CENTER FOR THE STUDY OF RURAL AMERICA
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Commentary on the rural economy

Will Farm Finances Stay Healthy in 2002?

By Kendall McDaniel
Associate Economist
Center for the Study of Rural America

Despite low commodity prices, farm finances remained healthy in 2001. Over the past four years, hefty government payments have propped up farm incomes. Many farm households have also benefited from the strong nonfarm economy, which has provided new jobs and additional cash flow. Throughout the 1990s, the strong nonfarm economy combined with the hefty government payments to boost farmland values, the main component of producers' balance sheets. Thus, farm finances were quite strong heading into 2002.

In the coming year, however, farm credit conditions may weaken. Producers' cash flow will be squeezed by reduced livestock receipts and a slower nonfarm economy. Buoyant land values will provide support for producer balance sheets, but rental rates will also rise, constraining cash flow, especially for young farmers. Nonetheless, recovery in the U.S. economy and government payments should limit the decline in farm finances.

How healthy is the U.S. farm economy?

The U.S. farm economy was generally healthy in 2001, but midway through 2002 storm clouds seem to be gathering. Hefty government payments and record-level livestock receipts lifted farm incomes in 2001, but the livestock industry is now in a slide. By July of this year, cattle prices had fallen 15 percent and hog prices had declined 20 percent from levels of a year ago, due mainly to larger supplies and weaker exports. The most recent USDA forecast indicates a 7 percent decline in livestock receipts for the year as a whole, one of the sharpest declines in memory.

Crop receipts will also be moderate in 2002. In June, USDA forecast a 0.5 percent decline in U.S. crop receipts for 2002. Since the June forecast, however, drought conditions have gripped much of the Midwest, raising prices but lowering production forecasts. It is unclear whether or not higher crop prices will offset the loss of production. It is clear, however, that the spike in crop prices will drive up feed costs and tighten margins in the livestock sector.

How sound are farm finances?

Despite low commodity prices, farm balance sheets were solid heading into 2002, thanks to off-farm income and government payments. Government payments to producers accounted for 43 percent of U.S. farm income in 2001. Without this aid, many farmers would have been unable to fully service their debt obligations. The same is likely to hold true for 2002.

Over the past decade, many farmers have relied on off-farm income to support their farm operations. The strong nonfarm economy from 1991 to the spring of 2001 gave many farmers and their spouses additional sources of income. In over half of all farm households, either the operator or the spouse (or both) work off the farm. Off-farm employment has undoubtedly played a key role in keeping many farmers in business.[1]

The strong nonfarm economy also brought new buyers to rural auctions. Many nonfarm buyers purchased farmland for recreational use, as a new homestead, or for investment purposes. Soaring nonfarm demand, coupled with heightened demand by farmers looking to expand their operations, has driven up farmland values. The average value of farmland in the Tenth District rose 3 percent per year in the 1990s, compared to an average decline of 3 percent per year in the 1980s.

Lofty land values have bolstered many producers' equity positions in recent years. Farm sector equity rose 2 percent in 2001 to $1.02 trillion, the 15th consecutive annual increase. The value of farm assets rose 2.4 percent in 2001 to $1.2 trillion due to strong gains in farmland values, which account for nearly 80 percent of farm assets. Farm debt, though, jumped 4.8 percent in 2001, reaching $192.8 billion, slightly above its 1984 peak. Despite the high debt level, the farm sector remains relatively solvent with a debt-to-assets ratio of 16 percent, well below the peak of 22 percent in 1984.

Agricultural lenders have benefited from healthy farm financial conditions and a strong nonfarm economy. Perhaps the biggest indicator of how well agricultural lenders are fairing is the number of bank failures. No agricultural bank has failed in the last two years and only five have failed since 1994. This is quite a contrast from the 1980s when 322 farm banks closed their doors. In addition, less than 2 percent of all farm loans can be classified as noncurrent, a far cry from the level posted in the 1980s farm crisis. Farm lenders report that loan delinquency rates, foreclosures, and net loan charge-offs all remained low in 2001. Farm loan repayment rates and the demand for new farm loans, however, edged down in the second half of 2001 and first half of 2002.

What is the outlook for farm finances?

Farm finances may weaken in the coming year. The U.S. economic recovery is still young, and job gains in rural America have been sluggish. Farmers are currently struggling with weaker export demand and growing supplies in the livestock sector. And rising land values are driving up rental rates for producers who rent farmland. Still, steady gains in farmland values and big government payments will limit the decline in farm finances.

