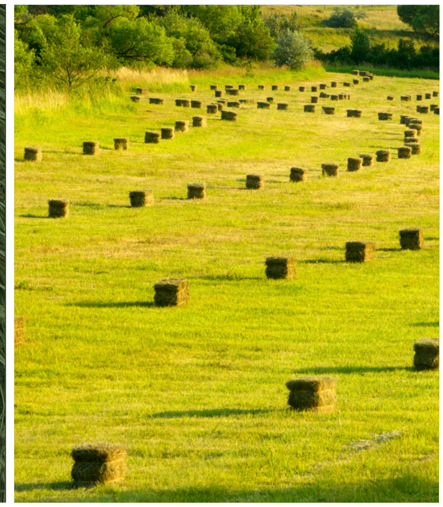
SURVEY *of* TENTH DISTRICT

Agricultural Credit Conditions



3rd Quarter 2013 | Federal Reserve Bank *of* Kansas City

Crop Prices Tumble on Rebound in U.S. Production

By Nathan Kauffman, Omaha branch executive, and Maria Akers, associate economist

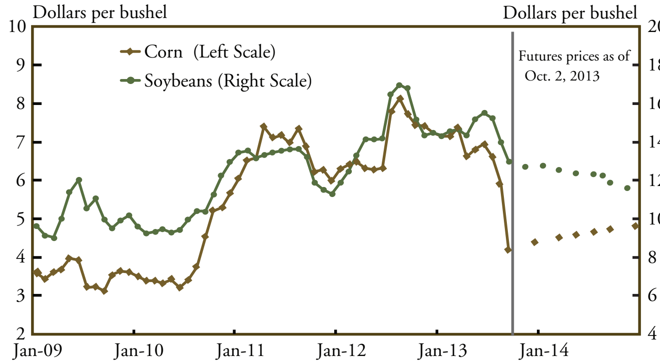
Falling crop prices dragged Tenth District farm income lower in the third quarter. After last year's drought, a rebound in U.S. crop production was under way in September, leading to a sharp drop in prices. Although persistent drought in the Western Plains stressed some District crops, preliminary estimates suggested that production would be relatively strong in many growing regions. However, the rebound in production may not have been enough to overcome the decline in prices, and more District bankers reported farm income fell short of year-ago levels. In fact, survey respondents noted some producers were holding grain inventories, hoping for higher prices in the future. Farm income was expected to remain soft for the remainder of the year despite some support from crop insurance and a gradual improvement in livestock sector profitability resulting from lower feed costs.

Despite lower farm income, farmland value gains did not moderate much in the third quarter. Bankers indicated that demand for high-quality farmland outpaced supply as fewer farms were for sale during the growing season. Both nonirrigated and irrigated cropland values were approximately 20 percent higher than a year ago while ranchland values gained 15 percent.

Farmland value gains continued to exceed annual increases in cash rental rates. A measure of cropland values relative to cash rents was nearly 50 percent higher than a comparable price-to-earnings measure in equity markets in the third quarter. However, an increasing number of bankers expected farmland values to plateau by the end of 2013. Some agricultural lenders have responded to the steep rise in farmland values by lowering loan-to-value ratios for farm real estate loans.

Shrinking incomes spurred demand for farm operating loans in the third quarter and cut farm capital spending. Loan repayment rates generally held steady, but bankers noted more requests for loan renewals and extensions. Interest rates on farm operating loans edged down and loan-to-value ratios for operating loans held steady.

Chart 1
U.S. Crop Prices



Source: Commodity Research Bureau and Chicago Board of Trade.

Chart 2
Tenth District Farm Income

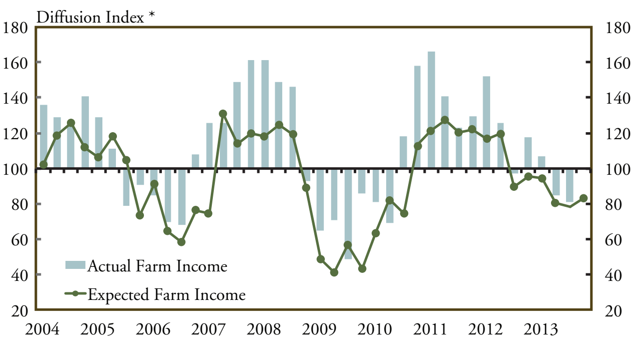
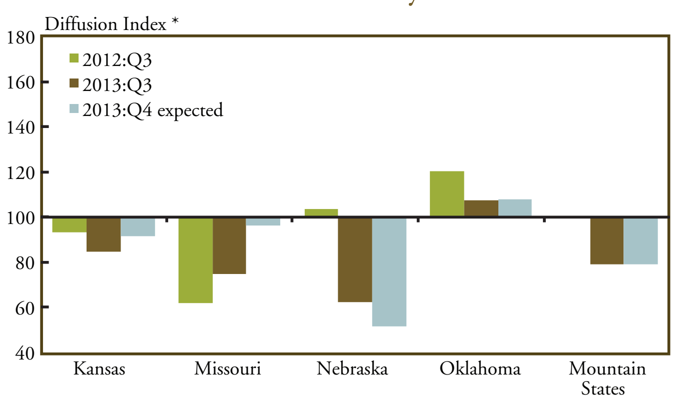


