Loan Performance Stays Strong as Farm Debt Grows

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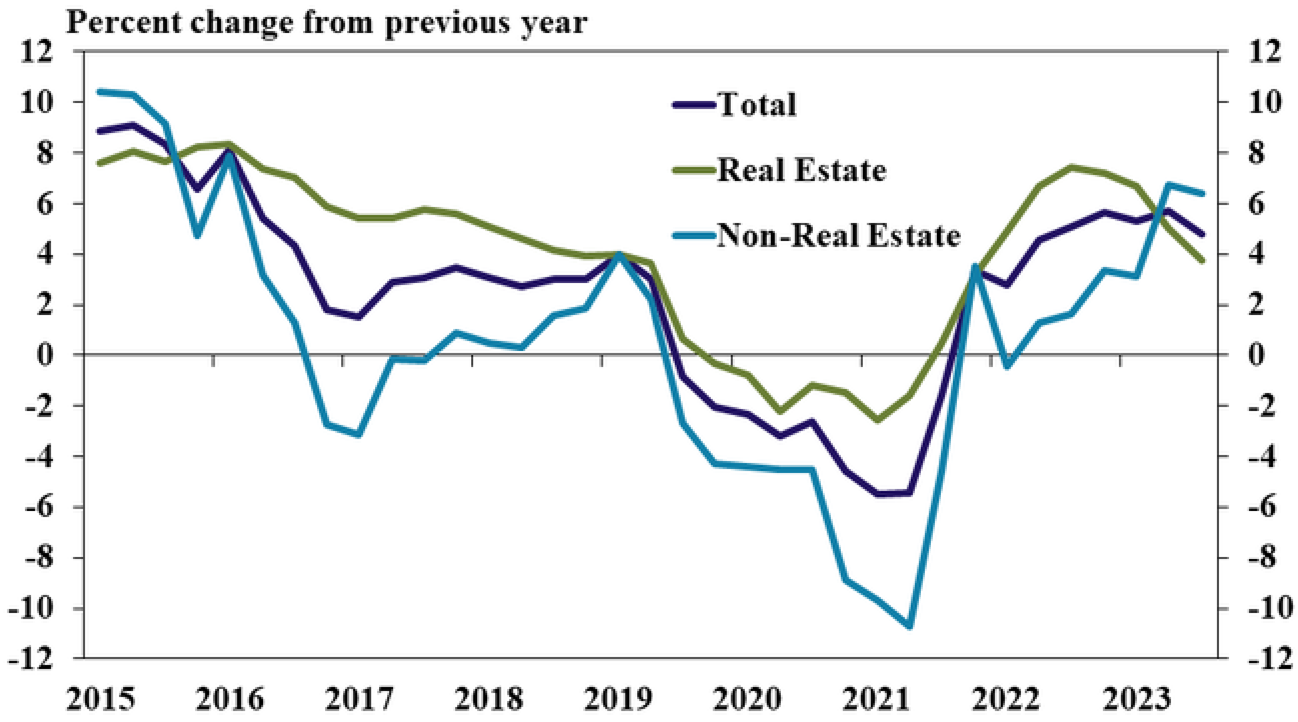
Farm debt balances at commercial banks grew steadily in the third quarter but loan performance remained strong. Despite some indications of slower lending activity in recent surveys and subdued loan demand for some lenders, outstanding debt at commercial banks in aggregate grew at a pace similar to the past year. Alongside ongoing strength in farm finances, delinquency rates on agricultural loans dropped for the third consecutive year and remained at historically low levels.

Steady loan growth has coincided with a pullback in deposit growth and firmed liquidity at agricultural banks. Higher interest rates have induced greater competition for deposits, pushed up costs of funding and compressed net interest margins slightly in recent months. Profits for agricultural banks, however, have stayed solid with support from higher interest income. Sound liquidity has continued to ease much of the risk surrounding elevated levels of unrealized losses at many banks and will remain important going forward.

Third Quarter Commercial Bank Call Report Data

The balance of agricultural debt continued to increase alongside growing demand for production loans. According to commercial bank Call Reports, farm debt was about 5% higher than the same time a year ago and has increased at a similar pace for nearly two years (Chart 1). The pace of growth in non-real estate debt was steady while growth in farm real estate debt was softer than previous quarters.

