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AG CREDIT
Credit Conditions Moderate

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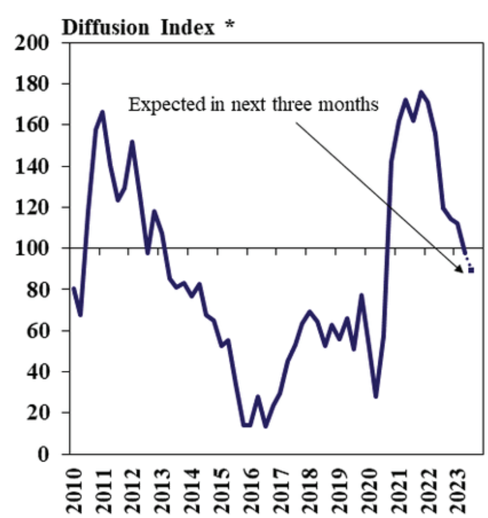
FEDERAL RESERVE BANK *of* KANSAS CITY

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.

Chart 1: Tenth District Farm Income



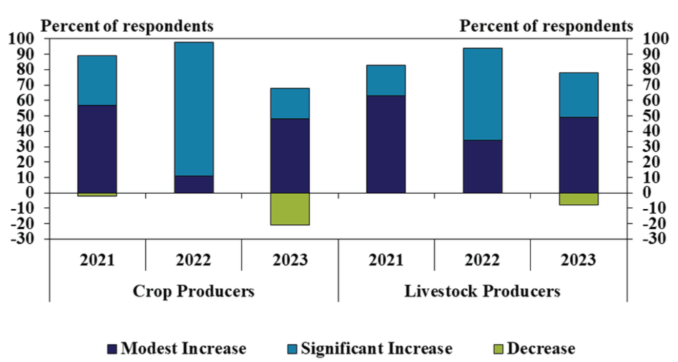
Farm Income

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.

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 percent of banks, while reductions in costs for livestock producers were more limited.

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. 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 2: Tenth District Change in Farm Production Expenses, Q2



Credit Conditions

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. 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.

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. The share of banks reporting slower repayment reached the highest level since 2020 and a similar share expected some slowing in the months ahead.

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

Chart 3: Average Tenth District Interest Rates

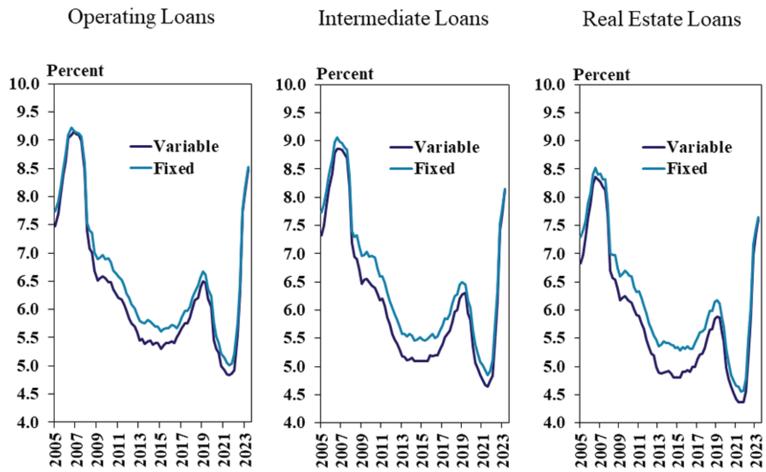
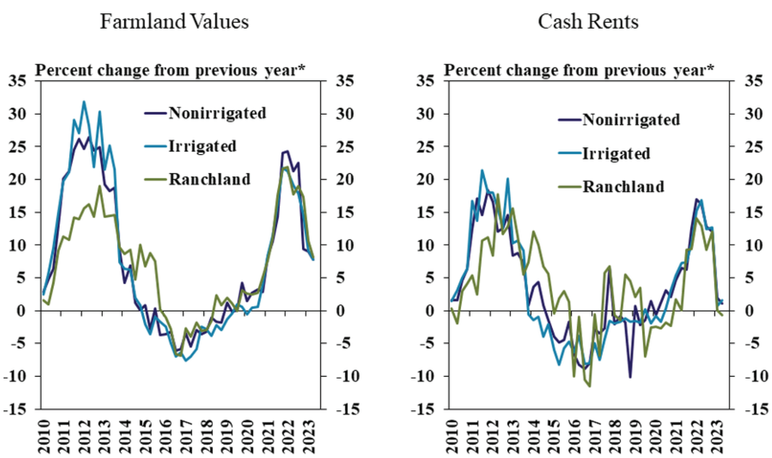


Chart 4: Tenth District Farm Land Values and Cash Rents



Interest Rates and Farmland Values

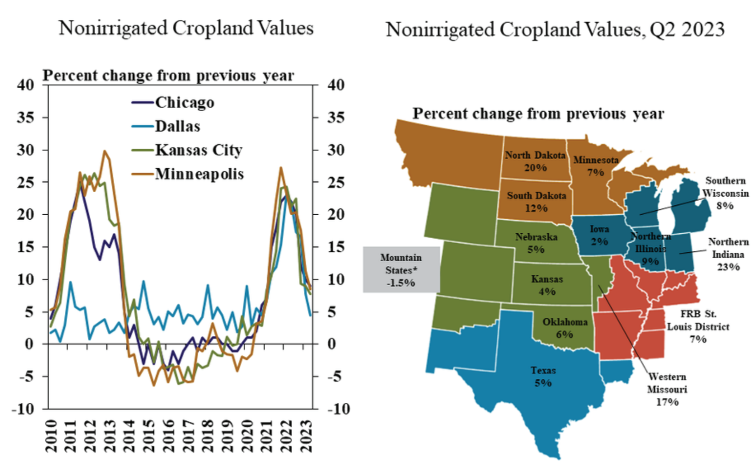
Average interest rates increased from the previous quarter alongside further increases in the federal funds rate, and the spread between variable and fixed rates narrowed. In the second quarter, interest rates on operating and intermediate loans increased by about 40 basis points from the previous quarter, and rates on real estate loans were more than three percentage points higher than in 2021 (Chart 3). 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.

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. 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 Tenth District over the second quarter.

Growth in farm real estate values remained relatively strong across the Tenth District, 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 4). 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.

Regional farm real estate markets remained resilient despite moderation in the farm economy and higher interest rates. The value of nonirrigated cropland increased from a year ago by an average of about 7 percent in all participating regions (Chart 5). Growth in land values has eased from recent years, but remained steady in most states and considerably stronger in some areas. The growth in farmland values has softened somewhat more for lower-priced land, but a steady supply of land sales and strong demand from farmers has likely supported broad resiliency of real estate values.

Chart 5: Regional Nonirrigated Cropland Values



*Mountain States include Colorado, northern New Mexico and Wyoming, which are grouped because of limited survey responses from each state.
Sources: Federal Reserve District Surveys of Agricultural Credit Conditions

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/tenth-district-ag-credit-conditions-moderate/.

For more information on regional farmland values, see: https://www.kansascityfed.org/agriculture/agfinance-updates/farmland-values-stay-resilient-as-farm-economy-moderates/.