Chart 3
Tenth District Farm Income by State



**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 is computed by subtracting the percentage of bankers who responded "lower" from the percentage who responded "higher" and adding 100.*

U.S. crop prices dropped sharply in the third quarter. In contrast to last year when drought-reduced yields spurred crop prices higher at harvest, a rebound in U.S. corn and soybean production pushed down prices in 2013 (Chart 1). In fact, the national cash price for corn plunged from a peak of $7.51 per bushel in March to $4.19 at the end of September, a 44-percent decline. Soybean prices dropped 11 percent in the same period. Futures markets also indicated that corn prices could remain below $5.00 per bushel through year-end and soybean prices may decline further.

The sharp drop in crop prices weighed on District farm income in the third quarter. Bankers reported a drop in farm income from last year despite some indications of better-than-expected crop yields throughout the District (Chart 2). While drought lingered in the Western Plains during much of the growing season, irrigation and August rainfalls helped corn and soybean yields return close to trend levels in most District states. Crop insurance could also underpin income in areas with poor yields or crop loss. Still, more bankers expected that District farm income would remain below year-ago levels primarily due to lower crop prices.

Farm income varied across the District during the third quarter (Chart 3). Bankers in Kansas and Missouri reported a drop in farm income in the quarter for the second straight year. After farm income increased slightly in 2012, a growing number of Nebraska bankers expected this year's farm income would fall short of last year's strong levels, particularly if producers refrain from selling harvested crops while waiting for higher prices. In contrast, more Oklahoma bankers reported a modest rise in farm income, noting that lower crop prices reduced feed costs for the livestock sector. Land lease revenues from mineral rights also supplemented farm income in energy-producing regions.

Chart 4
Tenth District Farmland Values–Annual Gains

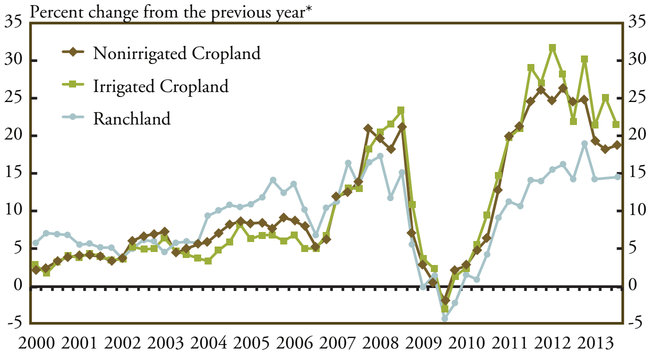


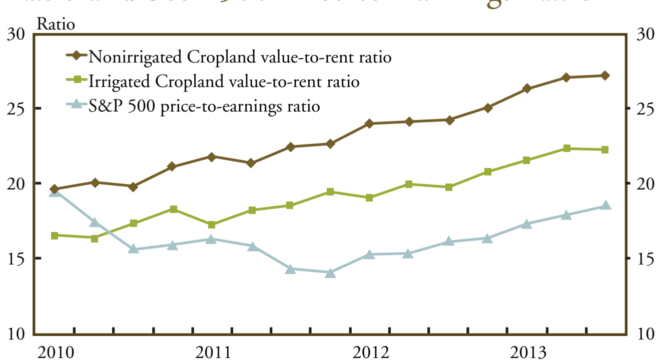
Table 1
Farmland Value Gains by State

Percent change from previous year*

	Nonirrigated	Irrigated	Ranchland
Kansas	22.5	20.6	16.8
Missouri	27.2	n/a**	13.2
Nebraska	13.1	20.4	19.5
Oklahoma	11.9	23.6	8.3
Mountain States	21.2	20.9	6.3
Tenth District	18.7	21.5	14.6

** Not reported due to small sample size.

Chart 5
Tenth District Farmland Value-to-Cash Rent Ratio and S&P 500 Price-to-Earnings Ratio



Source: Tenth District Agricultural Credit Survey and Standard and Poor's Indexes.

