14 November 2022 – Laramie, WY

Strong Farm Economy, but Interest Expenses and Drought Intensify Pressures

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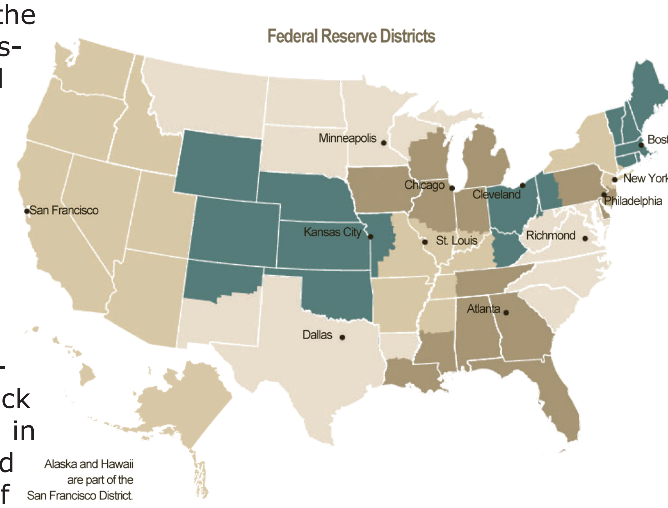
Interest rates on farm loans increased sharply in the third quarter and the acceleration in farm real estate values continued to ease. Farm income and credit conditions remained solid, but the pace of improvement softened. The financial impact of drought also intensified, particularly in the southern and western portions of the District. Despite recent headwinds, farm finances remained strong and continued to support sound agricultural loan performance.



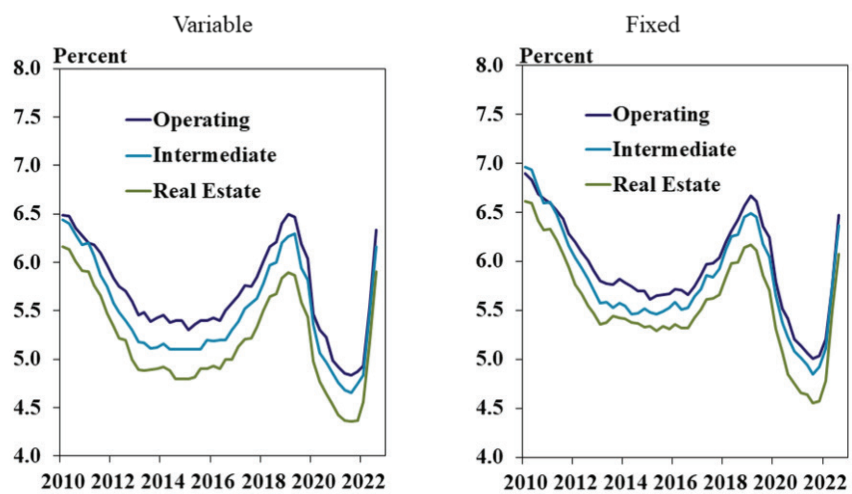
The outlook for the agricultural economy generally has remained positive despite a recent pull back in prices of some key farm commodities. Volatility in crop markets, higher expenses and drought could hinder incomes for some producers, but prices of key crops and livestock remained at multi-year highs and profit opportunities across the farm sector remained favorable. The substantial improvement in farm finances and a surge in agricultural real estate values over the past two years have also bolstered balance sheets and continued to provide ongoing support to many operations.

Interest Rates and Farmland Values

The average rate charged on farm loans rose rapidly alongside higher benchmark rates. Variable and fixed rates on all types of loans were about 75 and 65 basis points higher than last quarter, respectively (Chart 1). Farm banks have increased rates alongside the historically sharp rise in the federal funds rate and financing costs for farmers have reached the highest level since 2019.

As interest rates increased, growth in farm real estate values showed more signs of softening. The value of nonirrigated farmland increased about 23 percent and 3 percent from the previous year and quarter, respectively (Chart 2). The pace of growth has moderated following steep acceleration in 2021 and cash rental rates have also followed a similar path.

Chart 1. Tenth District Average Interest Rates



Additional growth in farmland values and cash rents was still anticipated in the coming months, but the expected pace of increase continued to moderate. About 30 percent of banks expected farmland values to increase in the next quarter compared with a year earlier, down from about half of respondents expecting future increases throughout 2021. The share expecting higher cash rents increased slightly from last quarter, but also remained below the average of 2021.

Farm Finances, Credit Conditions and Drought

Farm finances remained strong, but increases in income and liquidity were less pronounced than recent quarters. As the price of several major commodities declined from recent highs, farm income increased at a notably slower pace and borrower liquidity was steady compared with a year ago (Chart 3). Looking ahead, income was expected to remain unchanged and cash flow was expected to weaken slightly.

