



Tenth District Ag Credit Conditions Moderate

by: Cortney Cowley and Ty Kreitman

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Agricultural credit conditions in the Tenth District moderated in the second quarter and farmland values continued to increase. Following multiple years of considerable improvement, farm income softened, and borrower liquidity retracted somewhat alongside continued cost pressures and lower prices for most agricultural commodities compared to a year ago. Although cost increases have been more modest in 2023 than last year, many agricultural lenders expected loan demand to increase and repayment rates to decline in coming months. Despite sharp increases in interest rates and a notable slowdown in cash rents, farmland values still grew at a strong pace.

Despite some moderation, the Tenth District's farm economy was steady in the second quarter. Drought early in the quarter followed by heavy rains later contributed to difficulty with winter wheat harvest and spring planting. Some agricultural bankers commented that decreased grain prices, weather volatility, and stable production expenses could reduce borrower liquidity that had been very strong during renewal season. Higher interest rates have also increased borrowing costs for farmers, but loan demand has remained stable, and [bank liquidity](#) remained sound despite a slight pullback in deposit balances.

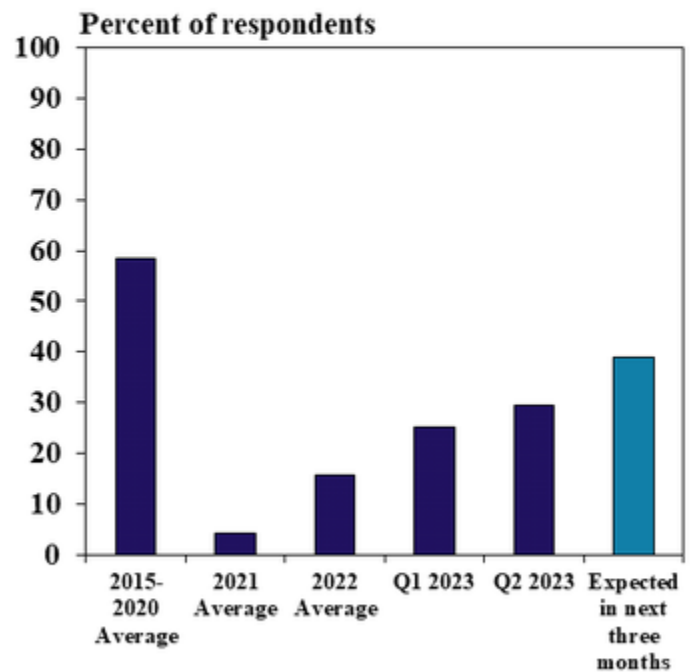
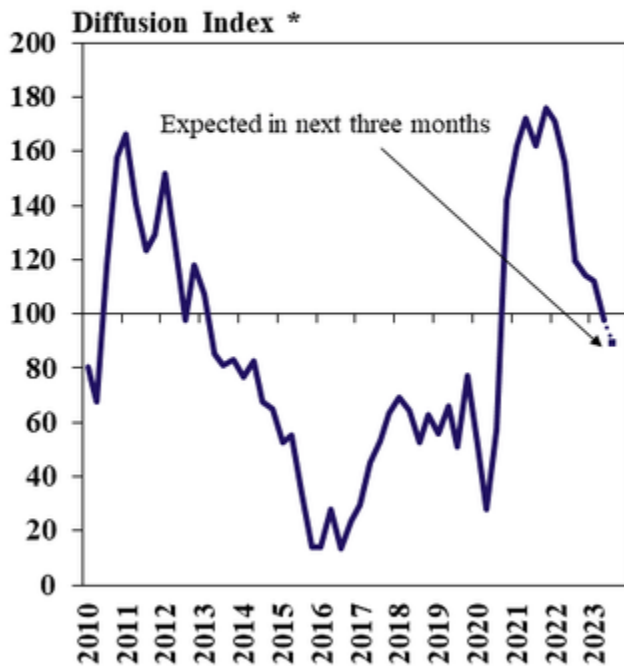
Credit Conditions

Farm incomes in the Tenth District have moderated alongside more tempered conditions in the agricultural economy. The changes in farm income across the region were flat in the second quarter following two years of considerable strength (Chart 1). The share of lenders reporting that farm incomes were lower than a year ago rose for the fourth consecutive quarter, and more than a third of respondents anticipated weaker conditions than last year in the next three months.

Chart 1: Tenth District Farm Income

Farm Income

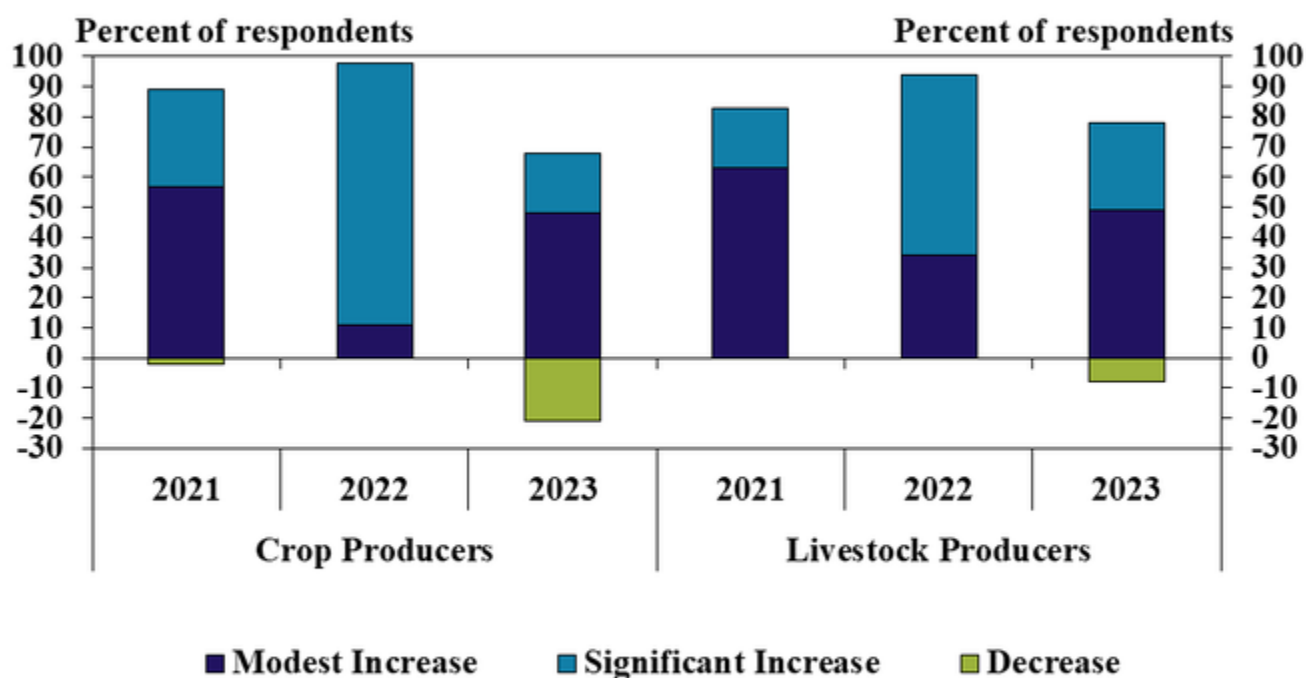
Share of Banks Reporting Lower Farm Income