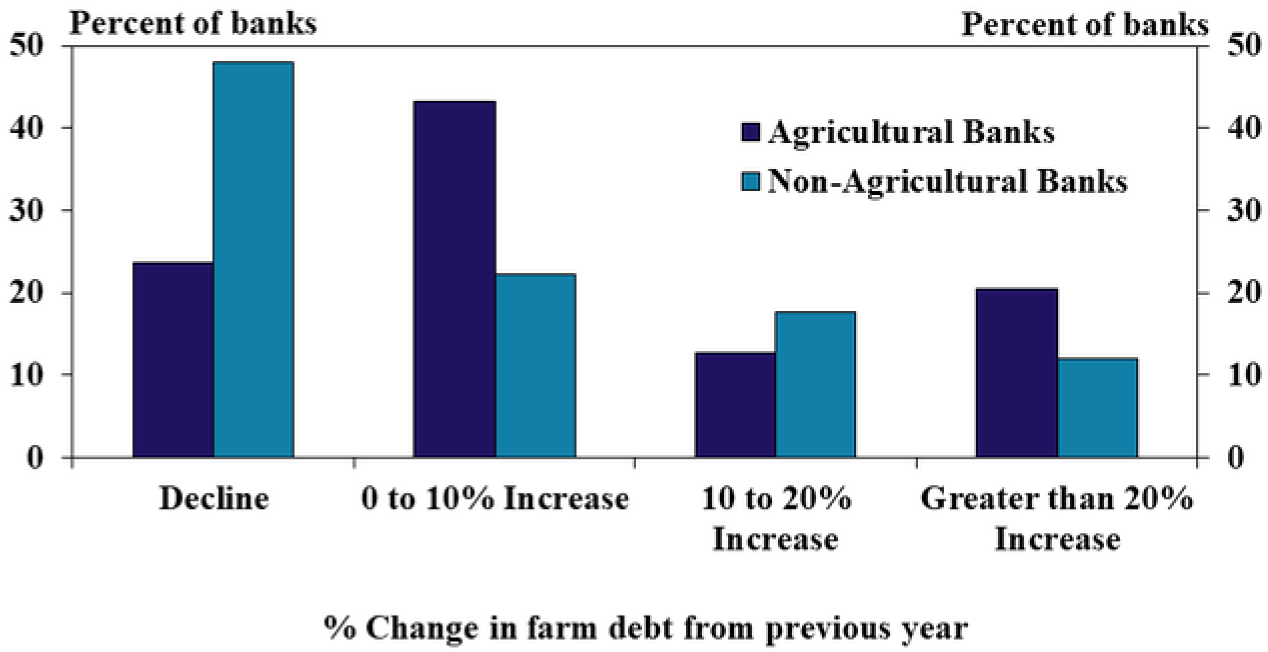
Chart 1: Farm Debt Outstanding at Commercial Banks



Sources: Reports of Condition and Income and Federal Reserve Board of Governors

Despite steady growth in total, farm debt remained subdued at some banks while growing considerably for others. Farm loan balances were lower than a year ago for a quarter of agricultural banks and half of non-agricultural banks (Chart 2). Outstanding debt grew by less than 10% for most agricultural banks, but increased more than 10% for a third of lenders.