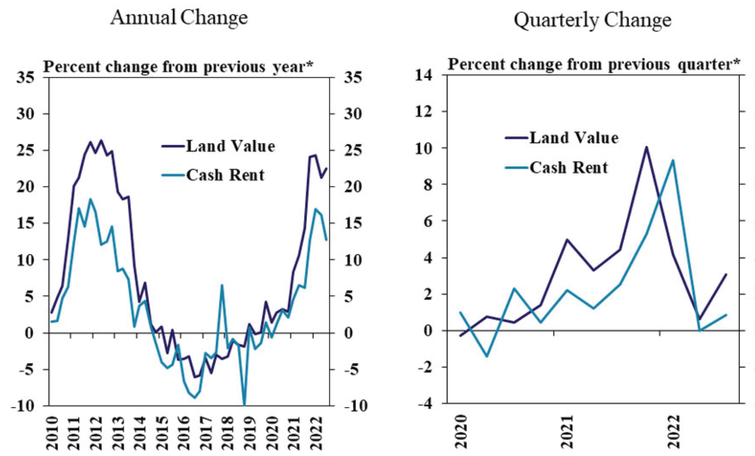
Credit conditions for most types of farm operations were expected to improve slightly or remain steady in the coming months. Farm loan repayment rates for crop farmers were expected to increase further in the next three months, but at a slower pace than last year. Bankers anticipated repayment for borrowers in the cattle industry to improve at a faster rate than last year, while conditions for hog and dairy producers were expected to be mostly steady.

Despite strong conditions in the broad farm economy, persistent drought throughout large portions of the District intensified concerns about financial impacts. As conditions have worsened, the share of banks reporting a modest and significant impact of drought increased from a year ago to about 50 percent and 35 percent, respectively (Chart 4). Conditions were comparatively worse in some areas of the District, particularly in Oklahoma, where 60 percent of bankers reported that the impact of drought was significant.

As drought has persisted over the past year, farm finances weakened in areas most impacted. In contrast to the same time a year ago, banks reporting a significant effect of drought also reported that farm income and borrower liquidity was lower than a year ago. Respondents who described the effect as modest continued to report strong conditions, but a slower pace of improvement.

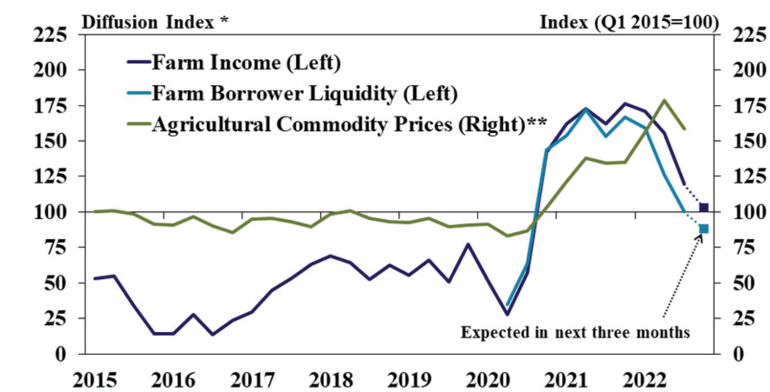
For more information:
https://www.kansascityfed.org/agriculture/ag-credit-survey/

Chart 2. Tenth District Nonirrigated Farmland Values and Cash Rents



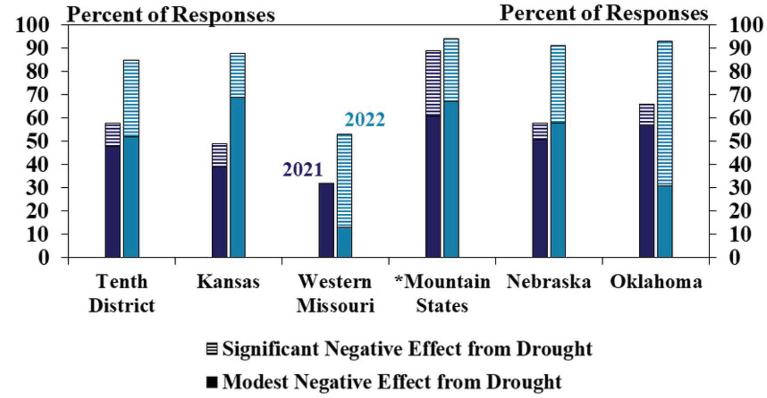
*Percent changes are calculated using responses only from those banks reporting in both the past and the current quarters.

Chart 3. 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.

Chart 4. Impact of Drought on Financial Conditions of Farm Operations, Q3



Note: Respondents were asked to indicate what has been the impact of drought on financial conditions of farm operations in their lending area?
*Mountain States include Colorado, northern New Mexico and Wyoming, which are grouped because of limited survey responses from each state.