Credit Conditions Soften with Farm Economy

by: Nate Kauffman and Ty Kreitman

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Farm income and loan repayment rates were lower than a year ago for the second quarter in a row.

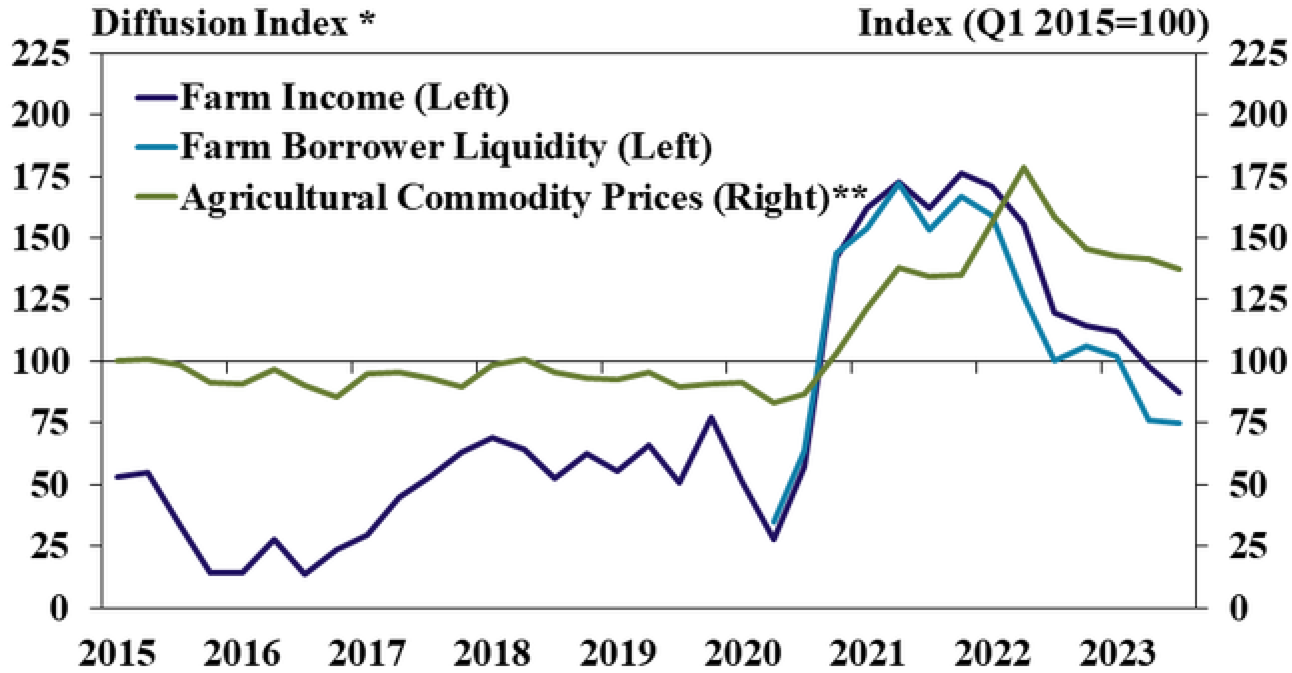
Agricultural credit conditions in the Tenth District softened during the third quarter. Farm income and loan repayment rates were lower than a year ago for the second quarter in a row. The moderation was more pronounced in areas most impacted by drought, but more tempered in areas most concentrated in cattle production. Conditions have weakened slightly following two years of significant improvement that continued to support loan performance. Despite softening farm finances and substantially higher interest rates, agricultural real estate values in the region remained firm.

The agricultural economy has softened in recent quarters alongside a moderation in commodity prices. Together with elevated production costs, a drop in the price of many key products over the past year has likely reduced farm income in 2023. Strong cattle prices have boosted margins for many ranches and feedlots, but profit opportunities have been much narrower for crop producers. Despite softening incomes and high interest costs, agricultural loan performance has remained solid with ongoing support from strong finances that bolstered the sector over the past two years.

Farm Finances and Credit Conditions

Farm income and producer liquidity cooled in recent months alongside lower commodity prices. Nearly half of respondents in the third quarter survey reported that farm income and borrower liquidity were less than a year ago, the highest share since 2020 (Chart 1). Farm financial conditions have softened from considerably strong levels as prices of key commodities have moderated.

