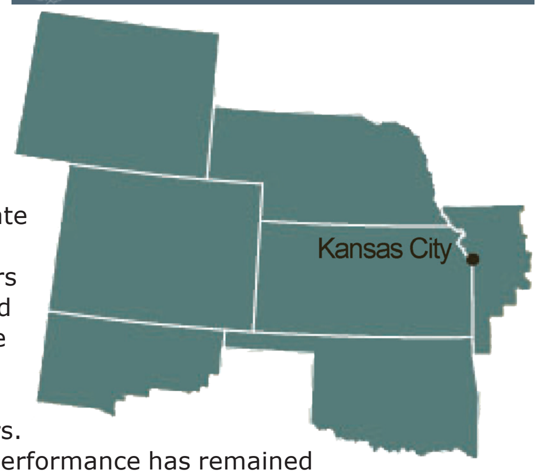
20 November 2023 – Laramie, WY

AG CREDIT
Credit Conditions Soften with Farm Economy

Agricultural credit conditions in the Tenth District moderated in the second quarter and farmland values continued to increase.

Federal Reserve Bank *of* Kansas City



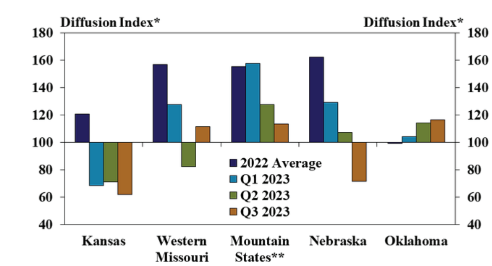
Agricultural credit conditions in the Tenth District softened during the third quarter. Farm income and loan repayment rates were lower than a year ago for the second quarter in a row. The moderation was more pronounced in areas most impacted by drought, but more tempered in areas most concentrated in 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. Farm financial conditions have softened from considerably strong levels as prices of key commodities have moderated.

Chart 1: Farm Income by State

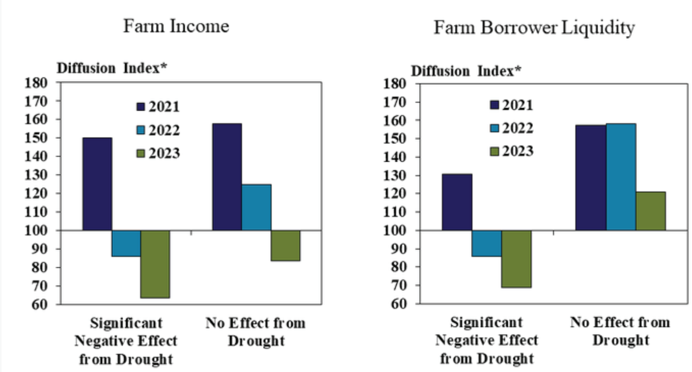


*Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than or the same as in the year-earlier period. The index numbers are computed by subtracting the percentage of bankers who responded "lower" from the percentage who responded "higher" and adding 100.
**Mountain States include Colorado, northern New Mexico and Wyoming, which are grouped because of limited survey responses from each state.

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 1). In contrast, conditions deteriorated at a moderate pace in Kansas and Nebraska which have many areas dependent on revenue from corn, soybeans, and wheat.

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 2, left panel). Similarly, farm borrower liquidity declined at a faster pace in areas significantly impacted by drought (Chart 2, right panel).

Chart 2: 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.

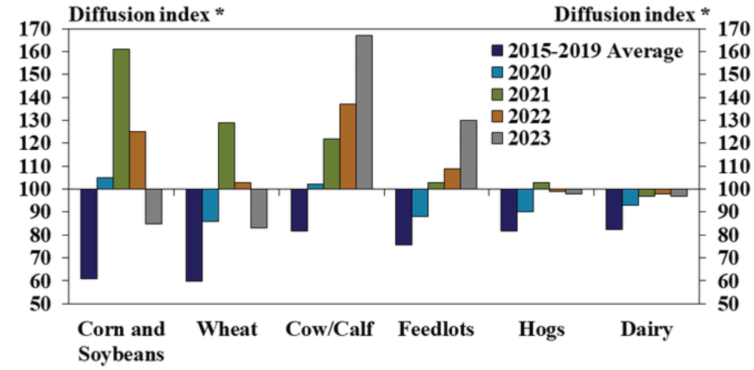
Alongside a moderation in farm income, credit conditions softened. Improvement in farm loan repayment rates halted with about 80 percent of lenders reporting repayment was unchanged from a year ago. Only about 10 percent of banks reported lower repayment rates during the quarter, however, and 20 percent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

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 3). The strength in cattle prices was expected to support improved repayment conditions for cow/calf producers and feedlots.

