Ag Banking and Credit Outlook

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The views expressed here are those of the speaker and do not necessarily reflect the opinions of the Federal Reserve Bank of Kansas City or the Federal Reserve System.
Ag Credit Outlook Themes

- The outlook for the U.S. agricultural economy remains solid, despite some slight declines in commodity prices recently.
- Agricultural credit conditions remain strong and have been supported by high commodity prices and carryover from government programs.
- However, ag lenders continue to express concerns related to weak loan demand, increasing input costs, and severe drought in the West and Northern Plains.
Ag banker anecdotes show continued concerns related to loan demand, input costs, and drought.

- Home loan refinance and PPP program income has been the significant source of bank income. Interest income and loan demand in ag and commercial is significantly decreased. – Nebraska

- Our non-PPP loan demand is down significantly due to government payments. Interest margin has been tough to maintain due to lots of liquidity, investments repricing, lower loan demand, and significant competition for loans. – Minnesota

- The rising costs of many products that farmers utilize are of major concern, from fertilizer to latex gloves. – Wisconsin

- Lack of supply has pushed expenses higher. Lack of availability of equipment will slow capital spending. – Kansas

- This region will experience a tough year in agriculture due to drought conditions. – Colorado, Wyoming, and North Dakota

- Severe drought conditions forcing the sale of breeding stock at a current lower rate. – Montana
Farm income has increased sharply in recent quarters.

Source: Federal Reserve Bank of Kansas City, Minneapolis, and St. Louis.
Amid increases in farm prices and income, farmers are spending again.

**Share of Banks Reporting Higher Farm Capital Spending**

- **Percent of respondents**
- **Percent of Respondents**

- **Tenth District**
- **Kansas**
- **Western Missouri**
- **Mountain States**
- **Nebraska**
- **Oklahoma**

**2015-2019 Average**

**Q1 2021**

**Q2 2021**

**Tenth District**

**Kansas**

**Western Missouri**

**Mountain States**

**Nebraska**

**Oklahoma**

**Mountain States include Colorado, northern New Mexico and Wyoming, which are grouped because of limited survey responses from each state.**

**Source:** Federal Reserve Bank of Kansas City
Incomes have increased despite higher production expenses, which are a concern moving forward.

Change in Production Expenses From Prior Year

Crop Producers

Percent of respondents

Significant Increase

Modest Increase

Livestock Producers

Percent of respondents

Significant Increase

Modest Increase

No Change or Decrease

Source: Federal Reserve Bank of Kansas City
We also are seeing broad improvement in repayment rates.

Source: Federal Reserve Banks of Chicago, Dallas, Kansas City, Minneapolis, and St. Louis.
Demand has declined for new loans and for renewals and extensions on existing loans.

Source: Federal Reserve Banks of Chicago, Dallas, Kansas City, Minneapolis, and St. Louis.
Drought has become a greater concern in the West and Northern Plains.

Drought and Change in Cattle Inventories

% Change from previous year

% Area in drought, 2020

Source: USDA, NOAA, UNL Drought Monitor
Financial conditions improved more rapidly in areas less impacted by drought.

Respondents Reporting Improved Financial Conditions by Type of Borrower, Q1 2021

Source: Federal Reserve Bank of Kansas City
Farm financial conditions have improved, but farm debt held at agricultural banks has dropped substantially.

*Includes all banks with agricultural loans comprising at least 25% of total loans.
Sources: Reports of Condition and Income and Federal Reserve Board of Governors.
Despite narrowing NIMs, profitability at agricultural banks has strengthened considerably.

Select Financial Indicators at Commercial Banks

- **Return on Average Assets**
  - Percent
  - 2010: 9.8%
  - 2015: 10.2%
  - 2020: 10.6%

- **Net Interest Margin**
  - Percent
  - 2010: 12.2%
  - 2015: 11.8%
  - 2020: 11.4%

- **Equity Capital Ratio**
  - Percent
  - 2010: 2.6%
  - 2015: 2.8%
  - 2020: 3.0%

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*Commercial banks with agricultural loans comprising at least 25% of total loans as of 3/31/2021. Sources: Reports of Condition and Income and Federal Reserve Board of Governors.*
Fees generated from PPP loans have supported incomes at agricultural banks.

Factors Providing Support to Bank Financial Performance

<table>
<thead>
<tr>
<th>Factor</th>
<th>Percent of survey respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Lending Programs (PPP)</td>
<td>100%</td>
</tr>
<tr>
<td>Borrower Financial Conditions</td>
<td>40%</td>
</tr>
<tr>
<td>Demand for Non-Agricultural Loans</td>
<td>20%</td>
</tr>
<tr>
<td>Excess Liquidity</td>
<td>10%</td>
</tr>
<tr>
<td>Demand for Agricultural Loans</td>
<td>0%</td>
</tr>
<tr>
<td>Bank Strategies Related to Non-Interest Income</td>
<td>0%</td>
</tr>
<tr>
<td>Other</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: Federal Reserve Bank of Kansas City
In Q1 2021, the average rate on non-real estate farm loans increased from the all-time low at the end of 2020.

Sources: Survey of Terms of Lending to Farmers, Federal Reserve Bank of Kansas City and Federal Reserve Board of Governors.
Expectations of long-term interest rates have declined in the aftermath of the pandemic.
Concluding Thoughts

- The outlook for agricultural credit conditions remains strong.
  - High commodity prices
  - Government support
  - Low interest rates
- Risks to the outlook for farm finances include drought in the West and Northern Plains and higher costs of production.
- The combination of low demand for farm loans and historically low interest rates has contributed to compressed interest margins for many agricultural lenders, but several factors have provided support to bank financial performance.
  - Government lending programs, such as PPP
  - Stronger financial conditions for borrowers
  - Demand for non-agricultural loans
Questions?

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