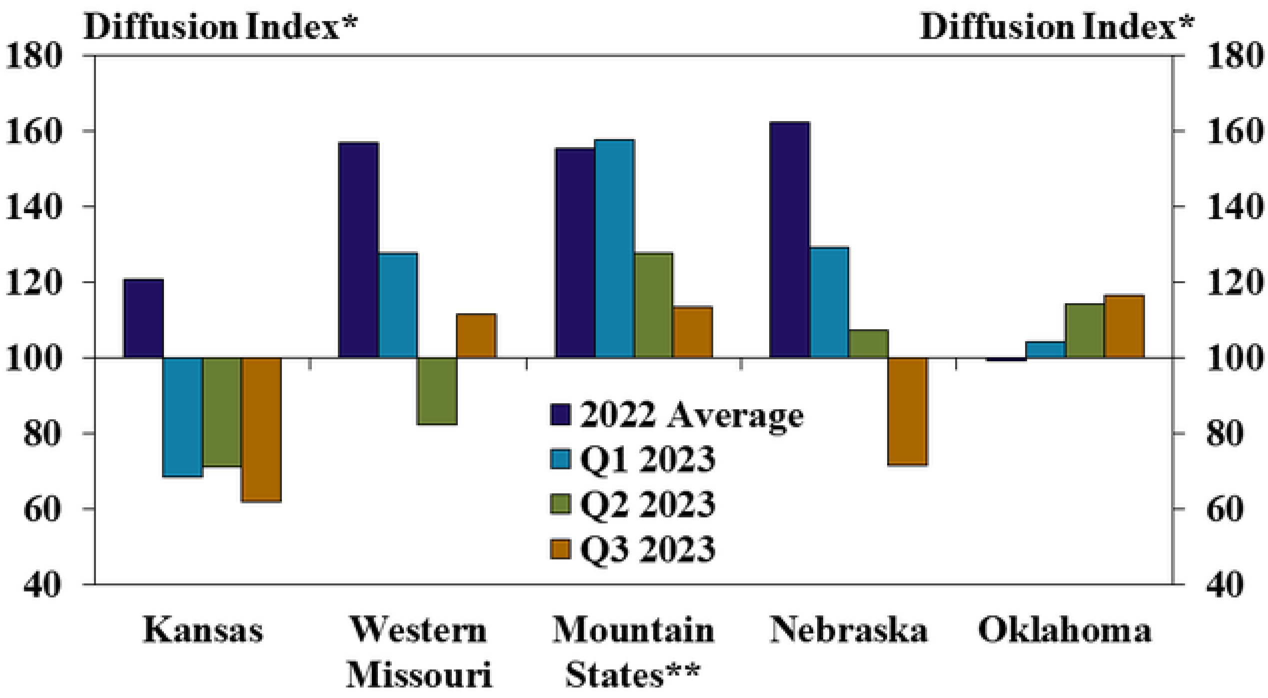
Chart 1: Tenth District Farm Income and Borrower Liquidity



*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.
**Average of individual indices for spot prices of corn, soybeans, wheat, cattle, and hogs.
Note: Collection of information about Farm Borrower Liquidity began in Q2 2020.
Sources: *Wall Street Journal* and Haver Analytics

Prospects for income were comparably worse in some states, depending on their industry concentration. Farm income was higher than a year ago in states more dependent on cattle production such as Oklahoma and the Mountain States (Chart 2). In contrast, conditions deteriorated at a moderate pace in Kansas and Nebraska which have many areas dependent on revenue from corn, soybeans, and wheat.

Chart 2: Farm Income by State



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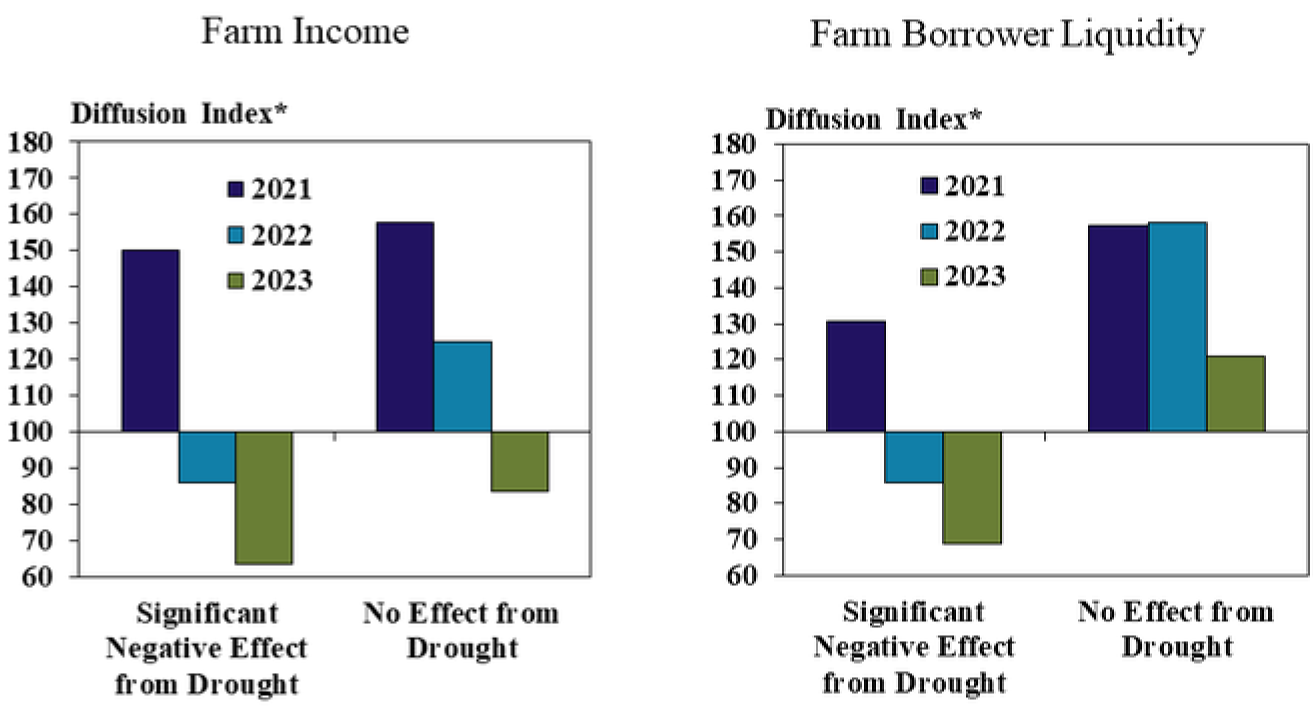
**Mountain States include Colorado, northern New Mexico and Wyoming, which are grouped because of limited survey responses from each state.

Drought was another key factor contributing to deterioration in farm finances. For banks indicating that drought was not impacting the financial conditions of their borrowers, farm income was higher than a year ago, but conditions weakened notably for areas significantly affected (Chart 3, left panel). Similarly, farm borrower liquidity declined at a faster pace in areas significantly impacted by drought (Chart 3, right panel).

