5
Food	June	234	0.2	3	7
Production or stocks					
Corn stocks *(mil. bu.)*	June 1	3,148	N.A.	–14	–27
Soybean stocks *(mil. bu.)*	June 1	667	N.A.	8	17
Wheat stocks *(mil. bu.)*	June 1	743	N.A.	–14	–24
Beef production *(bil. lb.)*	June	2.25	0.9	–5	–3
Pork production *(bil. lb.)*	June	1.75	–9.2	–4	–4
Milk production *(bil. lb.)**	June	15.5	–5.5	1	2
Agricultural exports *($ mil.)*	May	11,109	1.3	2	34
Corn *(mil. bu.)*	May	129	–4.4	–21	–34
Soybeans *(mil. bu.)*	May	67	–9.4	97	111
Wheat *(mil. bu.)*	May	103	–1.2	–19	50
Farm machinery *(units)*					
Tractors, over 40 HP	July	7,314	N.A.	14	10
40 to 100 HP	July	4,385	N.A.	4	–5
100 HP or more	July	2,929	N.A.	32	43
Combines	July	1,035	N.A.	21	–13

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.