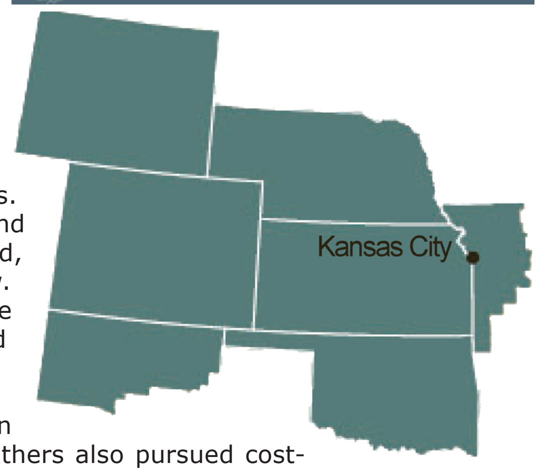
How Much is Right for You?

15 May 2023 – Laramie, WY

AG CREDIT SURVEY
Credit Conditions Hold Strong as Interest Rates Rise

Agricultural credit conditions in the Tenth District remained strong and farm real estate values continued to increase, but growth has softened.

Federal Reserve Bank of Kansas City



Agricultural credit conditions in the Tenth District remained strong and farm real estate values continued to increase, but growth has softened. Strength in farm real estate markets eased, but farmland values continued to increase despite downward pressure from higher interest rates. Farm income moderated alongside a slight pullback in commodity prices during the first quarter slowing the pace of increase in loan repayment rates. While improvement in farm finances and credit conditions steadied and some lenders expected a degree of deterioration in the months ahead, multiple years of strong incomes continued to keep credit stress low.

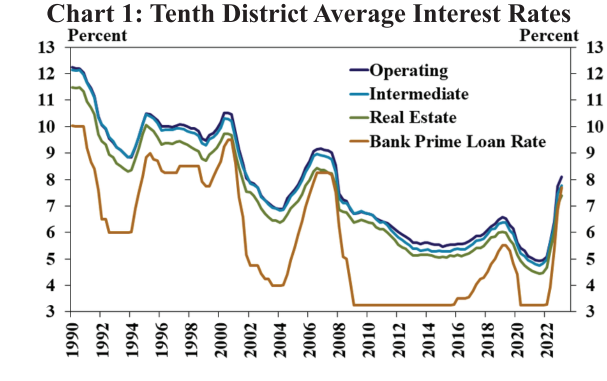
The outlook for the U.S. farm economy in 2023 remained favorable as prices of key commodities were at multi-year highs. Elevated production expenses, higher interest rates and drought continued to present headwinds for many producers, but current commodity prices kept profit opportunities within reach. Higher production expenses pushed many producers to increase lines of credit, but others also pursued cost-cutting measures or utilized cash to reduce financing needs, dampening loan demand at many banks. Financial performance and liquidity at agricultural banks remained solid and farm lenders appeared well-positioned to meet higher credit demand through the early months of 2023.

Interest Rates and Farmland Values

Farm loan interest rates rose alongside further increases in benchmark rates. The average rate charged on agricultural loans was about 30 basis points higher than the previous quarter and nearly 300 basis points higher than a year ago (Chart 1). Farm loan interest rates climbed alongside increases in the federal funds rate and other key benchmarks and pushed credit expenses up considerably.

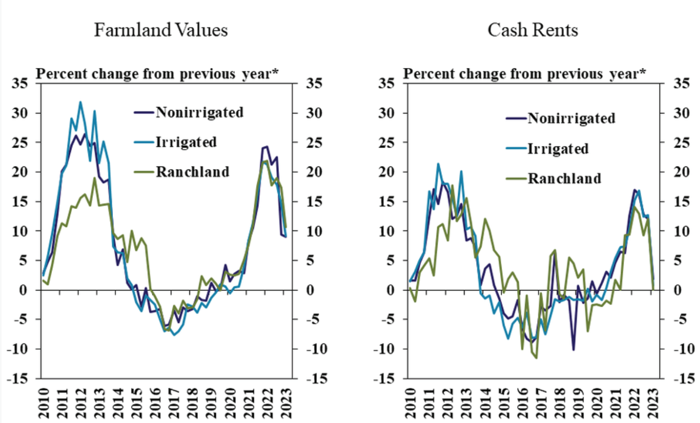
Growth in farm real estate markets has softened as interest rates have risen, but land values still continued to increase in the first quarter. The pace slowed from the rapidly accelerating growth in early 2022, but the value of agricultural land increased about 10 percent from a year ago (Chart 2, left panel). Cash rents on farmland have increased alongside growth in land values, but steadied quickly in the first quarter (Chart 2, right panel).

Chart 1: Tenth District Average Interest Rates



Note: Average rates are calculated as the average of fixed and variable rates for each loan category.
Sources: Federal Reserve Board and Haver Analytics

Chart 2: 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.

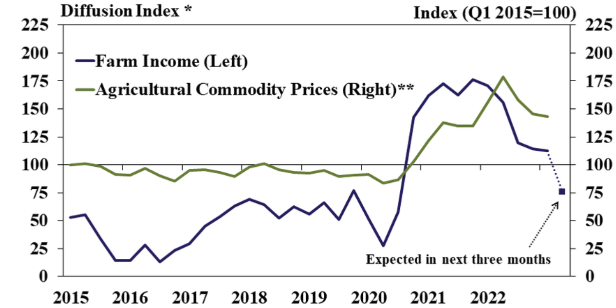
The outlook for land values and cash rents shifted considerably over the past year. Only about 20 percent of respondents expected an increase in nonirrigated farmland values in the coming months, compared with 50 percent who anticipated growth in values this same time a year ago. A similar path was expected for cash rental rates, with about 20 percent of banks expecting an increase in the next quarter.