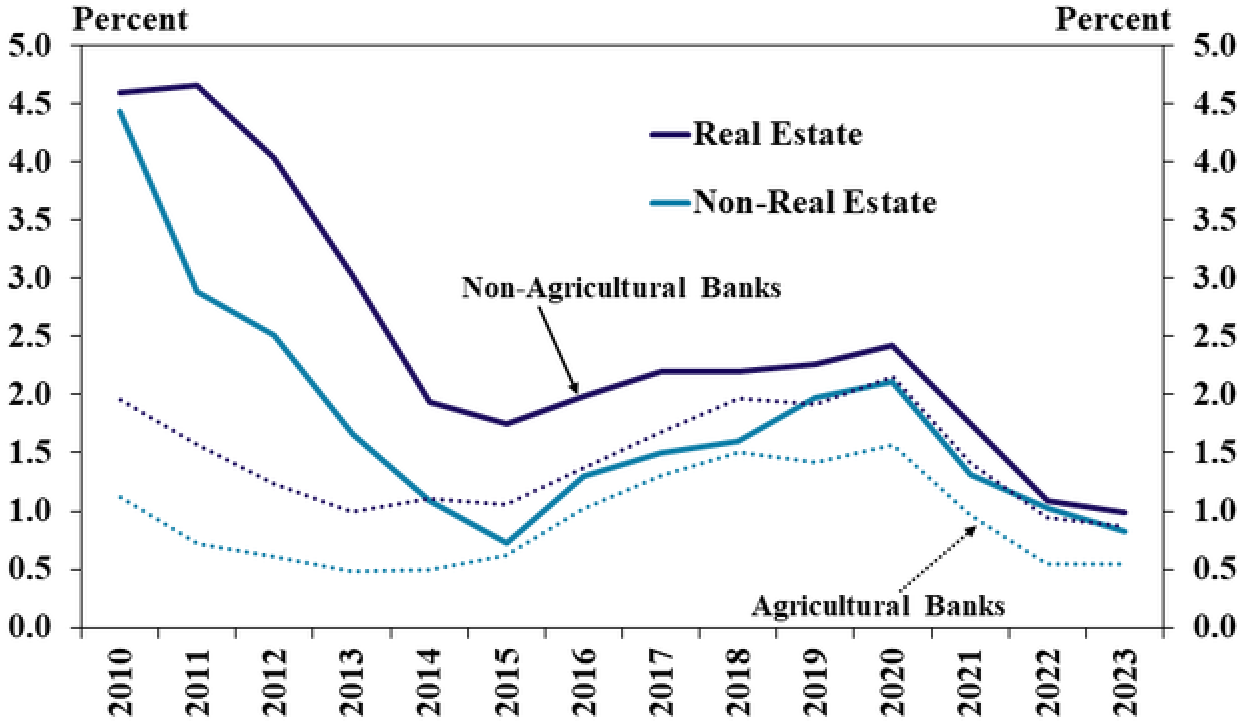
Chart 2: Share of Banks by Change in Outstanding Farm Debt, Q3 2023



Source: Reports of Condition and Income and Federal Reserve Board of Governors

Agricultural loan performance remained strong in the third quarter. Delinquency rates on both real estate and non-real estate farm loans declined for the third consecutive year at both agricultural and non-agricultural banks (Chart 3). Delinquencies dropped to all-time lows on real estate loans and were marginally higher than the all-time low for non-real estate loans.