*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 percentage of bankers who responded "lower" from the percentage who responded "higher" and adding 100.

Income growth has flattened alongside elevated production expenses, but cost pressures showed signs of easing. Well over half of respondents reported that production expenses for all types of producers continued to increase, but the degree of increase was notably more modest than last year (Chart 2). Costs for crop farmers declined in the lending areas of 20% of banks, while reductions in costs for livestock producers were more limited.

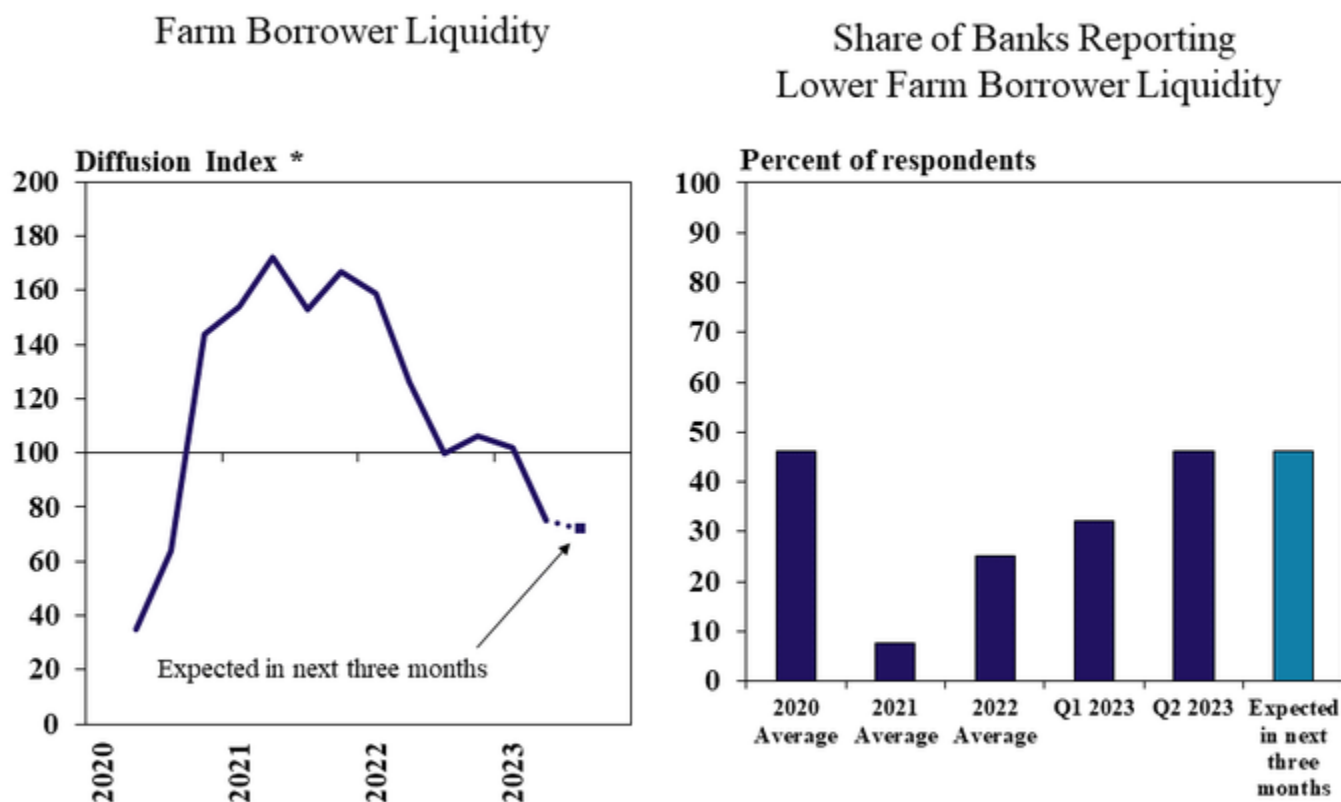
Chart 2: Change in Farm Production Expenses, Q2



Note: Respondents answered the following questions: How have year-to-date and planned production expenses changed for crop producers in your area relative to one year ago? How have year-to-date and planned production expenses changed for livestock and dairy producers in your area relative to one year ago?

Expense pressures and a moderation in commodity prices have reduced farm liquidity in the region. Farm borrower liquidity declined at a moderate pace in the second quarter for the first time since 2020 (Chart 3). Nearly half of respondents reported that producer cash reserves were less than the same time a year ago, and a similar rate of deterioration was expected in the next quarter.

