Agricultural Credit
Market Update

Todd H. Kuethe
Agricultural Credit Market Update

• Tight margins and exhausted working capital reserves
• Farms may wish to use debt capital to meet short-term liquidity needs
• Farmers likely to face increased scrutiny
Total farm debt has been increasing, slowly
Debt relative to income has been increasing, quickly (liquidity risk)

Source: USDA-ERS
Solvency position still strong, but signs of increasing risk

Debt/Asset Ratio

Source: USDA-ERS
After long period of decline, delinquencies are rising (slightly)

Source: Ag Finance Databook
Farm loan risk ratings are increasing (slightly)

Source: Ag Finance Databook
Credit risk migration for Illinois grain farms

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Source: FBFM
## Credit risk migration for Illinois grain farms

<table>
<thead>
<tr>
<th>Credit Class</th>
<th>Mean Sojourn Times</th>
<th>Probability of Next Credit Class</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>1</td>
<td>7.66</td>
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</tr>
<tr>
<td>2</td>
<td>2.86</td>
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<td>3</td>
<td>3.08</td>
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<td>4</td>
<td>1.53</td>
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<td>5</td>
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Federal Reserve Districts

- Quarterly surveys of agricultural bankers
  - Interest rates
  - Credit market conditions (subjective)
Quarter 3 Interest Rates

Chicago

<table>
<thead>
<tr>
<th>Year</th>
<th>Operating</th>
<th>Real Estate</th>
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<tbody>
<tr>
<td>2012</td>
<td>5.21</td>
<td>4.86</td>
</tr>
<tr>
<td>2013</td>
<td>4.94</td>
<td>4.68</td>
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<tr>
<td>2014</td>
<td>4.89</td>
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<tr>
<td>2015</td>
<td>4.87</td>
<td>4.58</td>
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<td>2016</td>
<td>4.82</td>
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St. Louis

<table>
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<tr>
<th>Year</th>
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<td>2012</td>
<td>5.7</td>
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<td>2013</td>
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<td>5.2</td>
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<tr>
<td>2014</td>
<td>5.5</td>
<td>5.6</td>
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<tr>
<td>2015</td>
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<td>5.3</td>
</tr>
<tr>
<td>2016</td>
<td>5.5</td>
<td>5.4</td>
</tr>
</tbody>
</table>

Source: Chicago Fed, St. Louis Fed
Credit conditions deteriorating

Source: Chicago Fed
Credit conditions deteriorating

Source: Chicago Fed
Credit conditions deteriorating

Source: Chicago Fed
Credit conditions deteriorating
FOMC’s Target Rate
The Fed’s Dual Mandate

• "The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices and moderate long-term interest rates." – Federal Reserve Act, 1977

• In English:
  – Keep inflation low (about 2%)
  – Keep employment near full potential (unemployment 4.5 – 5%).
The Fed’s Dual Mandate

Inflation

Unemployment

Source: FRED
The Fed’s Dual Mandate

Inflation

- PCE
- Target

Unemployment

- Unemployment
- Target

Source: FRED

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The Fed’s Dual Mandate

Source: FRED

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Why many are arguing for an immediate rate increase

Effective Federal Funds Rate
Business Cycle Peak and Trough

Jan 81 - Nov 82: 9.20
Jul 90 - Mar 91: 6.12
Mar 01 - Nov 01: 5.31
Dec 07 - Jun 09: 4.24
October 2016: 0.40

Source: FRED, NBER

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Federal Funds Rate and the Cost of Agricultural Borrowing

Operating Loans

Farm Real Estate

Source: FRED, Chicago Fed

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Summary

- Farmers should practice caution in acquiring new lines of credit
- Borrowers likely to face increase scrutiny
- Interest rate increases are likely