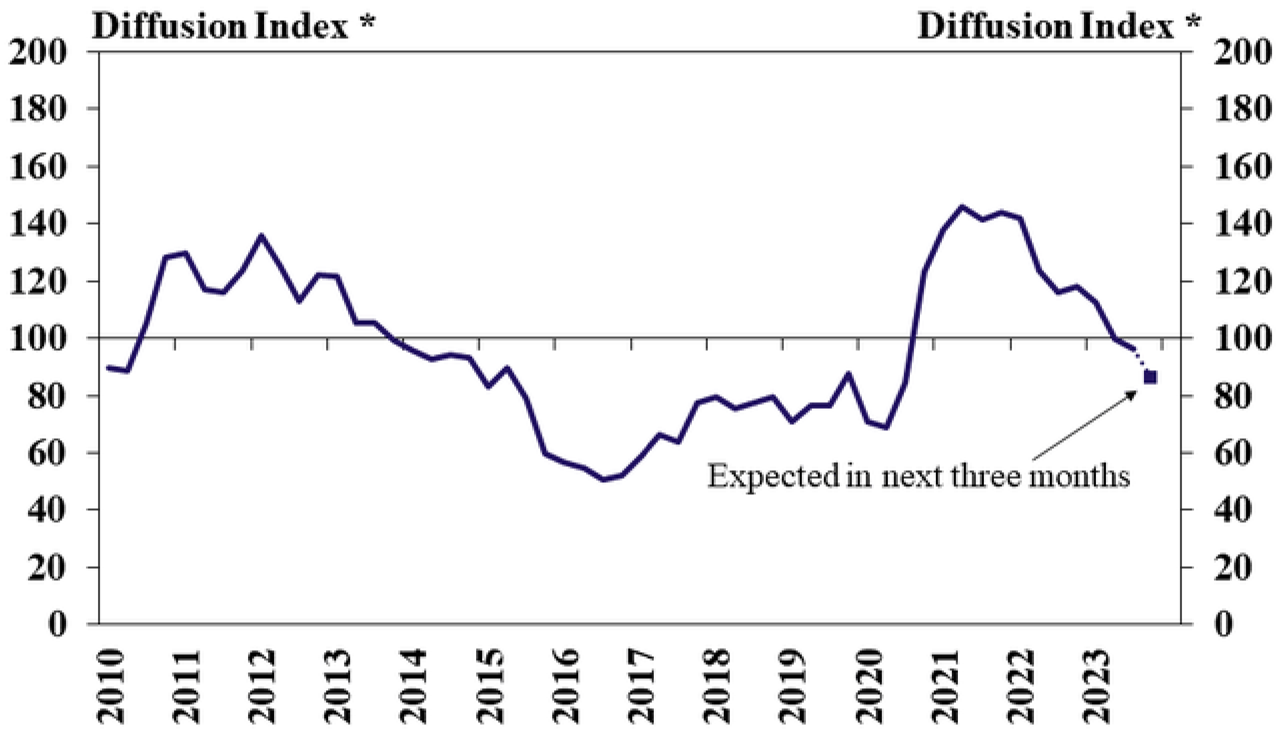
Chart 3: Farm Income and Borrower Liquidity by Drought Impact, Q3



Note: Respondents were asked to indicate what has been the impact of drought on financial conditions of farm operations in their lending area?
*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.

Alongside a moderation in farm income, credit conditions softened. Improvement in farm loan repayment rates halted with about 80% of lenders reporting repayment was unchanged from a year ago (Chart 4). Only about 10% of banks reported lower repayment rates during the quarter, however, and 20% expected a decline in the coming months.

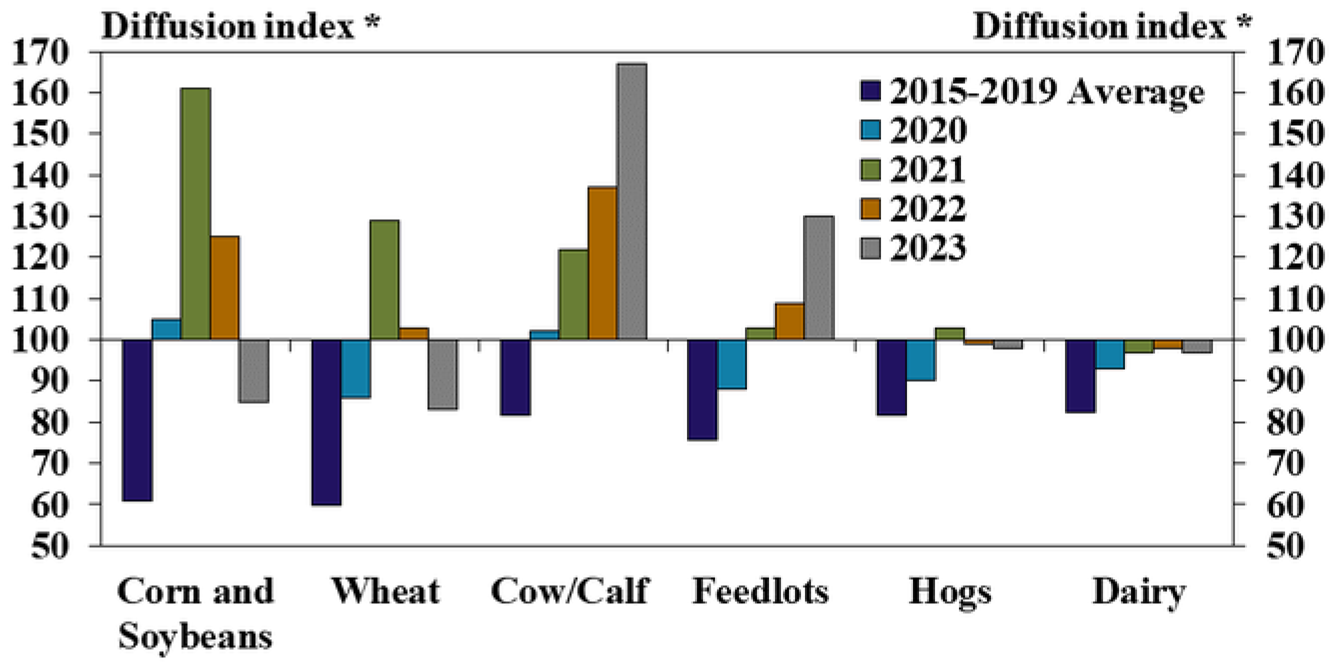
Chart 4: Tenth District Farm Loan Repayment Rates