Chart 3: Tenth District Farm Borrower Liquidity

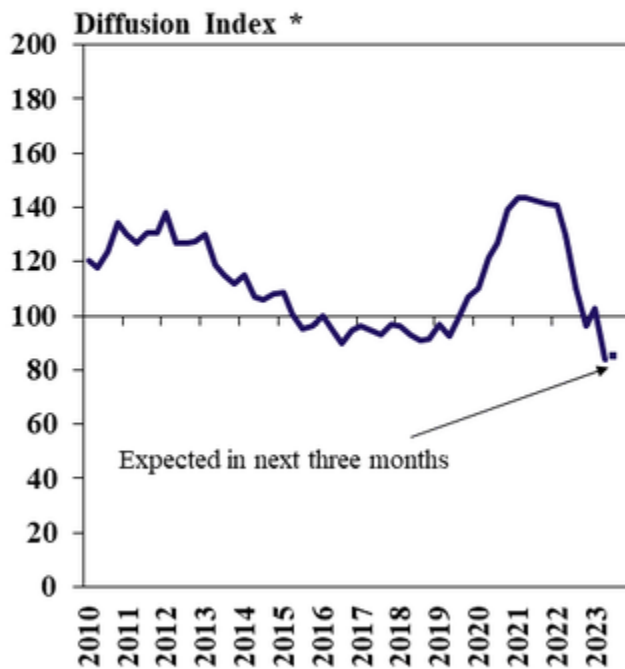


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 Note: Collection of information about Farm Borrower Liquidity began in Q2 2020.

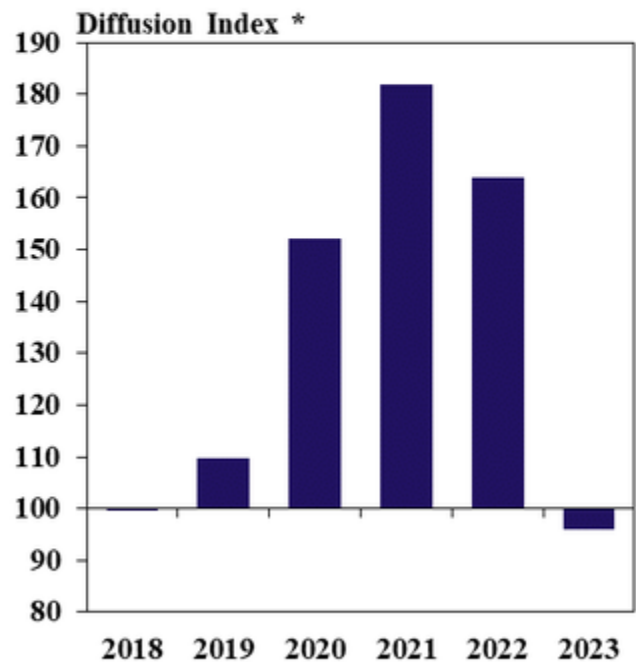
Bank liquidity has also retracted slightly in recent months as deposit growth has eased. Availability of funds declined at a modest pace in the second quarter following significant growth the past 2 years (Chart 4, left panel). Deposit balances were less than a year ago for many lenders, but [liquidity at agricultural banks](#) has remained sound following several years of strong deposit growth and subdued loan demand (Chart 4, right panel).

Chart 4: Tenth District Bank Liquidity and Deposits

Fund Availability



Bank Deposits, Q2

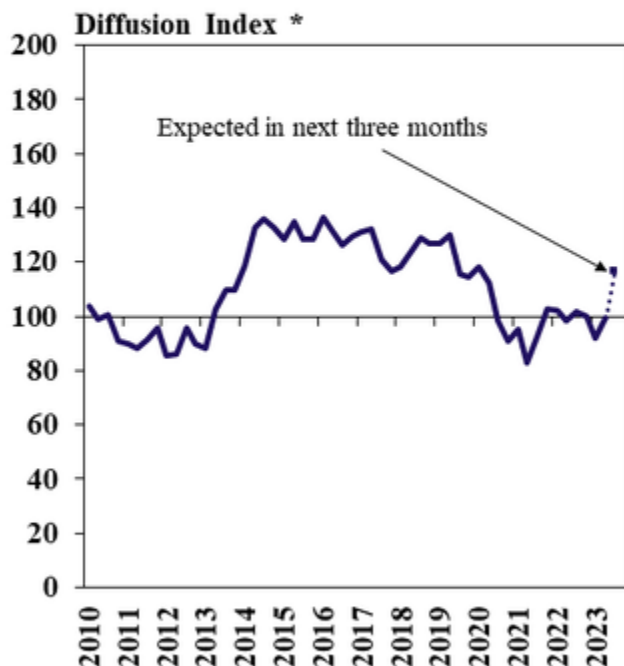


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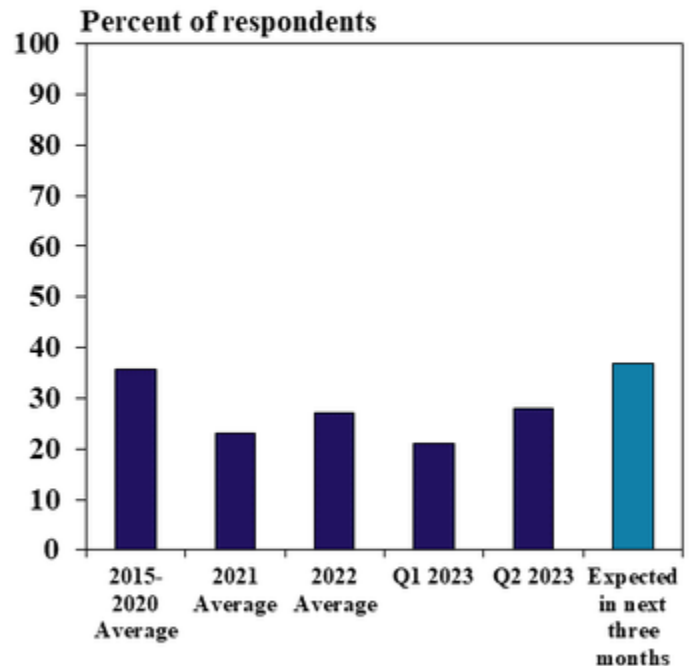
Loan demand in the District remained flat, but some bankers continued to expect a rebound alongside elevated costs and recent liquidity depletion. Demand for non-real estate farm loans was nearly unchanged across the region, with roughly a quarter of banks reporting increases and decreases from a year ago (Chart 5). Higher production costs have pushed up credit needs for some borrowers, while many others have utilized cash holdings to supplement loan balances and reduce interest expenses.