On net, some worsening is expected in farm lender portfolios during the second half of 2002. Falling livestock receipts and fewer off-farm jobs have squeezed producer cash flows. In addition, drought conditions have plagued many crops and pastures in parts of the nation. Loan repayment rates may slow in 2002, but government payments will prop up farm incomes and asset values, helping the sector avoid another downturn like the 1980s.

But not all producers benefit from big government payments and strong land values. Nearly half of U.S. farmland is rented, mostly to new farm operators. Profit margins of new farms continue to shrink as higher land values translate into higher rental rates or higher start-up costs. In addition, larger farms receive a disproportionate share of government payments, with the largest 8 percent of farms receiving 47 percent of all farm payments in 1998. And only 22 percent of livestock operations receive government aid compared to 83 percent of grain farms.

In summary, the combination of hefty farm payments, plentiful off-farm incomes, and lofty land prices supported many producers' financial position in recent years. Without these forces, many producers would have been forced to sell assets or take on additional debt.

Reduced livestock receipts and drought conditions will hinder the farm economy in 2002. Rising land values and farm payments will limit the decline in farm finances, but not all farmers receive government aid. These producers may need to find new products or new ways of doing business to boost profit margins.

[1]For more information on the structural and financial characteristics of U.S. farms see Structural and Financial Characteristics of U.S. Farms, 2001 Family Farm Report and Agricultural Income and Finance, Annual Lender Issue. The Economic Research Service at USDA publishes both.

Survey of Agricultural Credit Conditions

Federal Reserve Bank of Kansas City
March 31, 2002

Highlights from the first quarter survey.*

- District farmland values posted healthy gains in the first quarter of 2002. However, the rate of gain in 2002 was more modest than the pace set during the last three years. District farmland values rose 3 to 3.5% in 2002 versus a rate of 4 to 5% in 1998 through 2001. Farmland values in Missouri and the Mountain states have risen the fastest as nonfarm demand appears to be holding firm.
- The district farm commodity price index edged up in the first quarter, but it remains well below year ago levels. Soybean and livestock prices gained ground in the quarter while corn and wheat prices held steady. Since March, livestock prices fell, wheat and corn prices remained flat, and soybean prices turned sharply higher.
- Farm credit conditions deteriorated in the first quarter. Loan repayment rates slowed and renewals or extension moved up. Demand for new farm loans remained relatively low, suggesting that lenders and their farm borrowers continue to approach new farm debt cautiously.
- Farm interest rates edged down in the first quarter. At the end of the quarter, interest rates on new farm loans averaged 7.91% for operating loans, 7.70% for feeder cattle loans, 7.85% for intermediate-term loans, and 7.49% for real estate loans. Since March, interest rates in national money markets have remained steady.

Note: 284 bankers responded to the first quarter survey.

* Please refer questions to Nancy Novack, assistant economist, at 816-881-2423 or nancy.l.novack@kc.frb.org.

Farm Real Estate Values

March 31, 2002
(Average value per acre by reporting banks)

	Nonirrigated	Irrigated	Ranchland
Percent change from last quarter+			
Tenth District	1.09	1.23	1.29
Kansas	1.09	0.70	1.32
Missouri	1.19	0.79	1.29
Nebraska	1.39	1.58	1.62
Oklahoma	0.36	1.27	1.04
Mountain states*	0.45	1.39	0.47
Percent change from last year+			
Tenth District	2.89	3.17	3.39
Kansas	2.58	2.98	2.12
Missouri	3.19	3.63	7.91
Nebraska	2.66	3.69	3.32
Oklahoma	2.40	0.40	1.76
Mountain states*	7.36	3.19	5.68

* Colorado, New Mexico, and Wyoming combined.

+ Percentage changes are calculated using responses only from those banks reporting in both the past and the current quarter.

Source: Federal Reserve Bank of Kansas City

Selected Measures of Credit Conditions at Tenth District Agricultural Banks

	Loan demand (index)+	Loan Fund availability (index)+	Loan repayment rates (index)+	Average renewals or extensions (index)+	Loan-to-deposit ratio* (percent)	District farm commodity price index (1980=100)
2000						
Jan.–Mar.	107	95	92	108	67.1	100.6
Apr.–June	112	78	86	108	70.4	99.5
July–Sept.	103	85	84	112	70.8	93.0
Oct.–Dec.	106	90	82	120	70.9	103.0
2001						
Jan.–Mar.	111	106	78	123	70.5	105.3
Apr.–June	111	100	76	120	70.4	102.7
July–Sept.	98	116	83	115	71.2	99.7
Oct.–Dec.	98	118	82	115	69.5	91.4
2002						
Jan.–Mar.	100	116	74	121	71.7	94.7

* At end of period.

+ Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than, 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.

Source: Federal Reserve Bank of Kansas City

Summary of Economic Conditions

Highlights from the first quarter.*

- The rural non-farm economy emerged from the economic recession in the first quarter of 2002. Rural households report that job growth rose 0.8 percent above the previous year, a solid rebound from the 0.3 percent decline in the fourth quarter of 2001. Businesses also report that rural job growth improved in the quarter, but growth was still below year-ago levels.
- Businesses in the services and manufacturing sectors noted some improvement in rural jobs during the first quarter of 2002. In the first quarter, rural services job growth was only 0.2 percent below the previous year. The rural manufacturing sector appears to be recovering although job growth remains below year-ago levels.
- Rural construction activity continued to expand in the first quarter of 2002. Aided by low interest rates and mild weather, rural builders were issued 8.2 percent more permits than a year ago. Most of the permits were for single family housing.

* Please refer questions to Nancy Novack, assistant economist at 816-881-2423 or Kendall McDaniel, associate economist, at 816-881-2291.

Household Employment

	(1000s)	Annual percent change	
	Q1:2002	Q4:2001	Q1:2002
Rural Areas	24,688.1	-.25	.82
Adjacent Rural Areas	13,777.3	-.14	.71
(Town population 20,000+)	4,756.8	-.24	.80
(Town population 2,500–19,999)	7,830.5	-.10	.60
(Town population < 2,500)	1,190.0	.03	1.14
Nonadjacent rural areas	10,910.8	-.39	.96
(Town population 20,000+)	3,309.7	-.29	.97
(Town population 2,500–19,999)	6,040.4	-.50	.93
(Town population < 2,500)	1,560.7	-.19	1.03
Metro Areas	110,101.2	-.87	.18
Central city (Population > 1 mil)	63,235.8	-1.07	-.16
Fringe city (Population > 1 mil)	5,734.2	-1.02	.07
(Population 250,000–1 million)	30,519.0	-.63	.64
(Population < 250,000)	10,612.3	-.30	.96

Source: BLS, LAUS (Household) Survey and USDA Classifications

Industry Jobs

	(1000s)	Annual percent change	
	Q1:2002	Q4:2001	Q1:2002
Rural			
Total	25304.6	-1.5	-1.3
Construction and mining	1381.5	-1.0	-4.3
Manufacturing	4251.5	-8.0	-6.7
Trade	5842.5	-.3	-.6
Trans, comm & public utilities	1093.9	-5.0	-4.0
Finance, insurance & real estate	945.6	1.5	1.8
Services	6344.1	-.7	-.2
Government	5445.5	1.9	1.9
Metro			
Total	105180.4	-1.1	-.9
Construction and mining	5458.3	.6	-.8
Manufacturing	12792.5	-5.9	-5.2
Trade	23923.8	-1.5	-.7
Trans, comm & public utilities	5736.9	-3.4	-3.5
Finance, insurance & real estate	6737.8	.5	-.2
Services	34121.3	-.5	-.2
Government	16409.8	2.0	1.6

Source: BLS, CES (Business) Survey

Rural Employment by County Type

	(1000s)	Annual percent change	
	Q1:2002	Q4:2001	Q1:2002
Typology Codes			
Farming	2,131.8	.31	1.82
Mining	1,133.5	1.66	.64
Manufacturing	7,667.9	-1.15	.13
Government	3,092.0	.03	.84
Services	5,132.3	.29	1.43
Nonspecialized	5,530.5	-.25	.88
Policy Codes			
Recreation	3,956.9	.32	1.79
Retirment	2,784.9	.56	1.63
Persistent poverty	4,010.4	-1.23	.40
Commuting	3,064.8	-.32	.51

Source: BLS, LAUS (Household) Survey and USDA Classifications

Construction Activity

	(1000s)	Annual percent change	
	Q1:2002	Q4:2001	Q1:2002
Rural			
Total permits	55.7	-4.9	8.2
Single unit	47.9	-2.3	9.3
Total value ($)	6218.3	3.8	9.9
Single unit	5894.4	7.0	11.9
Metro			
Total permits	320.0	2.5	.1
Single unit	242.9	2.0	3.6
Total value ($)	39,281.9	5.3	4.8
Single unit	34,145.6	4.5	6.1

Source: Census Bureau

Note: Data for all tables are not seasonally adjusted.