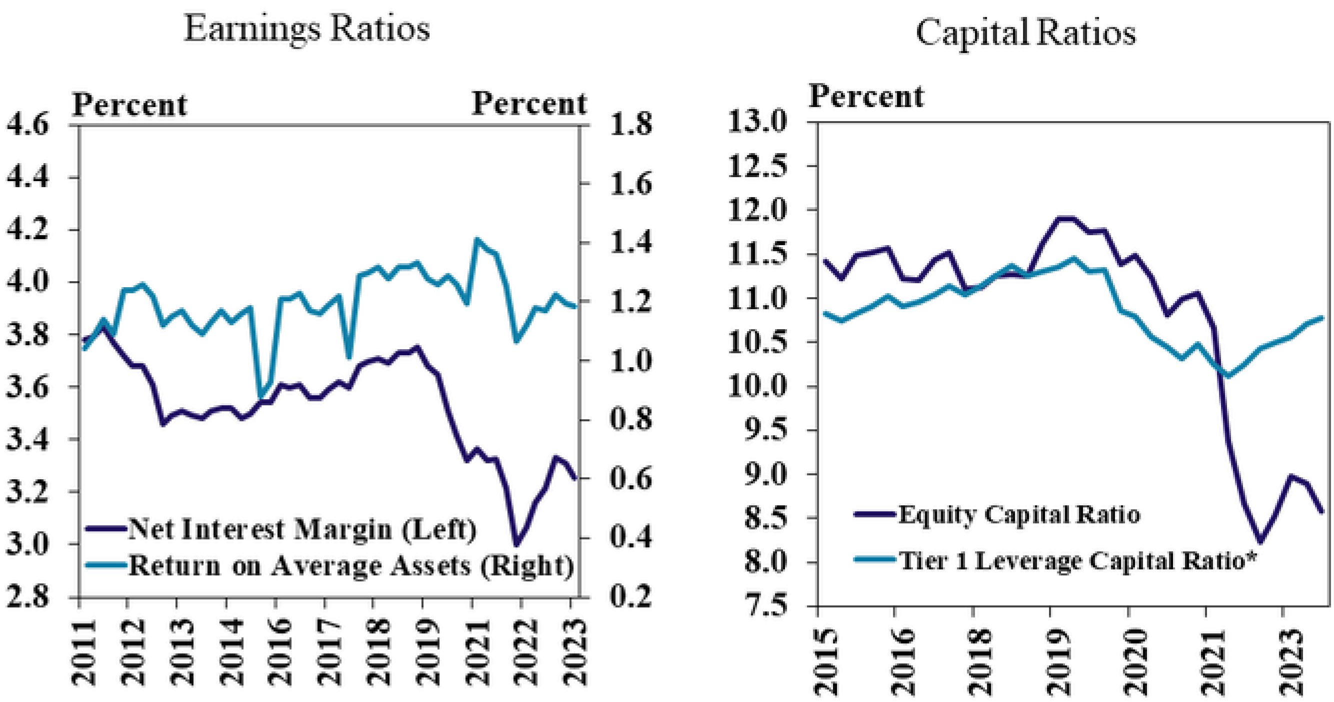
Chart 3: Farm Loan Delinquency Rates, Q3



Note: Delinquent farm loans include all agricultural loans past due 30 or more days or non-accruing. Agricultural banks include all banks with farm loans comprising at least 25% of total loans.
Sources: Reports of Condition and Income and Federal Reserve Board of Governors

Financial performance at agricultural banks also remained sound, despite some compression in margins and persistently elevated unrealized losses. The return on average assets at agricultural banks remained near the historic average, but was reduced slightly alongside a modest drop in the net interest margin that was squeezed by higher funding costs (Chart 4, left panel). The unrealized losses on investment portfolios remained elevated, but measures of capital excluding those valuations continued to improve (Chart 4, right panel).

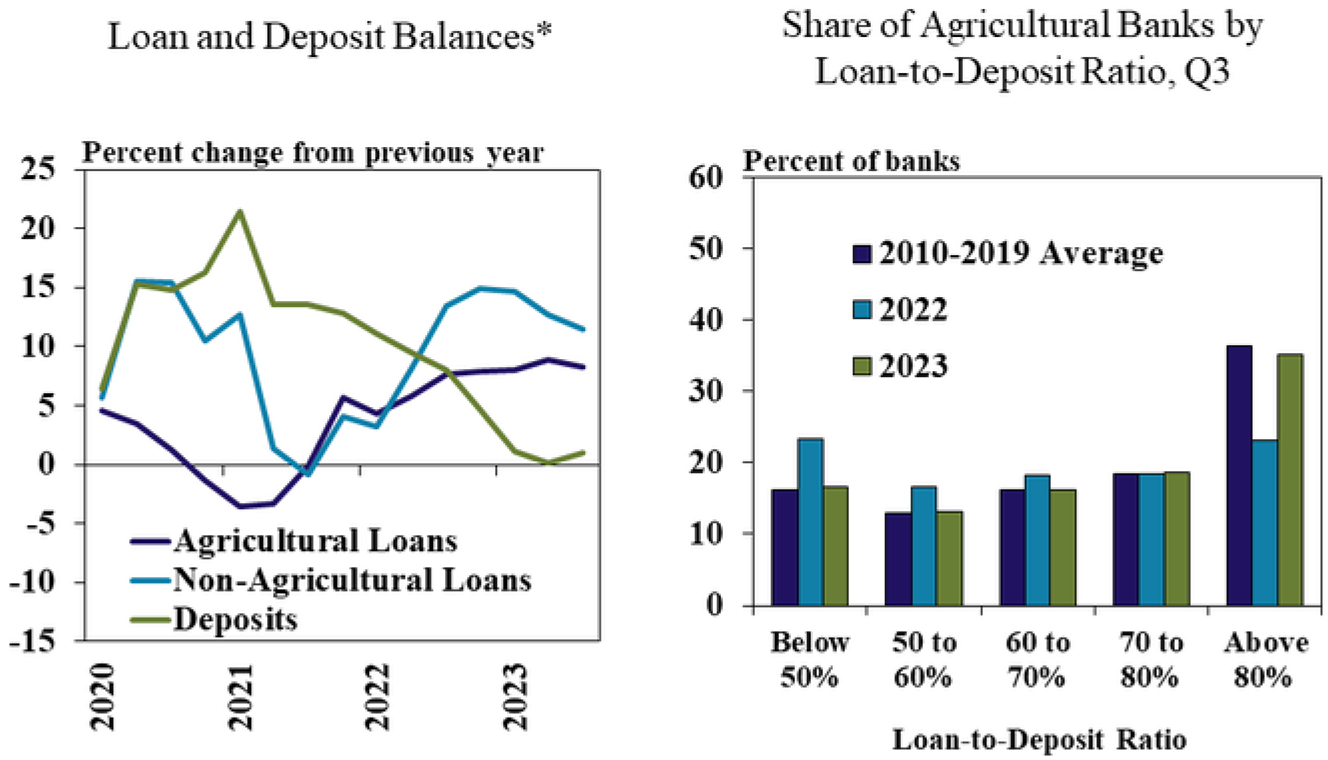
Chart 4: Select Financial Indicators at Agricultural Banks