Chart 5: Tenth District Farm Loan Demand

Farm Loan Demand



Share of Banks Reporting Higher Farm Loan Demand



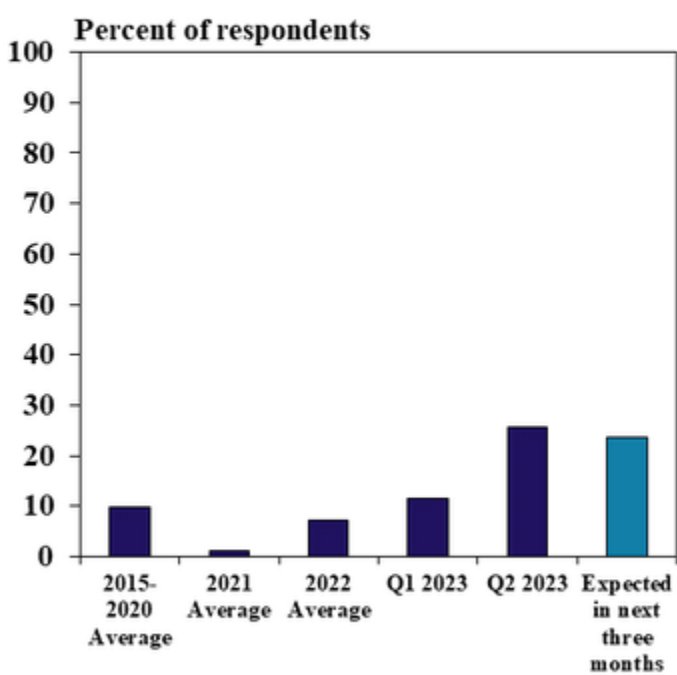
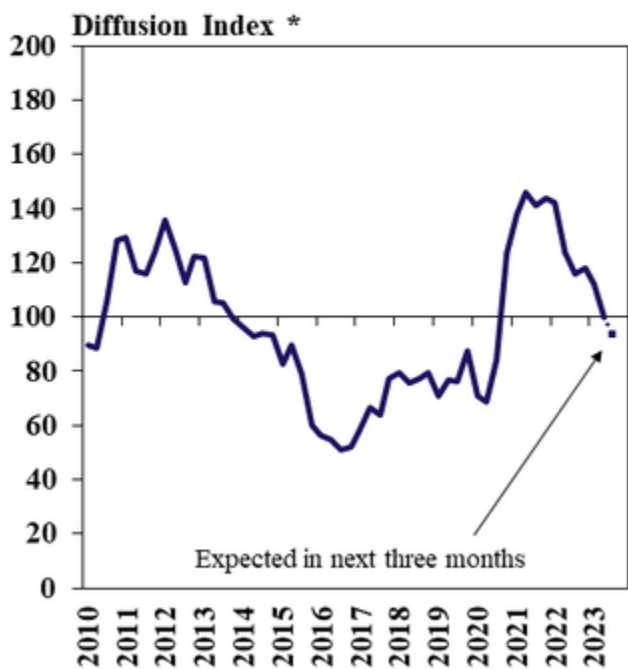
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Similar to farm income, improvement in farm loan repayment rates has also moderated in recent months. Changes in farm loan repayment rates were flat in the second quarter following considerable improvement during recent years (Chart 6). The share of banks reporting slower repayment reached the highest level since 2020 and a similar share expected some slowing in the months ahead.

Chart 6: Tenth District Farm Loan Repayment Rates

Farm Loan Repayment Rates

Share of Banks Reporting Lower Farm Loan Repayment Rates

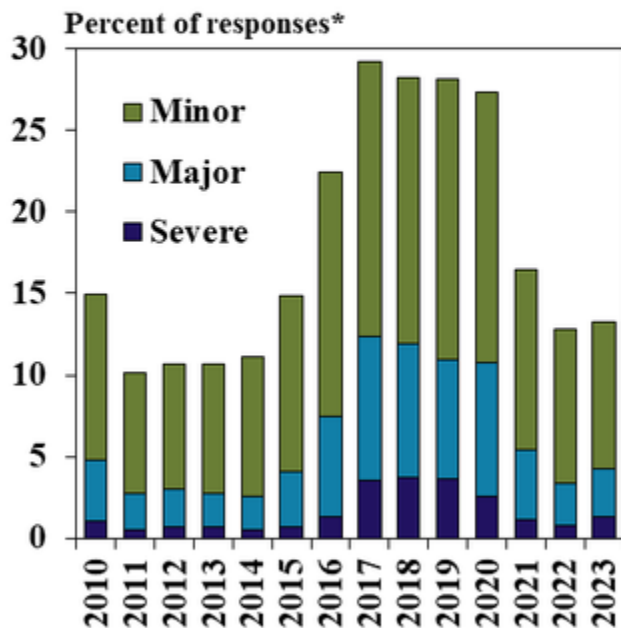


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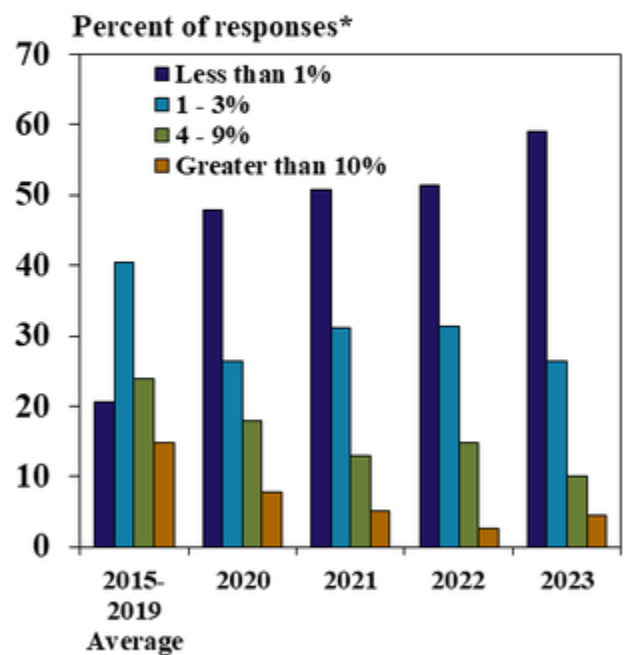
The degree of repayment issues, however, remained marginal through the second quarter. On average across the District, fewer than 15% of all farm loan balances had repayment problems and the vast majority of issues were considered minor (Chart 7). The broad strength in agricultural credit conditions also kept the rate of denials on farm operating loans at historically low levels.