Despite weaker farm income, growth in District cropland values was only slightly slower than the previous two years. With drought still lingering in the Plains, irrigated cropland has posted the strongest annual value gains for the past year, rising almost 22 percent above 2012 levels in the third quarter (Chart 4). Nonirrigated cropland values increased 19 percent in the third quarter compared with last year while year-over-year gains in ranchland values held steady at just below 15 percent. In addition, irrigated, nonirrigated and ranchland values rose 0.9, 2.8 and 2.0 percent, respectively, from the second quarter to the third quarter of 2013.

With less farmland typically for sale before harvest, strong demand for high-quality cropland kept prices elevated. However, some survey respondents noted longer marketing times and commented that price gains had moderated somewhat. For example, as of the end of September, the value of nonirrigated cropland in Nebraska increased 13 percent from 2012 to 2013, significantly less than the 30-percent gain from 2011 to 2012 (Table 1). Some states, however, continued to post annual gains similar to recent quarters. While most bankers surveyed expected farmland values would hold steady, some indicated farmland values could begin a gradual decline as 2014 approaches, particularly if income from crop production weakens further.

Farmland value gains have continued to outpace increases in cash rental rates, highlighting the potential for a future adjustment in farmland values. The ratio of nonirrigated cropland values to cash rents, historically less than 20, recently reached 27 in the District, according to survey results (Chart 5). Irrigated cropland values have also risen significantly faster than cash rents in recent years. This ratio is notably higher than an analogous measure in U.S. equity markets, the price-to-earnings ratio for the Standard and Poor's (S&P) 500, which is currently 18.

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

Chart 6
Tenth District Farm Loan Demand and Funds Availability

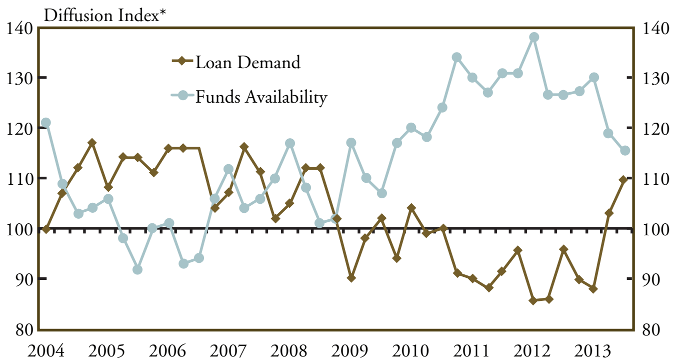


Chart 7
Tenth District Farm Interest Rates

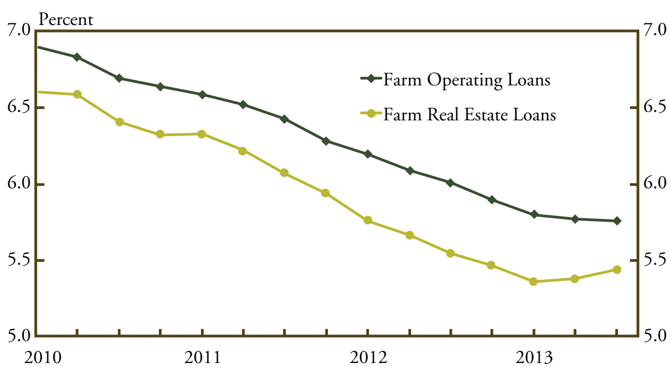
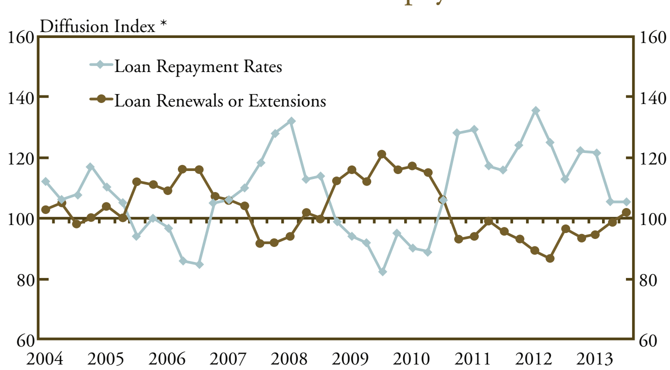


Chart 8
Tenth District Farm Loan Repayment Rates



**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 is computed by subtracting the percentage of bankers who responded "lower" from the percentage that responded "higher" and adding 100.*

Demand for farm operating loans strengthened further in the third quarter with reduced farm income and high production costs. Building on second-quarter gains, the third quarter index of farm operating loan demand climbed to a five-year high (Chart 6). More bankers noted a rise in short-term financing, particularly in Nebraska where the decline in the farm income index was steepest. In addition, farm capital spending was expected to wane as producers concentrated on current cash flow needs and potentially retained inventories to sell next year.