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. Strong farm finances in recent years have bolstered many producers and problem loan rates remained at or near historic lows.

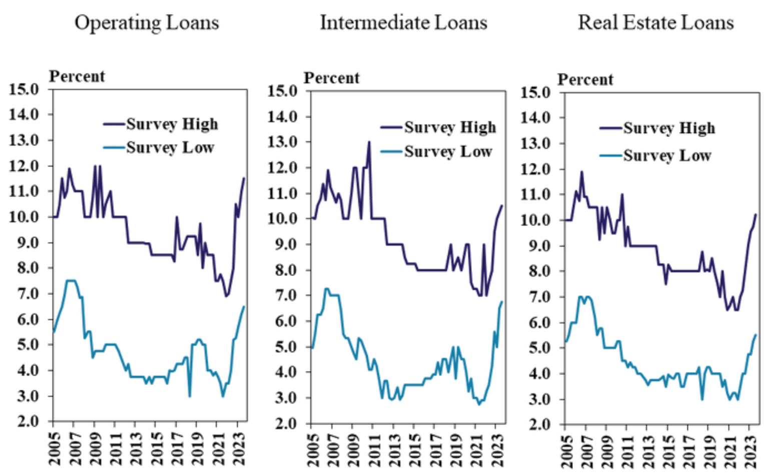
Alongside ongoing strength in loan performance, few borrowers had plans of liquidating assets to improve working capital. More than half of bankers in the District expected no borrowers to sell assets for liquidity purposes and another quarter thought less than 5 percent of their customers would have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

Chart 3: 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.

Chart 4: Average Tenth District Interest Rates



Interest Rates, Lending Activity and Farmland Values

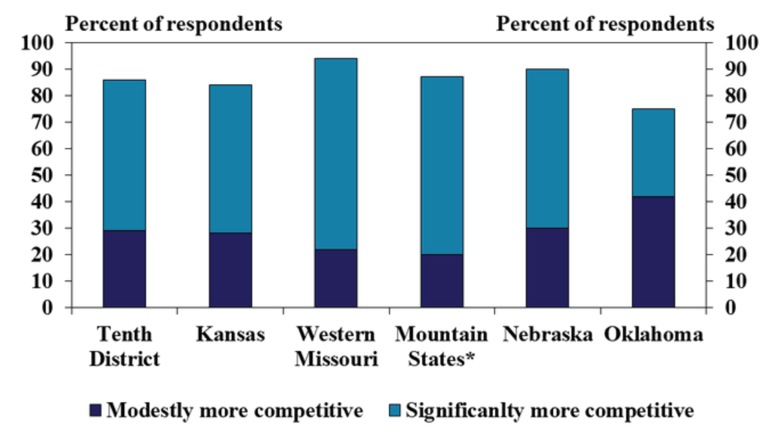
The moderation in agricultural credit conditions has coincided with a rapid rise in farm loan interest rates. The lowest average rates offered on non-real estate and real estate farm loans has increased about 400 and 300 basis points, respectively over the past two years (Chart 4). The highest average rates have grown by a similar amount with many borrowers paying a rate of interest on farm debt above 10 percent.

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 percent higher than a year ago and cash rents on those acres increased by about 2 percent. Irrigated and ranchland values grew by about 10 percent and, while cash rents on irrigated acres increased, rent charges on ranchland were lower than a year ago.

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. Availability of funds was lower for nearly a third of lenders as deposit levels have moderated.

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 5). Higher benchmark rates have pushed up rates on deposits and similar products, intensifying competition and increasing funding costs.

Chart 5: 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.

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-soften-with-farm-economy/.

For more Ag Finance Updates, see: https://www.kansascityfed.org/agriculture/agfinance-updates/.