

PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Farm related businesses hit with smaller bottom lines

The recent agricultural reports of the Kansas City, St. Louis, and Chicago Federal Reserve Banks paint a picture of a US agricultural sector facing the challenge of lower crop prices. To be sure, the situation is nothing like it was in 1998 or even 1997, but those who ignore the current economic conditions, do so at their own peril.

Clearly it will take more that flooded fields, some prevented planting, and a rainy spring to return the crop sector to the heady days when nearly everyone was convinced that we would never see corn prices fall below \$4.25 per bushel or soybean prices to fall into the single digits.

One Arkansas banker quoted in the St. Louis Federal Reserve Bank (SLFRB) "Agricultural Finance Monitor" Second Quarter 2015 issue (<http://tinyurl.com/odlnh78>) said, "Payments associated with the 2014 Farm Bill will probably be too little and too late to head off severe financial damage to most grain operations. Lenders, suppliers, and equipment dealers will also be adversely affected." The situation is little different in southern Illinois where a banker wrote, "Our trade area is primarily cash grain and the lower grain prices will have a negative impact on farm income, prompting producers to reduce spending for both business and household."

To no one's surprise, the SLFRB reports that across the Eighth District not only is farm income down from a year ago, but so is household and capital spending by agriculturally-related households, with the greater decline in capital spending. In addition, respondents from a limited sample of banks report that cash rents for both quality farmland and ranchland/pastureland are down in the range of 5 percent.

In its quarterly "Ag Credit Survey" (<http://tinyurl.com/oskbcjvc>) the Kansas City Federal Reserve Bank (KCFRB) begins its report: "Agricultural credit conditions in the Tenth District of the Federal Reserve continued to weaken in the second quarter of 2015, but despite that weakening most bankers reported few significant problems with loan repayment. Bankers also reported that a weakening agricultural economy has further boosted loan demand, lowered cropland values, and generally slowed Main Street business activity in the District's agricultural regions. Demand for non-real estate farm loans increased in every state."

The KCFRB says, "Regionally, farm income declined in every state but Oklahoma, where incomes continued to be supported by positive profit margins for cow-calf producers." As a result, ranchland values, unlike cropland have seen price increases. At the same time, bankers in Oklahoma report denying 20 percent of the farm operating loan applications they received.

"Agricultural land values in the Seventh Federal

Reserve District decreased 3 percent from a year ago for the second quarter of 2015. In addition, 'good' farmland values moved down 1 percent from the first quarter to the second quarter of 2015, according to a survey of 221 agricultural bankers. The declines in farmland values may have been tempered by a rally in corn and soybean prices toward the end of the second quarter, before these crop prices slid in July," writes the Chicago Federal Reserve Bank (CFRB) in its August 2015 agricultural newsletter (<http://tinyurl.com/nft9wg>).

The CFRB reports that "repayment rates for non-real-estate farm loans were down relative to a year ago again in the second quarter of 2015.... The slippage in repayment rates over the past year resulted in more agricultural loans having minor, major, or severe repayment problems (7 percent, 3 percent, and nearly 1 percent of the District loan portfolio, respectively). Also, 33 percent of the survey respondents observed more loan renewals and extensions over the April through June period of 2015 compared with the same period last year, while just 1 percent observed fewer of them."

The focus of each of these three Federal Reserve district agricultural reports was slightly different, but together they paint a common picture of an agricultural sector under increasing stress as commodity prices remain low. And the effect of these low prices goes beyond the farmgate to affect Main Street suppliers of agricultural inputs.

While a number of agricultural producers are currently experiencing financial stress, at this point, most producers are in better financial shape to continue to weather low prices than they were two decades earlier.

Given the insight from the Arkansas banker quoted above, it's becoming clear that if commodity production does not decline—for whatever reason—to more closely match demand or demand does not begin to increase at a rate faster than the increase in supply, farm bill provisions may not provide the level of risk/income protection to crop farmers that the legislation's authors had in mind.

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