Funds were available to satisfy increased loan demand as agricultural lenders continued to compete for qualified borrowers. The average fixed interest rate on farm operating loans edged down in the third quarter and has fallen from 6.0 percent to 5.7 percent in the past year (Chart 7). In contrast, survey respondents indicated the average fixed interest rate on farm real estate loans moved slightly higher in the third quarter to 5.4 percent, but remained below the 5.6-percent rate reported last year. Bankers noted loan-to-value ratios for operating loans were little changed from previous surveys, averaging about 73 percent. Meanwhile, loan-to-value ratios for farm real estate loans have edged down during the past three years, dipping from about 73 percent to 70 percent. Collateral requirements eased in Oklahoma and the Mountain States, held steady in Kansas and Nebraska, and tightened slightly in Missouri.

Bankers reported farm loan repayment rates remained flat from the second to the third quarter (Chart 8). Furthermore, farm loan repayment rates were not expected to improve during the next three months due to weaker farm income. More bankers also noted a slight rise in requests for loan renewals or extensions as the index edged up for the third straight quarter, exceeding 100 for the first time since 2010.

BANKER COMMENTS *from* *the* TENTH DISTRICT

"With normal grain production in the Corn Belt, farmers' cash flows are going to get much tighter. With lower grain prices, we expect land prices and cash rents to go down 10 to 20 percent over the next few years."
–Southeast Nebraska

"We expect continued reliance on crop insurance as crop input prices go up and income drops."
– Northeast Colorado

"Cattle expenses are still high, but coming down. Farm income will decline with the grain market dropping."
– Western Kansas

"Ag income has been greatly reduced for 2013 due to carry-over effects from the drought."
– Southeast Colorado

"We have had significant rainfall that has increased buying interest in cattle and will improve crop yields."
– Northeast New Mexico

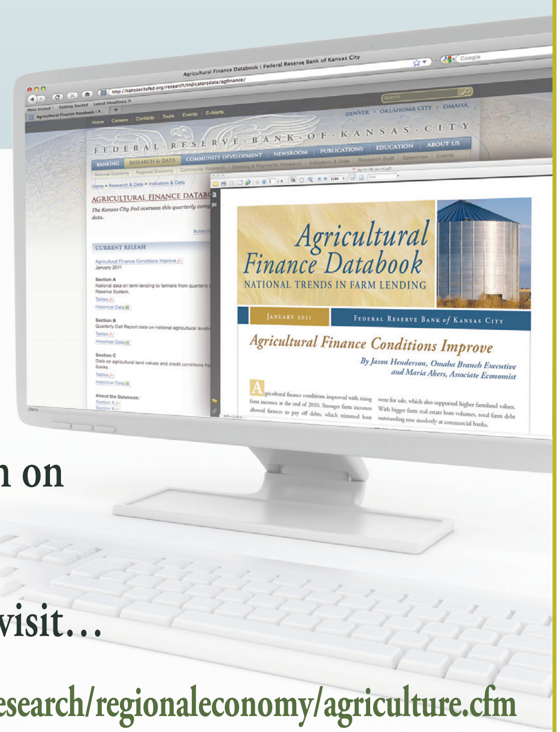
"We are expecting 10 to 20 percent less gross income for 2013 due to continuing drought and lower commodity prices. Smaller operations will struggle to make a profit."
– South Central Nebraska

"Land values have remained steady over the last few months." *– Western Missouri*

"Cash rents may soften as cash flows are adjusted for lower corn prices." *– Northwest Missouri*

"Lower grain prices are affecting year-end capital outlay plans." *– Northeast Kansas*

Notes: *A total of 219 banks responded to the Third-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. Please refer questions to Nathan Kauffman, Omaha branch executive, or Maria Akers, associate economist, at 1-800-333-1040, or* ***Nathan.Kauffman@kc.frb.org*** *or* ***Maria.Akers@kc.frb.org****. The views expressed in this article are those of the authors and do not necessarily reflect the views of the Federal Reserve Bank of Kansas City or the Federal Reserve System.*



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