*Unrealized gains (losses) are included in the calculation of accumulated other comprehensive income (AOCI). Banks may elect to "opt-out" of including AOCI in the calculation of Tier 1 Leverage Capital utilized for regulatory purposes. However, these amounts are included in the calculation of the equity capital variable utilized in the Ag Finance Update – Commercial Bank Call Report data tables.
Note: Agricultural Banks are defined as banks with total agricultural loans comprising at least 25% of total loans.
Source: Reports of Condition and Income and Federal Reserve Board of Governors

Strong loan growth and a dearth of new deposits has tightened liquidity for many lenders. Steady increases in agricultural and non-agricultural loans continued into the third quarter while deposit levels were flat (Chart 5, left panel). In contrast to recent years, with an abundance of liquidity, the share of agricultural banks with loan-to-deposit ratios above 80% increased to the average over the past decade.

Chart 5: Liquidity at Agricultural Banks



Note: Agricultural Banks are defined as banks with total agricultural loans comprising at least 25% of total loans.
*Figures are calculated using a panel of 1,000 agricultural banks from Q3 2023.
Source: Reports of Condition and Income and Federal Reserve Board of Governors

Data and InformationCommercial Bank Call Report Historical Data
Commercial Bank Call Report Data Tables
About the Commercial Bank Call Report Data

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Nate Kauffman is Senior Vice President and Omaha Branch Executive at the Federal Reserve Bank of Kansas City. In his role as the Kansas City Fed's lead economist and representative in the state of Nebraska, Nate provides strategic direction and oversight for the Omaha Branch, regional research, and economic outreach throughout the state. He serves as a local connection to the nation's central bank and is responsible for briefing the Kansas City Fed's president – a member of the Federal Open Market Committee – on regional economic and business activity.In addition, Nate is the Kansas City Fed's principal expert in agricultural economics. He is a leading voice on the agricultural economy throughout the seven states of the Tenth Federal Reserve District and the broader Federal Reserve System. Nate oversees several Bank and Federal Reserve efforts to track agricultural economic and financial conditions. He also speaks regularly on the agricultural economy to industry audiences and the news media, including providing testimonies at both U.S. Senate and U.S. House Agriculture Committee hearings.Nate joined the Federal Reserve in 2012. He received his Ph.D. in economics from Iowa State University. Prior to receiving his Ph.D., Nate spent three years in Bosnia and Herzegovina coordinating agricultural economic development projects.Nate lives in Omaha with his wife and four children.

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