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

Credit conditions for crop producers were expected to deteriorate in the months ahead while survey respondents anticipated conditions to improve for cattle producers. Lenders expected a modest pace of decline in loan repayment rates for crop, hog and dairy producers in the next quarter alongside lower prices and thinner margins (Chart 5). The strength in cattle prices was expected to support improved repayment conditions for cow/calf producers and feedlots.

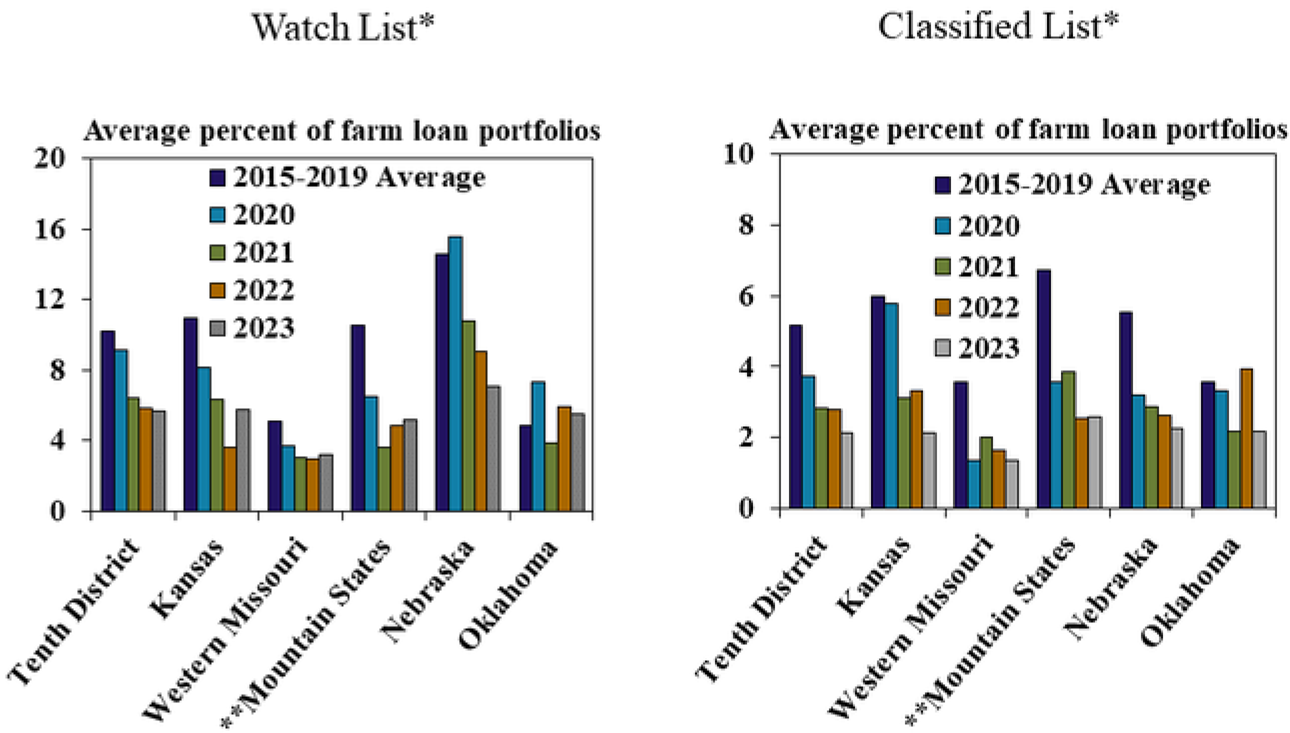
Chart 5: Expected Change in Loan Repayment Rates by Operation Type, Q3



Note: Bankers responded to the following questions: For the following farm operations, how are loan repayment rates expected to change over the next three months? *Bankers responded by indicating whether conditions during the next quarter were expected to be 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.

