Survey of Agricultural Credit Conditions

First Quarter 2006 FEDERAL RESERVE BANK of KANSAS CITY

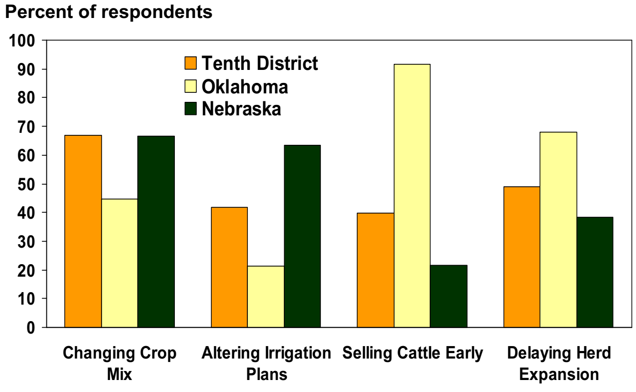
Drought conditions and high input costs signal caution

by Nancy Novack, Associate Economist

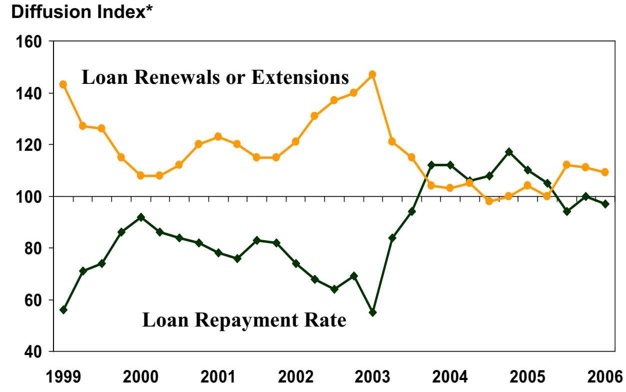
- District farm credit conditions held firm, but bankers are increasingly cautious about drought and high energy prices. When asked about the impact the drought was having on producers' production plans, the most common response for the district was a change in crop mix, especially in northern parts of the district such as Nebraska. However, in Oklahoma where the drought is most severe, the major drought impacts are focused on the cattle industry. There, the drought has delayed cattle herd expansion and forced cattle into feedlots earlier than normal.

- Some bankers commented that higher production costs are having a bigger impact on production plans than the drought. As a result of the higher costs, the index of farm loan repayment rates pulled back in the first quarter. The index of renewals and extensions edged down, improving only marginally from the spike last fall. Looking ahead, nearly a fifth of respondents expect these credit indicators to weaken in the coming quarter.

Drought Impacts on Production Plans



Loan Repayment Rates and Renewal and Extensions

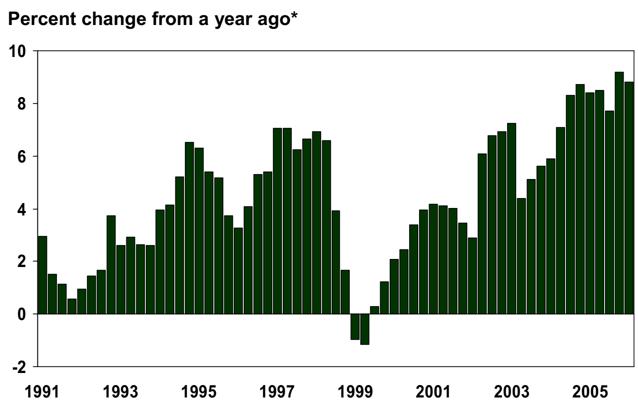


*Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100.

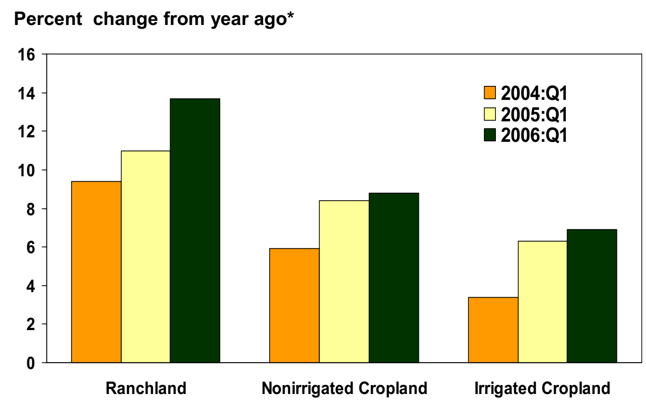
- Annual gains in district farmland values remained solid in the first quarter. On average, growth in nonirrigated cropland values was 8.8% over a year ago, slightly slower than the previous quarter's growth rate. Growth in district irrigated cropland values was 6.9%. Ranchland values remained robust, increasing 13.7% over last year. Gains were especially strong in Missouri, Oklahoma, and the Mountain States, but gains in Nebraska have slowed from the strong levels posted in 2005.

- Industry analysts are predicting a slowing of farmland value gains in 2006, and this trend is starting to surface in bankers' expectations of farmland values. Respondents were asked their expectations for the trend in farmland values in the next three months. Compared to last year, fewer bankers expect values to increase in the coming quarter. In addition, a larger share expected steady or declining values, suggesting that gains may moderate in future surveys.