Chart 7: Degree of Repayment Problems and Loan Denials, Q2

Share of Farm Loan Portfolio with Repayment Problems



Share of Farm Operating Loan Applications Denied

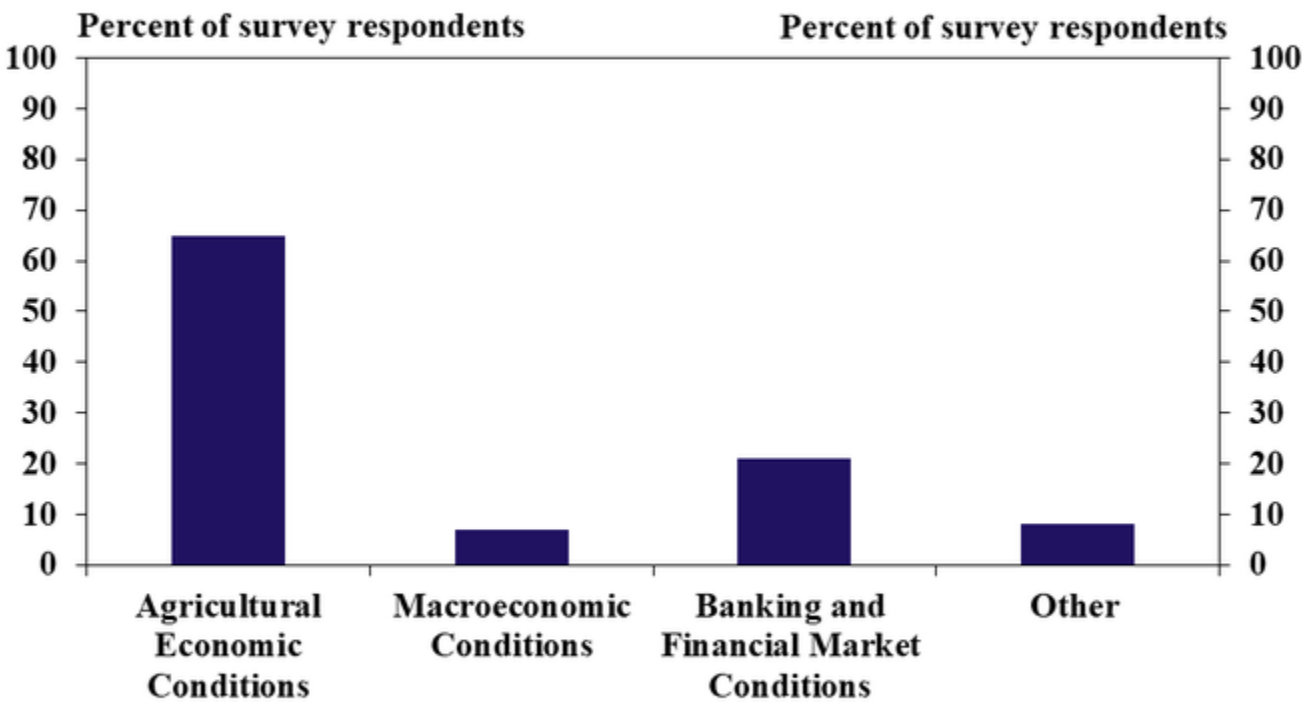


*Survey average

Note: Respondents answered the following questions: Please indicate the percentage of the dollar amount of your bank's farm loan portfolio that currently falls within each of the following repayment classifications (None, minor, major or severe). From January 1 to now of this calendar year, what percentage of your total farm operating loan applications were denied?

Conditions in the farm economy remained the primary factor for determining credit standards for agricultural borrowers, but banking and financial market conditions were more important for some lenders. About two-thirds of respondents indicated that agricultural economic conditions were the most influential factors in agricultural loan application decisions (Chart 8). A smaller, but sizable 20% of banks considered broader banking and financial market conditions the most important factor.

