Net Farm Income and Loan Defaults

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The U.S. Situation

The Federal Reserve provides data about Delinquency rates on loans to finance agricultural production from all commercial banks (series DRFAPGACBN). This series only goes back to 1987 so it doesn't catch the entire farm financial crisis of the 1980's.

When this series started, the farm financial crisis effects were still being played out so that delinquency rates were still near 10%. As the farm economy situation improved, delinquency rates quickly improved to around a 3% delinquency rate over the late 1990's and the early 2000's.

Around 2010, there were a few years the delinquency rate rose but it has been declining ever since. The current delinquency rate of under 1% is at or near record lows.

A question lenders and producers should ask is what does the delinquency rate indicate about the health of the agricultural sector. As one might expect, when the agricultural sector is struggling, delinquency rates increase and when the sector is doing well, delinquency rates decrease.

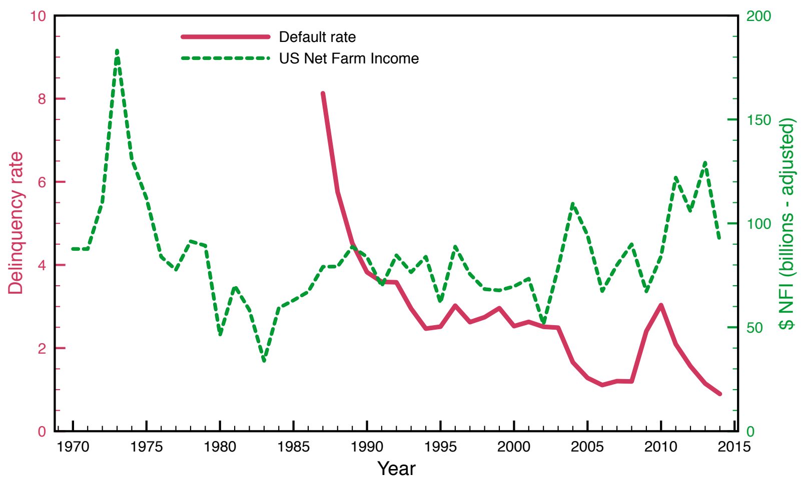

Figure 1. Comparison of U.S. Net Farm Income vs Commercial Bank Delinquency Rate for Farm Loans

However, the timing of when the delinquency rate of agricultural loans starts to increase is important. By the time delinquency rates have risen, the profitability of the agricultural sector is already in trouble.

Figure 1 plots the delinquency rate of agricultural loans made by commercial banks against the inflation adjusted U.S. net farm income. The delinquency rate is in red and is plotted against the y-axis of the left. The U.S. net farm income is in green and is plotted against the y-axis of the right.

Preliminary analysis indicates that the delinquency rate may lag the level of net farm income by up to 4 years. In addition, just using the level of net farm income to explain the delinquency rate is not adequate either as there are other factors affecting the delinquency rate.

Summary

Trying to use the delinquency rate of agricultural loans as a measure of the health of the agricultural sector is not appropriate. By the time that the delinquency rate indicates a problem, many farms will have been under financial stress for a period of time. Thus, lenders and producers should not be lulled into a sense of security that the farm economy is fine since the delinquency rate is so low currently. The last two years of lower net farm income that grain producers have experienced just haven't been reflected in the delinquency rate yet. Thus the delinquency rate should be looked at as a trailing indicator of the farm economy.