Farm Income and Credit Conditions

The acceleration in farm real estate values also slowed alongside a moderation in farm income. About 40 percent of respondents reported that income was higher than a year ago and 25 percent reported that income was lower (Chart 3). The prices of some key commodities have retracted from historically high levels in recent months and production costs remained elevated, putting downward pressure on profit margins and tempering the outlook for liquidity and farm income.

Capital spending flattened quickly in recent quarters while household spending continued to grow more steadily. The pace of increase in farm borrower capital spending was measured, with 30 percent and 25 percent of banks reporting higher and lower spending compared with last year, respectively. Alongside broad inflationary pressures, household spending increased at a firmer pace and nearly 50 percent of banks indicated that farm borrowers increased their household spending.

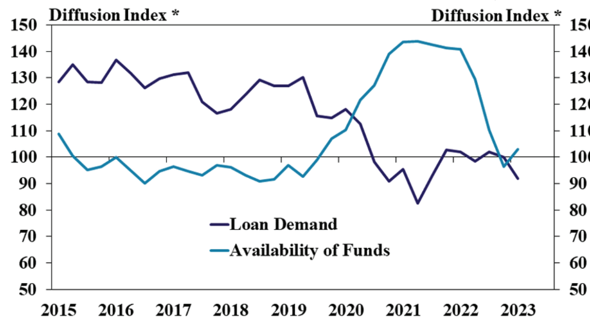
Chart 3: Tenth District Farm Income and U.S. Agricultural Commodity Prices



*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.
Sources: *Wall Street Journal*, Haver Analytics and staff calculations

Strong farm income in recent years has bolstered borrower liquidity and continued to dampen loan demand at many banks. Non-real estate farm loan demand was less than a year ago at nearly 30 percent of reporting banks and higher at 20 percent (Chart 4). Despite some moderation in recent months, liquidity at agricultural banks remained sufficient to meet credit demands and 75 percent of respondents indicated availability of funds was unchanged from a year ago.

Chart 4: Tenth District Non-Real Estate Loan Demand and Fund Availability



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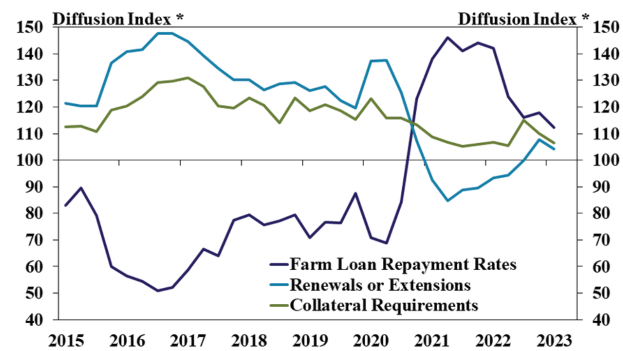
Elevated production costs have led many producers to cut costs or request credit line increases. According to respondents, many producers tried to reduce expenses by making changes or becoming more diligent about monitoring costs, and others have increased credit usage. Many borrowers also utilized cash reserves to reduce lending needs and interest expense as financing costs have also increased considerably alongside higher interest rates.

Agricultural credit conditions remained strong, but improvement has steadied with farm income. The pace of increase in farm loan repayment rates continued to slow gradually across the District, along with other measures of credit conditions (Chart 5). About 20 percent of banks reported higher repayment rates than a year ago, and about 75 percent indicated no change.

Chart 5: Tenth District Credit Conditions

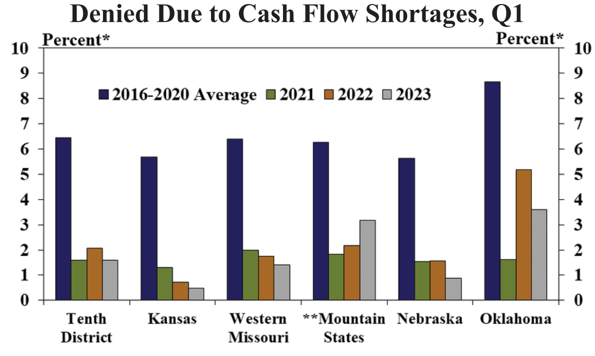


*Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than or the same as in the year-earlier period. The index numbers are computed by subtracting the percentage of bankers who responded "lower" from the percentage who responded "higher"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

Broad strength in farm finances continued to keep credit stress low as borrowers renewed operating loans. The share of new loans involving restructuring remained at multi-year lows across all states in the District. Despite ticking up slightly in Kansas and the Mountain States, the percent of borrowers with carryover debt also remained low throughout the region.

Loan denials due to financial constraints also continued to be limited. Lenders across the region indicated on average, less than 2 percent of all loan requests were denied due to cash flow shortages (Chart 6). Rates of denial dropped slightly from a year ago in all states except the Mountain States.

Chart 6: Share of Loan Requests Denied Due to Cash Flow Shortages, Q1



*Average of survey responses
**Mountain States include Colorado, northern New Mexico and Wyoming, which are grouped because of limited survey responses from each state.
Note: Respondents answered the following question : In the last three months, what percent of total farm loan requests has your bank denied due to custom cash flow shortages?

While agricultural credit conditions remained strong, pessimism about the outlook grew slightly. With a drop in commodity prices and high input costs, many lenders across the region expected farm income and borrower liquidity to contract from historically high levels a year ago. Alongside the expected moderation in incomes, a small number of banks also anticipated some deterioration in loan performance and higher lending demand.

For more information:

For more information on the Tenth District agricultural economy or to access the complete Ag Credit Survey, see: https://www.kansascityfed.org/agriculture/ag-credit-survey/credit-conditions-hold-strong-as-interest-rates-rise.