Chart 8: Factors Most Influencing Credit Standards, Q2 2023

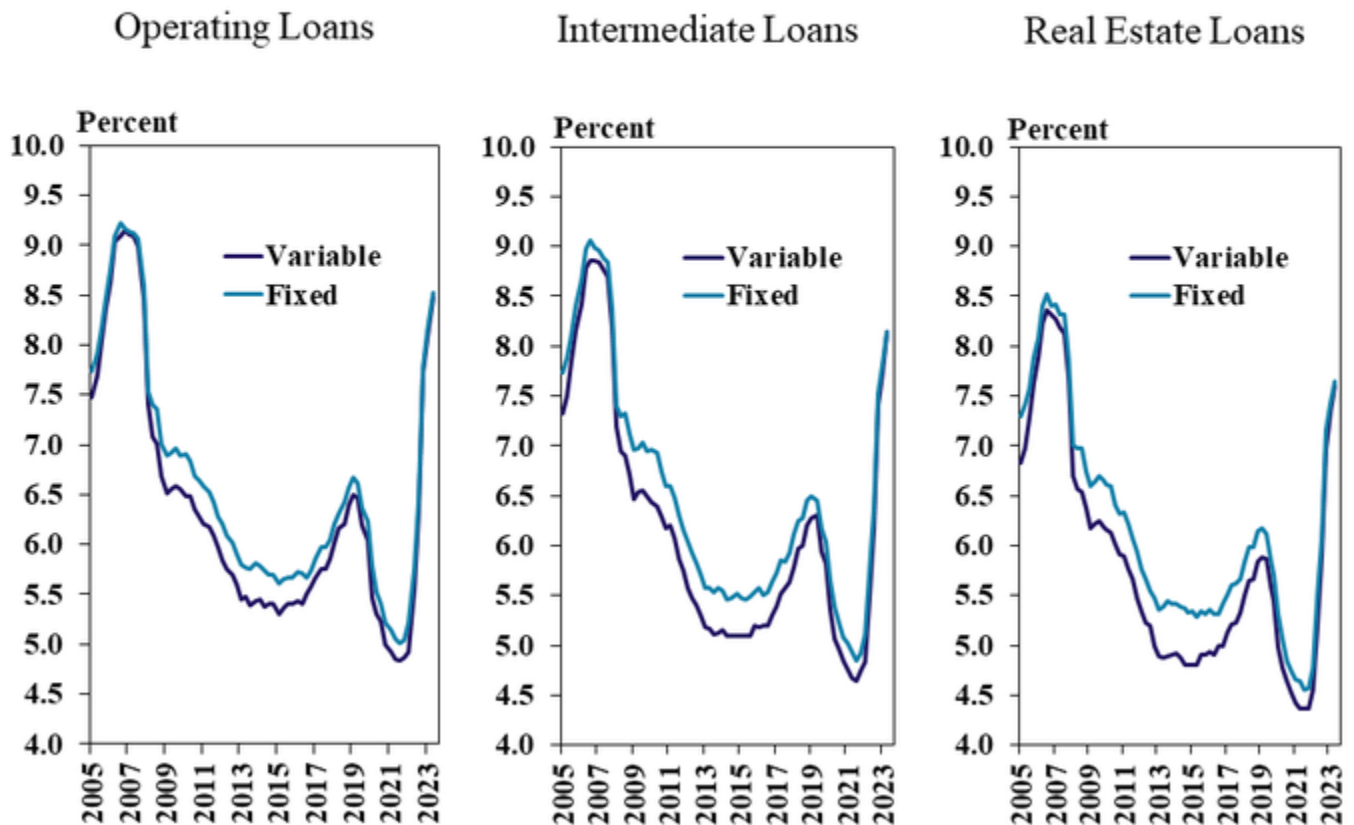


Note: Respondents answered the following question: What factor has most influenced the credit standards for approving agricultural loans at your bank during the past three months when compared with the same three months a year ago?

Interest Rates and Farmland Values

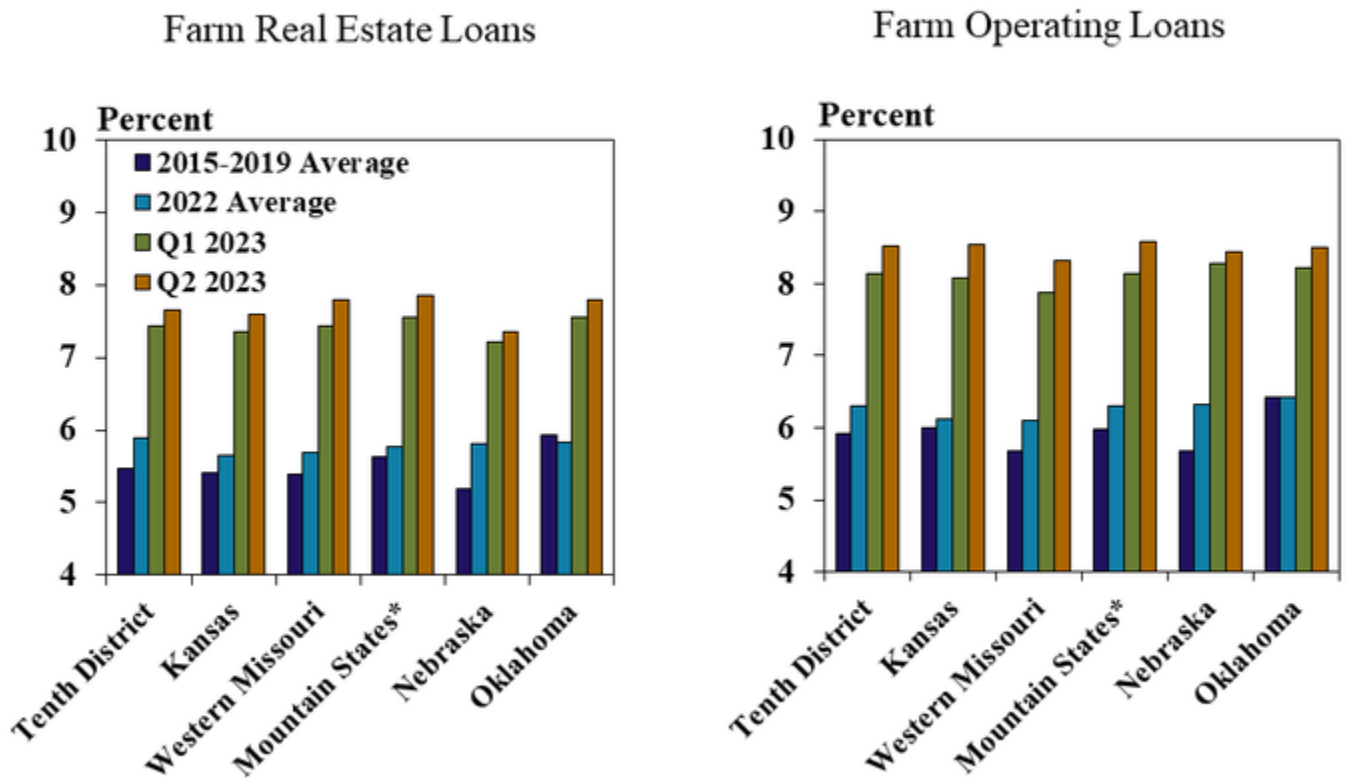
Average interest rates increased from the previous quarter alongside further increases in the federal funds rate, and the spread between variable and fixed rates narrowed. In the second quarter, interest rates on operating and intermediate loans increased by about 40 basis points from the previous quarter, and rates on real estate loans were more than three percentage points higher than in 2021 (Chart 9). Fixed rates have historically been higher than variable rates, particularly during periods of rate reduction, however, variable and fixed rates were nearly equal for all loan types in the second quarter.