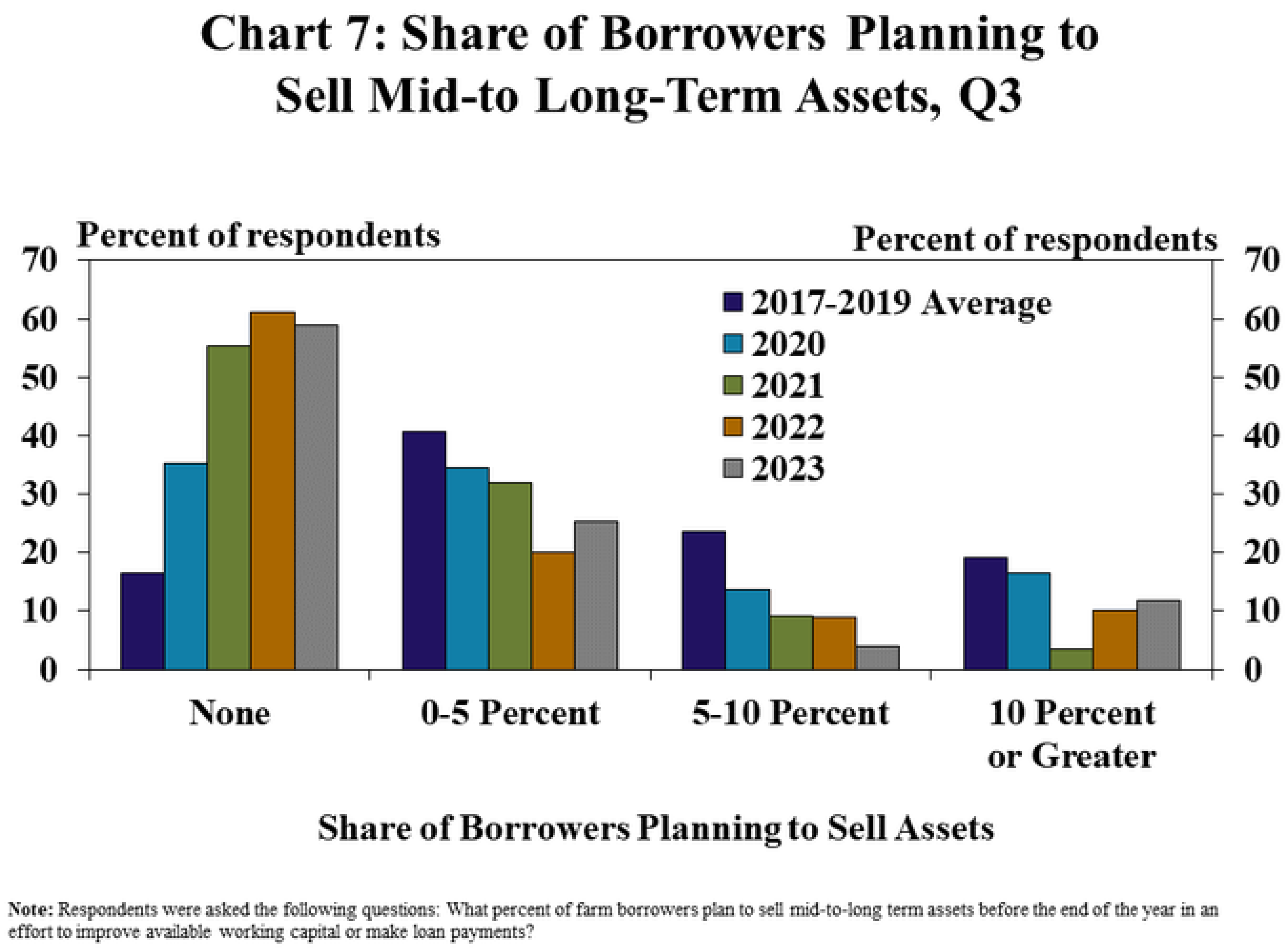
Despite signs of a reduced rate of loan repayment, credit quality of agricultural loans remained strong across the region. The share of farm loan portfolio volumes identified for watch and classified lists generally remained similar to a year ago in most states (Chart 6). Strong farm finances in recent years have bolstered many producers and problem loan rates remained at or near historic lows.

Chart 6: Problem Loan Rates, Q3



Note: Respondents were asked to indicate the percentage of their bank's farm loan portfolio currently on the 'Watch" and "Classified" lists.
*For purposes of this article, a "Watch List" loan is interpreted as a qualifying credit but is being closely monitored for potential problems (deterioration in borrower financial conditions, management changes, etc.). A "Classified List" loan is a loan with a defined weakness (inadequate debt service, insolvent collateral position, etc.) that requires specific documentation and potential bank reserve adjustments.
** Mountain States include Colorado, northern New Mexico and Wyoming, which are grouped because of limited survey responses from each state.

