Survey of Agricultural Credit Conditions

Second Quarter 2006 **FEDERAL RESERVE BANK *of* KANSAS CITY**

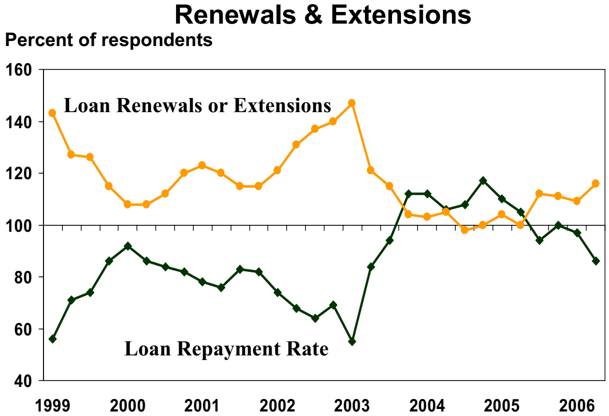
Drought conditions deepen and threaten the farm outlook

by Nancy Novack, Associate Economist

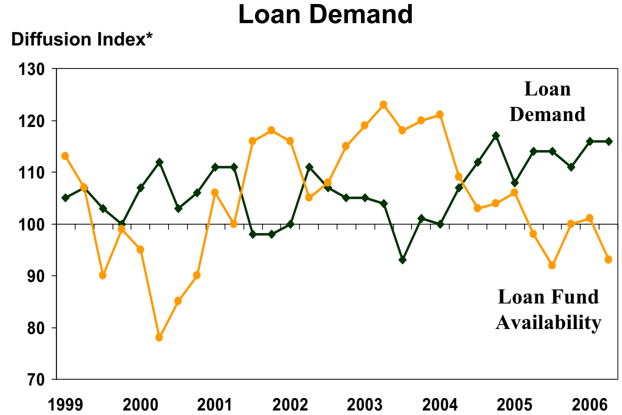
- Bankers' concerns about the impact of high production costs and drought conditions on farm incomes this year rang clear in the second quarter survey, conducted in late June. The index of farm loan repayment rates dropped again due to the tightening financial situation of many producers. In addition, bankers reported an increase in requests for renewals and extensions of existing farm loans. While the majority of respondents had not changed their credit standards, a third indicated they had tightened them somewhat compared to last year.

- Increased spending on input costs continued to push the index of farm loan demand higher in the second quarter. The index of loan fund availability dropped during the quarter. Most bankers reported no change in the availability of funds, but 16 percent reported that loan funds were lower than a year ago.

Loan Repayment Rates and Renewals & Extensions



Loan Fund Availability and Loan Demand



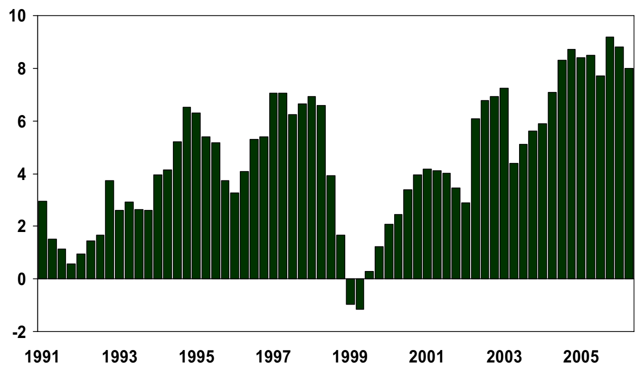
*Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and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

- Annual gains in district farmland values pulled back from recent quarters but remained healthy. On average, growth in nonirrigated cropland values was 8.0% over a year ago. Growth in district irrigated cropland values was 5.0%, nearly two percentage points lower than the previous quarter. Gains in ranchland values remained in the double digits, increasing 10.2% over last year. Missouri continued to post the strongest gains, while gains elsewhere in the district moderated from previous quarters.

- Although gains in land values are historically healthy, the slower gains realized this quarter, coupled with cooling expectations for land values in the near term, suggest the market may be decelerating. Continuing the trend reported in the first quarter, fewer bankers expect values to increase in the coming quarter. In addition, a larger share expected steady or declining values compared to recent surveys. Some bankers commented that nonlocal money, recreational demand, and purchases by large farms requiring little financing are propping up land markets. Rising interest rates and higher input costs are limiting many farmers' ability to make land purchases at the high prices.