Chart 9: Average Tenth District Interest Rates



Interest rates on farm real estate and operating loans have grown rapidly across all states. Last year, average interest rates were slightly above the pre-pandemic average in most states (Chart 10). In Oklahoma, average rates on farm real estate loans were slightly below the average from 2015 to 2019. However, the rate environment in 2023 has changed notably for farm borrowers, as interest rates on operating loans rose above 8 percent, on average, in all states in the second quarter.

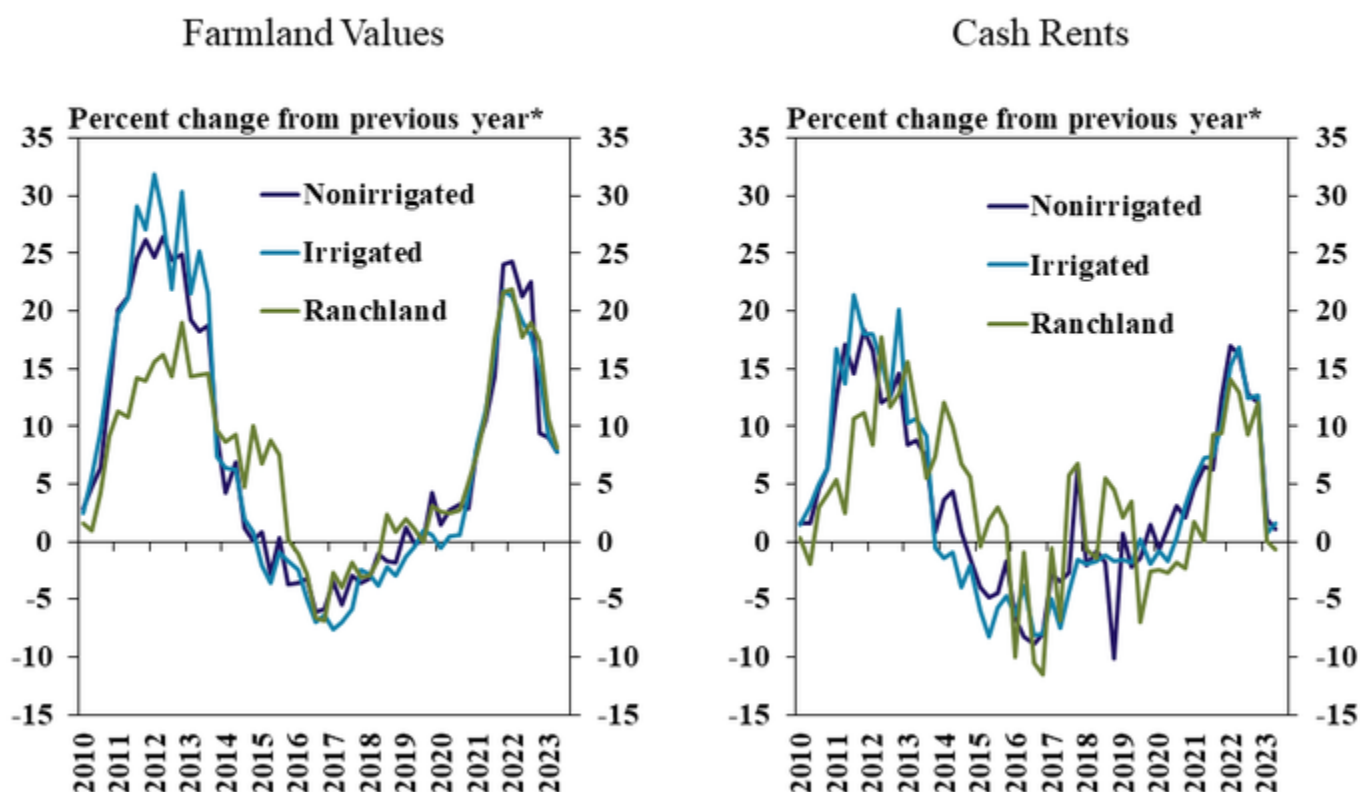
Chart 10: Average Interest Rates by State



*Mountain States include Colorado, northern New Mexico and Wyoming, which are grouped because of limited survey responses from each state.

Growth in farm real estate values remained relatively strong despite the rapid rise in interest rates and some moderation in the farm economy. Values for all types of farmland grew by almost 8 percent in the second quarter (Chart 11). Although the average rate of growth for nonirrigated cropland declined from more than 20 percent a year earlier, continued strength in farmland markets has occurred alongside more pronounced softening in cash rents. Cash rents for ranchland declined slightly for the first time since 2020 in the second quarter, and rents for cropland increased by only 1 percent.