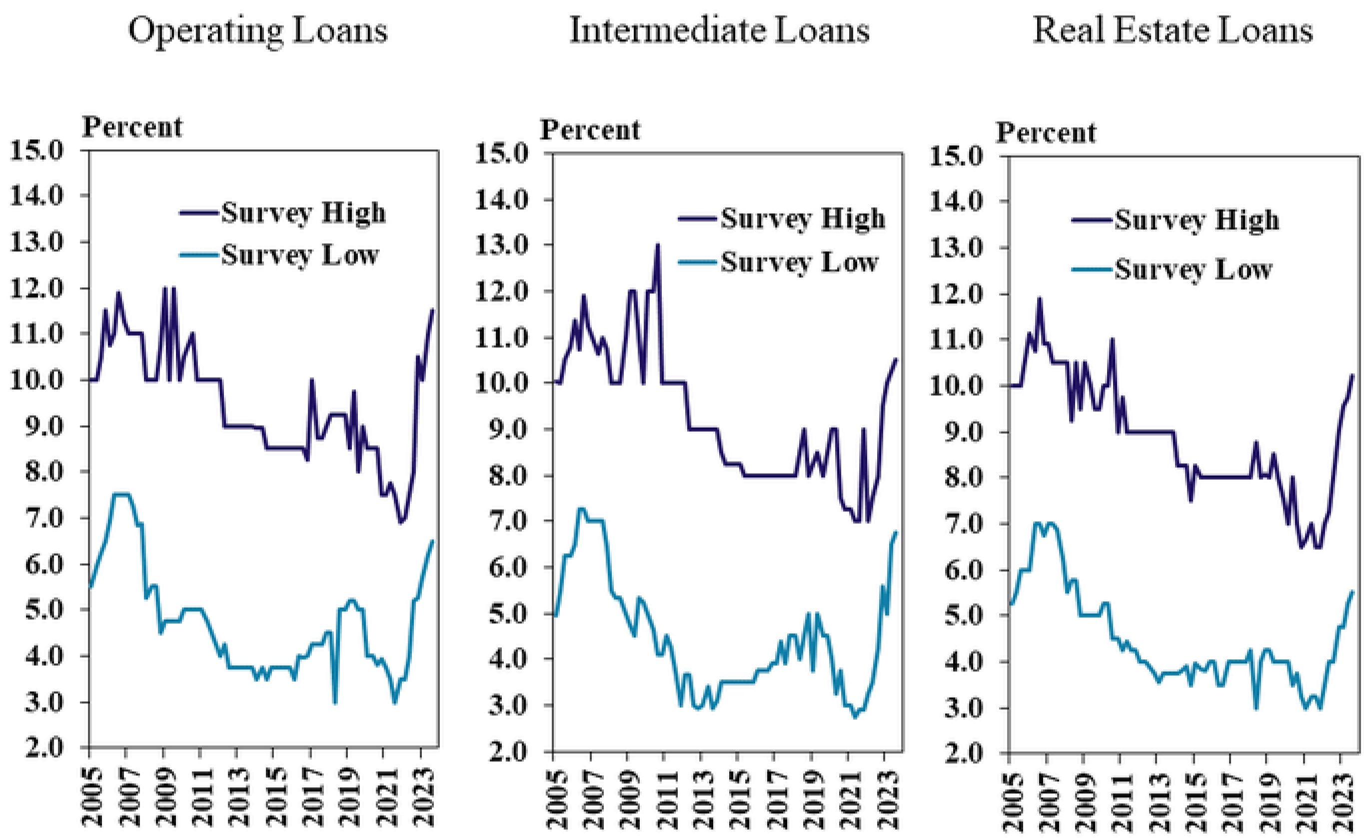
Alongside ongoing strength in loan performance, few borrowers had plans of liquidating assets to improve working capital. More than half of bankers in the District expected no borrowers to sell assets for liquidity purposes and another quarter thought less than 5% of their customers would have liquidations (Chart 7). The portion of banks with elevated instances of asset sales remained modest.



Interest Rates, Lending Activity and Farmland Values

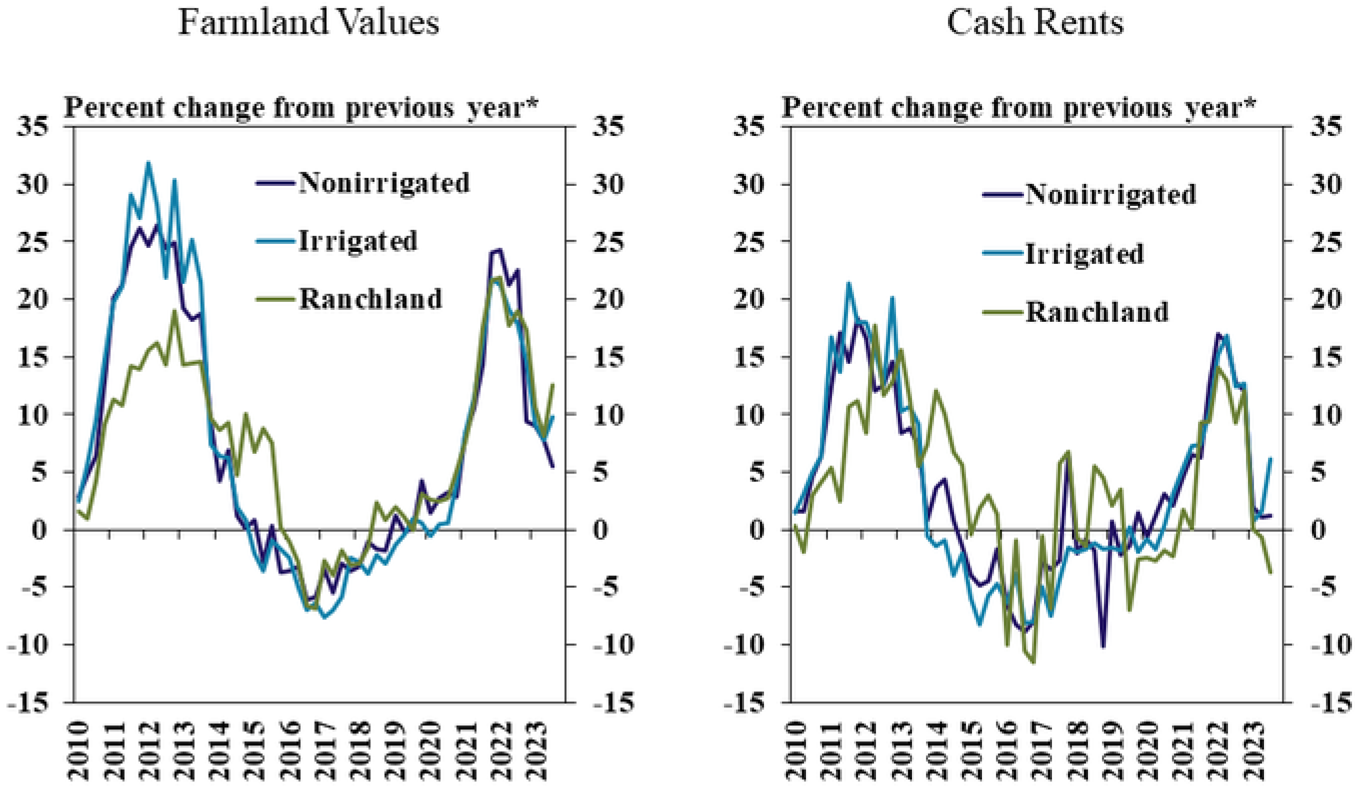
The moderation in agricultural credit conditions has coincided with a rapid rise in farm loan interest rates. The lowest average rates offered on non-real estate and real estate farm loans has increased about 400 and 300 basis points, respectively over the past two years (Chart 8). The highest average rates have grown by a similar amount with many borrowers paying a rate of interest on farm debt above 10%.