Nonirrigated Cropland Values

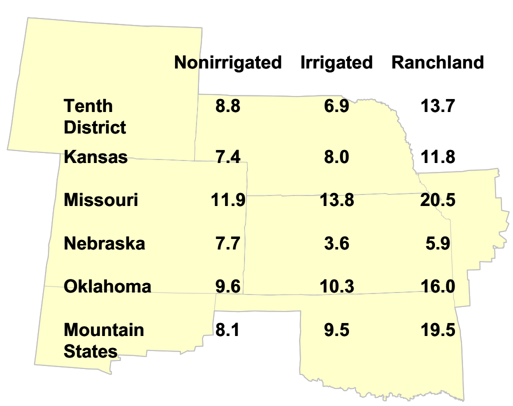


Farmland Value Gains



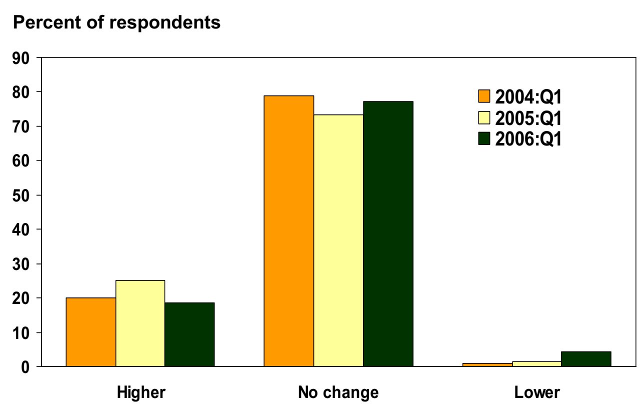
Farmland Value Gains by State

Percent change from year ago*



	Nonirrigated	Irrigated	Ranchland
Tenth District	8.8	6.9	13.7
Kansas	7.4	8.0	11.8
Missouri	11.9	13.8	20.5
Nebraska	7.7	3.6	5.9
Oklahoma	9.6	10.3	16.0
Mountain States	8.1	9.5	19.5

Expected Trend in Farmland Values
(next 3 months)

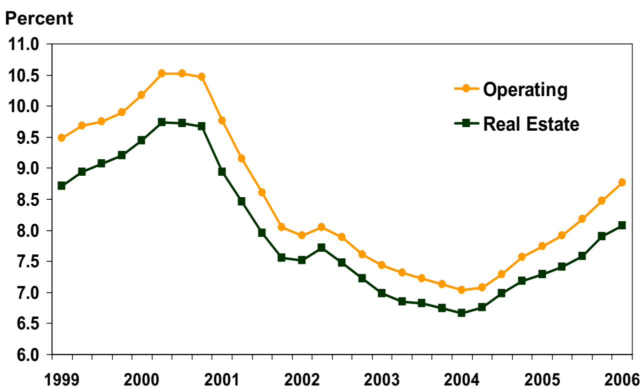


* Percent changes are calculated using responses only from those banks reporting in both the past and the current quarter.

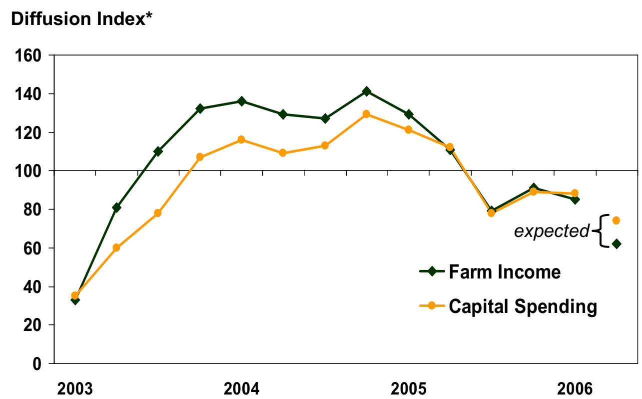
- Interest rates on new farm loans moved up in the fourth quarter. At the end of the quarter, interest rates on new farm loans averaged 8.48% for operating loans, 8.40% for machinery and intermediate-term loans, and 7.90% for real estate loans. Since the end of December, interest rates in national money markets have moved higher.

- The indexes of farm income and capital spending remained below year-ago levels in the first quarter (diffusion indexes below 100 indicate a contraction). Respondents expect a further decline in the upcoming quarter relative to last year. More than 40% expect farm incomes to decline from a year ago, while a third expect capital spending to fall.

District Farm Interest Rates



Farm Income and Capital Spending



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Selected Comments from District Bankers

"Land values have exploded in this area. It's great for those who are selling but paints a fairly bleak picture for operators wanting to expand or begin farming. It appears a correction is looming in the near future." *–NE Kansas*

"Net worths on financial statements have generally held steady or gone up slightly. However, cash flow projections with today's prices and production costs make future progress questionable." *–E. Nebraska*

"Drought conditions are extreme resulting in adjustments to cattle numbers and cropping plans." *–SW Oklahoma*

"The outlook for irrigation water supplies is not looking good for this area. Petroleum prices are impacting all ag producers. Managers are being very keen in their decisions around the cost of additional inputs relative to the benefit received." *–SE Colorado*

Note: 277 banks responded to the first quarter Survey of Agricultural Credit Conditions in the Tenth Federal Reserve District—an area that includes Colorado, Kansas, Nebraska, Oklahoma, Wyoming, the northern half of New Mexico, and the western third of Missouri.
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The views expressed in this article are those of the author and do no necessarily reflect the views of the Federal Reserve Bank of Kansas City or the Federal Reserve System.

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