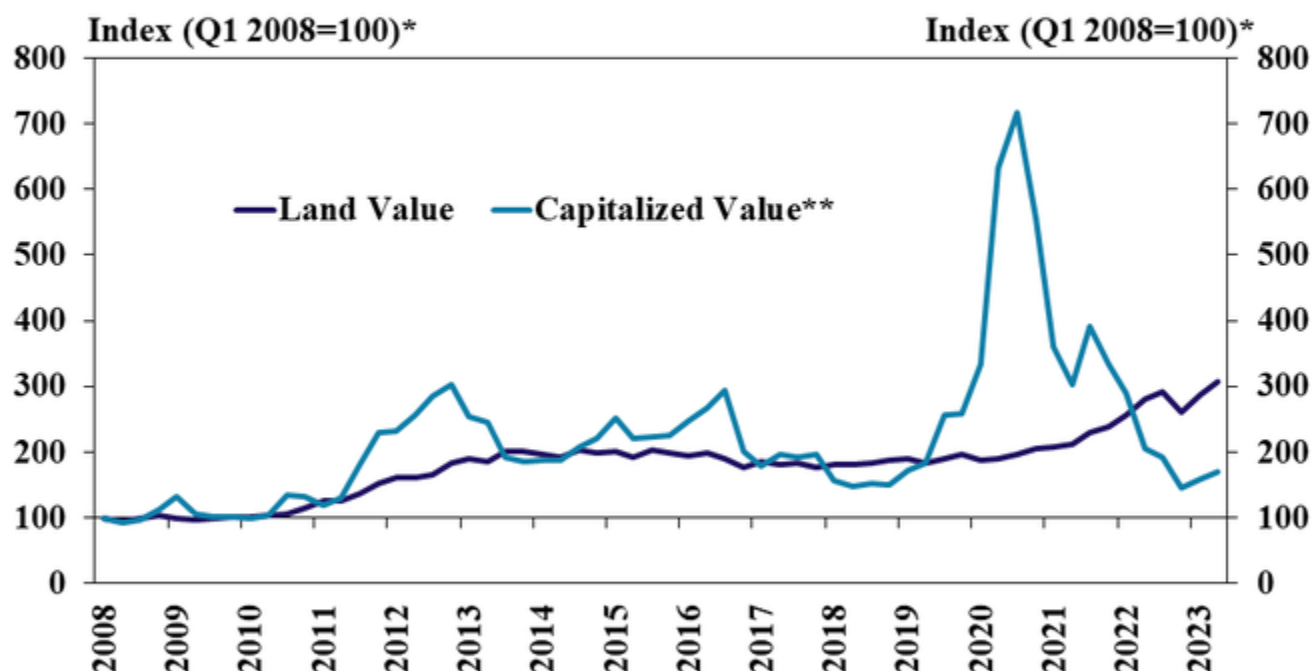
Chart 11: Tenth District Farmland Values and Cash Rents



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

Considerable strength in farmland markets has pushed values above what may be expected given the current interest rate environment and prospects for financial returns from cash rents. Reported values of farmland in the District have continued to rise steadily in recent months as the estimated value based on the relationship between cash rents and benchmark interest rates (capitalized value) has dropped considerably (Chart 12). Capitalization values provide a way to evaluate the combined effects of interest rates and returns^[1] and have declined alongside the rapid increase in interest rates and a moderation in cash rents. Some moderation in farmland values could be expected given these downward pressures, particularly for more marginal or less productive tracts, however, a steady supply of land sales and strong demand from farmers has likely supported broad resiliency of real estate values.

Chart 12: Actual and Capitalized Value of Farmland in the Tenth District



*Derived from quarterly percent changes calculated using responses only from those banks reporting in both the past and the current quarters.

**The capitalized value of farmland is equal to cash rents divided by market yields on U.S. Treasury securities at 10-year constant maturity

Banker Comments Q2 2023

“Our area has been severely impacted because of wildfire last year and this year. It is really hard to predict the future of land values along with cattle sales because ranchers are having to sell their herds because of the fires.”- Northern New Mexico

“Drought conditions are making for a poor wheat harvest. Rains lately have helped the spring crop potential.”- Southwest Kansas

“Prospects for an average to good fall harvest are looking better with recent rains, but higher interest rates and increased production costs are not helping and cattle sales have been reduced as many head were sold due to drought and not carried through winter.”- Central Kansas

“With the 60-year low cattle inventory, this market is expected to stay strong and anyone with grass is buying cattle with expectations of increased prices later this fall.”- Northcentral Kansas

“Most farmers are in a good financial condition; however, drought will affect everyone to some degree with higher input costs, high interest rates and a severe drought are making this a tough year, but most farmers will work through it.” – Central Missouri

“The drought is hitting us hard. We are seeing several cow-calf operators reducing herd size due to lack of hay production.” – Southwest Missouri

“Drought conditions locally have caused forage concerns for beef cattle producers and will be a big limiting factor going forward for those producers when determining whether to expand or reduce herd numbers.” – Northwest Missouri

“Livestock producers are very optimistic with significantly higher calf prices this spring and early summer and crop producers are cautiously optimistic with grain prices currently presenting an opportunity to market crop at very profitable levels.” – Northcentral Nebraska

“At renewal time, farm customers had excellent balance sheet liquidity. Three to six months later, however, with decreased grain prices and dryness in our area, it is possible that a noticeable amount of this liquidity could erode.” – Northeast Nebraska

“Land values are remaining high with good demand for cropland. Higher interest rates don't seem to be affecting our local economy at this time.” – Southcentral Nebraska

“Interest rates, equipment costs, and operating expenses - especially fuel, fertilizer, feed, and practically all operating expenses have placed increased pressure on farm/ranch profitability.” – Southeast Oklahoma

“Rising costs for feed and fertilizer are major concerns for our area and overall market conditions are increasing costs for stockers.” – Southwest Oklahoma

“Higher interest rates have increased expenses for farmers and in turn they are borrowing less money.” – Southeast Oklahoma

Endnotes

[1] Schnitkey, G., C. Zulauf, K. Swanson, N. Paulson, J. Baltz and J. Coppess. "Farmland Prices Higher but Still in Line with Market Fundamentals." *farmdoc daily* (12):121, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, August 16, 2022.[Permalink](#)

Data: Credit Conditions | Fixed Interest Rates | Variable Interest Rates | Land Values A total of 136 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. Please refer questions to Cortney Cowley, senior economist or Ty Kreitman, assistant economist at 1-800-333-1040.

Authors



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Cortney Cowley is a senior economist in the Regional Affairs Department of the Federal Reserve Bank of Kansas City. She also serves as a special advisor on the agricultural economy to Federal Reserve Governor Miki Bowman. Cortney's current research focuses on agricultural finance, commodity markets, farm management, and natural resource economics and policy. Her responsibilities also include writing for the *Tenth District Survey of Agricultural Credit Conditions* and *Agricultural Finance Updates*. Cortney joined the Bank in 2015 after completing her Ph.D. in Agricultural Economics at Oklahoma State University. She holds a B.S. degree in Biosystems Engineering from Oklahoma State and a M.S. degree in Civil Engineering from Colorado State University.



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