Chart 8: Average Tenth District Interest Rates



Despite the rapid rise in interest rates and a recent moderation in the farm economy, agricultural real estate values held firm. The value of nonirrigated cropland was about 5% higher than a year ago and cash rents on those acres increased by about 2% (Chart 9). Irrigated and ranchland values grew by about 10% and, while cash rents on irrigated acres increased, rent charges on ranchland were lower than a year ago.

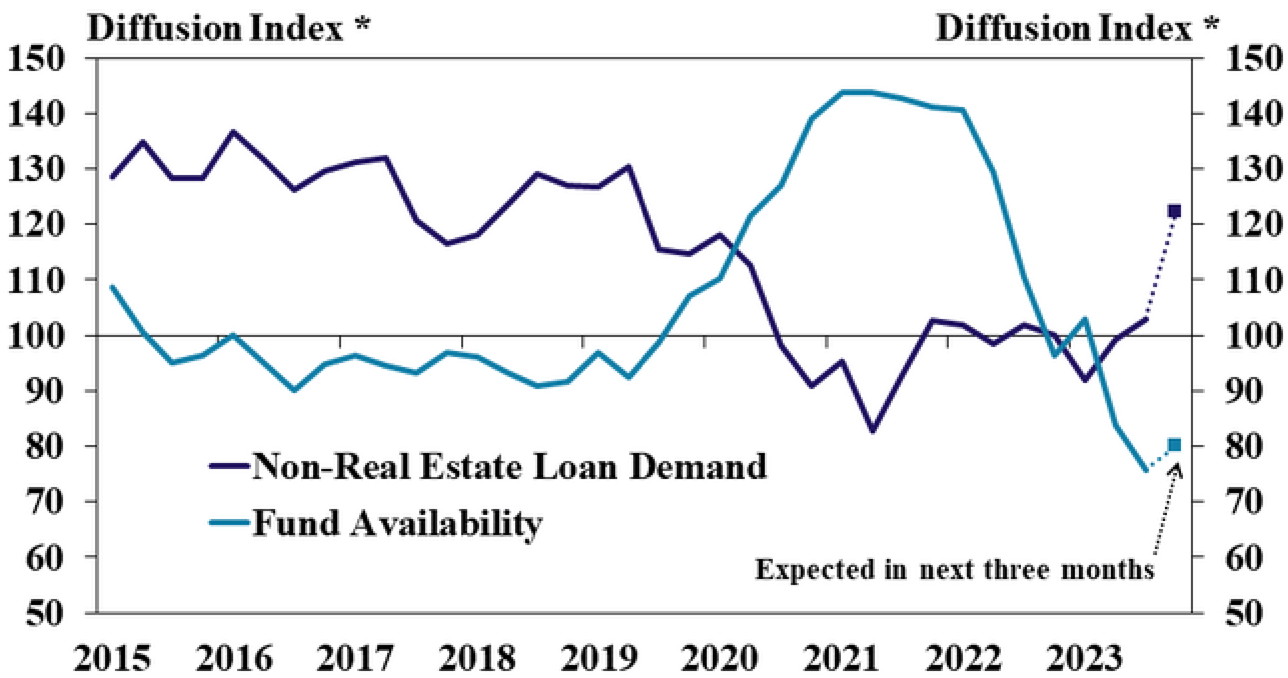
Chart 9: Tenth District Farmland Values and Cash Rents



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

Farm loan demand remained subdued for many lenders alongside high financing costs, while fund availability diminished from record highs. Nearly equal shares of respondents reported higher and lower demand for non-real estate farm loans, but a far higher share expect demand growth in the coming months (Chart 10). Availability of funds was lower for nearly a third of lenders as deposit levels have moderated.