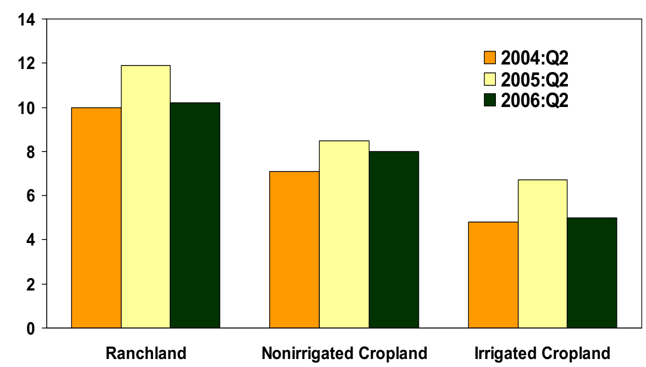
Nonirrigated Cropland Values

Percent change from a year ago*



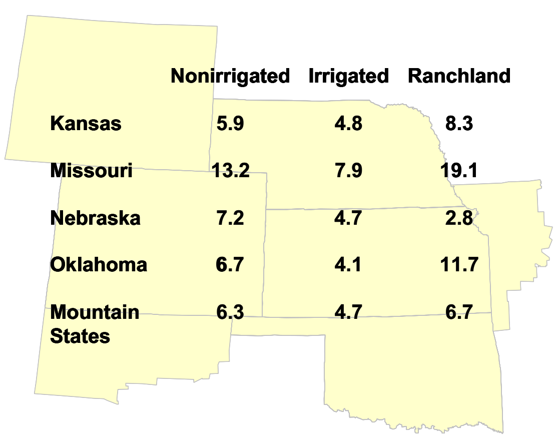
Farmland Value Gains

Percent change from year ago*



Farmland Value Gains by State

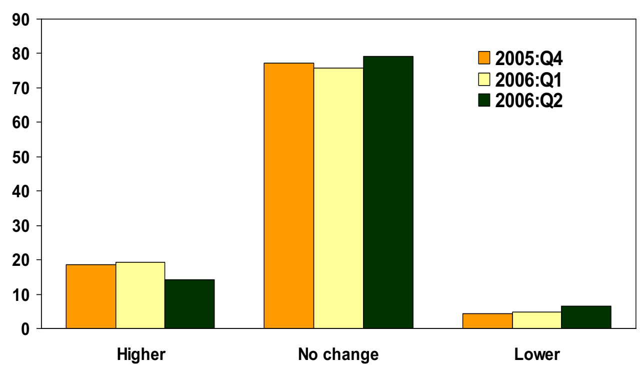
Percent change from year ago*



	Nonirrigated	Irrigated	Ranchland
Kansas	5.9	4.8	8.3
Missouri	13.2	7.9	19.1
Nebraska	7.2	4.7	2.8
Oklahoma	6.7	4.1	11.7
Mountain States	6.3	4.7	6.7

Expected Trend in Nonirrigated Farmland Values
(next 3 months)

Percent of respondents

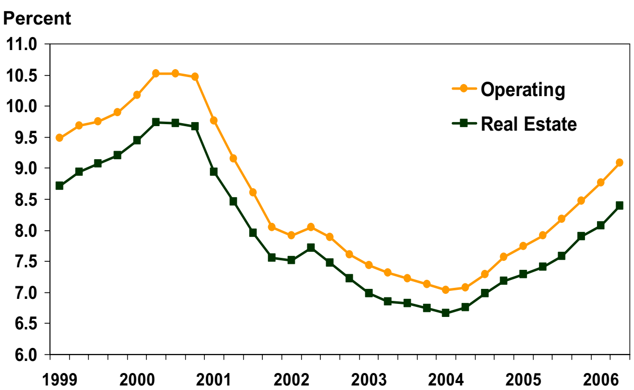


* Percent changes are calculated using responses only from those banks reporting in both the past and the current quarter.

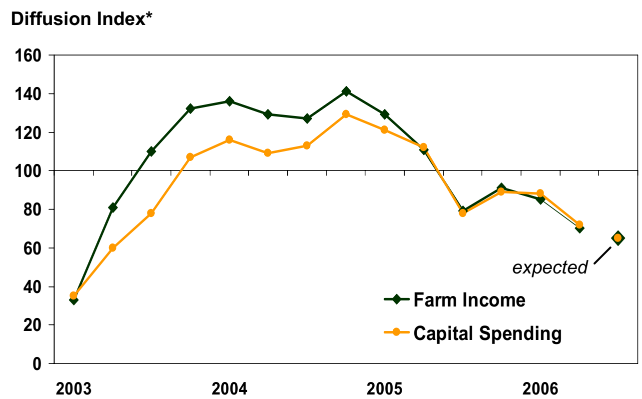
- Interest rates on new farm loans moved up again in the second quarter, continuing the trend that began two and a half years ago. At the end of the quarter, interest rates on new farm loans averaged 9.09% for operating loans, 8.91% for machinery and intermediate-term loans, and 8.40% for real estate loans.

- The indices of farm income and capital spending fell again in the second quarter. (diffusion indices below 100 indicate a contraction). Respondents' outlook for the upcoming quarter relative to a year ago suggest further weakening. More than 40% expect both farm incomes and capital spending to decline from a year ago in the third quarter of this year.

District Farm Interest Rates



Farm Income and Capital Spending



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Selected Comments from District Bankers

"The expense side of the income statement is out of control. Fuel, fertilizer, interest, and family living costs are rising in excess of income." *–NE Kansas*

"Approximately 30% of irrigated acres are idle due to water shortages in this area of Colorado. Cow herds are also reduced by 30% to 50% because of forage reductions in pastures. Some operators are seeking part-time off-farm employment to fill the income gap." *–SE Colorado*

"It appears that the demand for farmland may be slipping. Most of the land bringing really high prices is an IRS 1031 exchange." *–NC Missouri*

"This is the worst year our farmers have seen in a very long time due to high costs for fuel, fertilizer, and repairs and very dry conditions." *–Southern Oklahoma*

Note: 274 banks responded to the second 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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