Chart 10: Farm Loan Demand and Fund Availability



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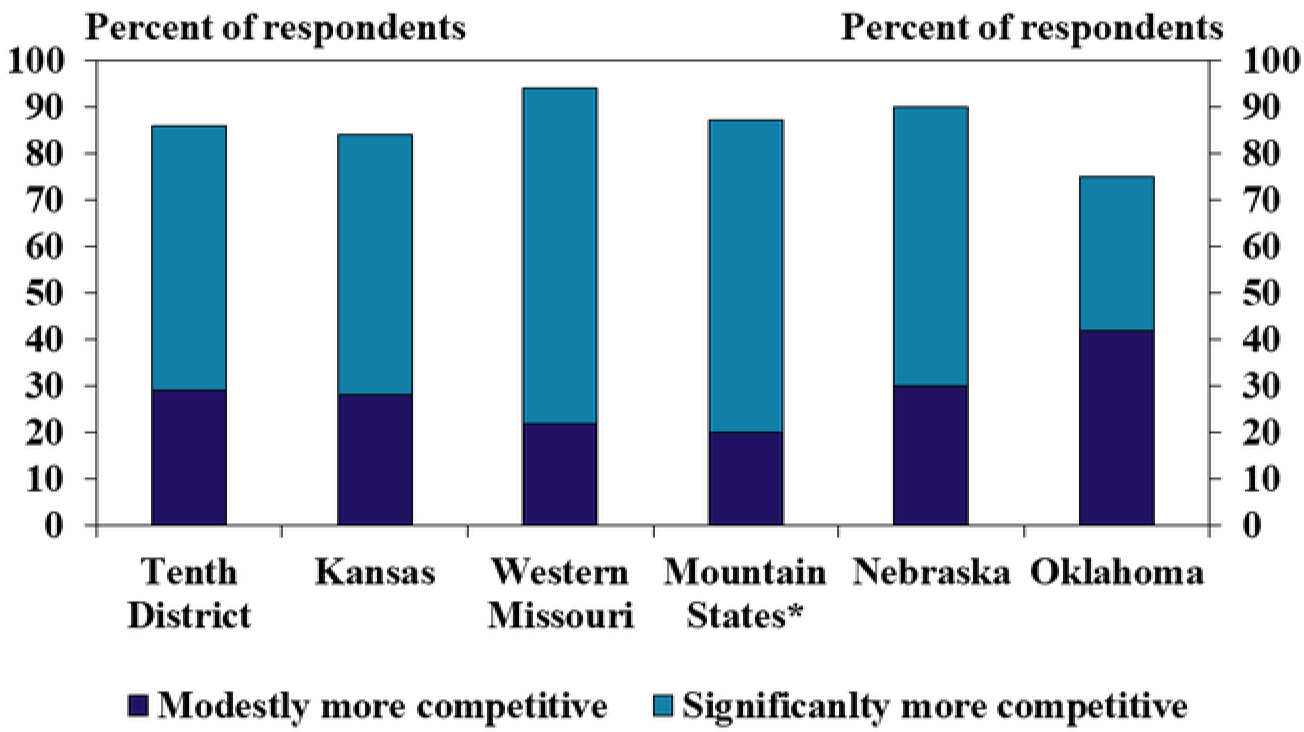
A considerable increase in competition has contributed to a reduction in deposits at many agricultural banks. A majority of lenders across all states in the District reported that competition for deposits increased significantly from a year ago (Chart 11). Higher benchmark rates have pushed up rates on deposits and similar products, intensifying competition and increasing funding costs.

Chart 11: Change in Competition for Deposits, Q3 2023



Note: Bankers responded to the following question: What changes occurred in competition for deposits in your business area in the previous three months compared with the same months a year ago?
*Mountain States include Colorado, northern New Mexico and Wyoming, which are grouped because of limited survey responses from each state.

Banker Comments Q3 2023

"Expenses in all categories (fuel, chemical, repairs, etc.) remain high while commodity prices have dropped."- Southeast Colorado

"Last year we had the worst and biggest wildfire in New Mexico history that devastated many producers. The grazing land is in strong demand and water rights are at a premium, the beauty of the land is gone for many of the surrounding areas for decades to come."- Northern New Mexico

"Inflationary pressures are impacting cashflows along with the increase in interest rates."- Northern Wyoming

"Drought has been a major concern in this area for over 12 months."- Southwest Kansas

"High interest rates have decreased the appetite for real estate purchases and capital purchases have also gone down due to interest rates and decreased liquidity due to lower grain prices. The one bright spot is cattle prices."- Northwest Kansas

“Drought has significantly hurt our agricultural borrowers and rising interest rates and lower commodity prices are adding to the struggles.”- Southeast Kansas

“Severe drought and higher funding costs are concerns for community banking. Most farmers are in good financial condition, but the drought will impact everyone, and inflation is also a big factor.”- Central Missouri

“The drought has made a major impact on all row crops in our area. Pastures are in really bad shape. And hay is in short supply.”- Southwest Missouri

“Higher interest rates are significantly impacting ag income and bank liquidity is becoming critical and could affect loan availability in 2024.”- Northwest Nebraska

“Key concerns have been lack of moisture, higher interest rates, lower commodity prices and higher input costs.”- Northeast Nebraska

“Crop prices have been reduced to breakeven prices or less and dryland crops will be dependent on revenue insurance payments that most likely will be below the cost of production. The bright spot in our economy is the historically high cattle prices.”- Southwest Nebraska

“Moisture is again beginning to be a concern, due to low pond water, and ability to plant winter wheat in a timely manner.”- Northwest Oklahoma

“Drought in the wheat and cotton sector has really affected area farmers. If the cattle prices stay steady it could really affect their long run profits.”- Southwest Oklahoma

“Late summer rains should help soybeans and milo production and cow/calf will benefit too, but it was too late to help the hay crop much.”- Eastern Oklahoma

Data: **Credit Conditions** | **Fixed Interest Rates** | **Variable Interest Rates** | **Land Values**A total of 137 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, senior vice president and branch executive or Ty Kreitman, assistant economist at 1-800-333-1040.

Authors

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Senior Vice President, Economist, and Omaha Branch Executive

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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Ty Kreitman is an associate economist in the Regional Affairs Department at the Omaha Branch of the Federal Reserve Bank of Kansas City. In this role, he primarily supports the Federal Reserve Bank of Kansas City and the Federal Reserve System efforts surrounding agricultural economics research, analysis and outreach. His responsibilities include co-authoring the *Tenth District Survey of Agricultural Credit Conditions* and *Agricultural Finance Updates.*Ty joined the Bank in 2015 as an assistant bank examiner in the Examinations & Inspections Department at the Omaha Branch and transferred to his current position in 2018. He holds a B.A. degree in Economics and Finance from the University of Nebraska-Lincoln and a M.A. degree in Financial Economics from Youngstown State University.