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**Comparing and Contrasting 1970-1980 and 2010-2020: Déjà Vu?**

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Baseball Hall of Famer and New York Yankee Great Yogi Berra had a famous saying, "It is déjà vu all over again." In strategic planning sessions with lenders and agribusinesses this past summer, many boards and management teams are wondering whether agriculture and agricultural lending could repeat the decades of the 1970s and 1980s. Let us explore this subject to determine the similarities and differences compared to the last great downturn in North American agriculture. Will the Yogi-ism play out in agriculture?

First, farm and ranch land values in both eras were driven by the perception of a growing global marketplace with increasing standards of living in emerging nations. The theme of yesteryear was "plant fence row to fence row to feed a growing world population," a slogan by Dr. Earl Butz, Secretary of Agriculture during the Nixon Administration. Today's buzzword is globalization, as experts indicate there is a "new normal" for the demand for food, fiber, and fuel that is being capitalized into land values.

Is agriculture in a credit bubble similar to the 1970s, the S&L crisis, and the recent stock market and housing bubble? The answer is yes and no. In the downturn of the 1970s and 80s, total farm debt to net farm income was $14 of debt for every $1 of net farm income. In this decade, the debt to income ratio has been hovering around 2 to 1. This would suggest agriculture is in an asset bubble instead of a credit bubble, where producers and investors are applying more cash down payments, and lenders are much more conservative on loan-to-value ratios than in the previous era. A word of caution, however, is a few aggressive growth-oriented producers are financially leveraged and are utilizing extended high-priced contracts for rented ground. Any correction could quickly result in margin compression and a problem loan. Despite the current debt to income ratio of approximately 2 to 1, if commodity prices correct back to $3 to $4 per bushel for corn, and soybean prices decrease to the single digits, it could cause net farm incomes to plummet, which could cause debt to income ratios to increase quickly to 5 to 1 or even 8 to 1.

In the 1970s and 1980s, farm debt was dispersed over a large number of farms and ranches. Today, a good share of the farm debt is with a few producers. While there are over 2.2 million farms nationwide, approximately 270,000 farms generate 80 percent of the agricultural revenue and carry over 60 percent of U.S. farm debt. Risks today that were not as prevalent in the previous downturn are third party/counter-party risk and the interconnectedness of U.S. farm debt. For example, if an integrator or a large producer has financial difficulty, contracts, alliance obligations, and ownership interests make these large, complex loans potentially risky in portfolio concentration.

A downturn this time would most likely be regional, particularly in the Midwest and the upper Midwest. The downturn would focus on large, growth-oriented producers and agribusinesses purchasing or renting large tracts of land or businesses, a.k.a. the "alpha dog" producers. These are the producers who are in high gear concerning growth who often fail to maintain sufficient levels of working capital or equity as a cushion for volatility shocks.

Interestingly, producers, lenders, and the agribusiness community in the 1970s and 1980s were 30 to 35 years from the Great Depression. Today, the agriculture community is 30 to 35 years from the last downturn. With many of the people who have institutional experience and memory retiring from the agriculture field, will history repeat itself? There is an old saying that the first generation builds the business, and the second generation maintains the business, while the third generation loses it because principles and practices for success are not passed between the generations. It is critical for every ag lending institution or agribusiness to have a mentoring program and a succession plan.

One positive characteristic of today's environment is that now there are more uniform farm financial records, particularly on large commercial agricultural loans, compared to the downturn of the 1970s and 1980s. Financial records and databases for benchmarking, risk rating, and competitive pricing are much more advanced. That being said, like the previous period, the hypercompetitive marketplace creates challenges as underwriting standards may be loosened and producers become much more complacent as the good times roll on.

Finally, the ag lending industry has changed dramatically. Well over 12,000 banks and 1,000 Farm Credit associations populated the U.S. landscape in the 1970s and 1980s. Today these numbers have consolidated down to 7,000 banks and 82 Farm Credit associations. With increased banking regulation impacting the lending landscape, less public policy support for the economics of agriculture, and the population becoming more distant from agriculture and rural areas, agricultural safety nets and financial assistance may be less generous than in the previous crisis. This could be detrimental to agriculture and ag lending.

As Yogi would say, will it be déjà vu all over again? Cycles tend to repeat themselves every 30 to 50 years. Similar to the 1980s, a slowdown in global market demand, higher interest rates, and a stronger dollar with less support for alternative energy could result in a repeat. This time the problems could be larger and more concentrated with fewer entities impacted. Hopefully, stronger underwriting and risk management will be the recipe for minimizing adversity in the dismount from the great super cycle.

Lender Tip

Some lending institutions have relationship officers who interact with the customer base and separate credit analysts and underwriters who analyze loans. They are requiring the underwriters and analysts to go out on farm and business visits once a month. This has been a beneficial concept that brings a personal side to the numbers for analysts. Another positive result is improved teamwork between the front line staff and underwriters or analysts.

Global Economics
The global economy continues to be in a synchronized slowdown. Twelve of the 17 euro sector economies are officially in recession. Germany and France are the bright spots. Central banks in the European region have provided support for countries in Southern Europe and a stimulus package to spur growth. These economies combined are 26 percent of the world economy and are potentially big players in global economics and the economic health of the emerging nations.

Speaking of emerging nations, China's economic growth continues to slow and some experts suggest it may decline to 6 percent, substantially slower than its recent historical trend. Trade issues between China and Japan, the second and third largest economies in the world, over a few small Pacific islands is conflict worth watching as leadership changes in China. This could mean some volatile times in that area of the world.

Domestic Economics
Confusing would be the best word to size up the U.S. economy. The Leading Economic Index and the LEI diffusion, which are forward-looking economic indicators, have been mixed to slightly higher over the past two months. The purchasing manager index jumped above 50 in September, to 51.5, which is a sign of a growing economy for the first time in three months. Another positive indicator for the U.S. economy has been factory utilization, which is near optimal capacity, in the high 70s.

A negative surprise was the downgrade of U.S. gross domestic product (GDP) growth from 1.7% to 1.3% for the second quarter; however, a positive point was that the third quarter advance estimate came out higher, at 2.0 percent. Despite the strong stimulus, GDP growth is still less than the desired target of 3 percent to 4 percent. Core and headline inflation both remain tame at 2.0 percent, well within or below the Federal Reserve's target ranges for inflation.

Housing starts are improving, at 872,000 annual housing starts for September, but still well below the target of 1.1 million, which would be considered a full recovery. The overall improvement is a positive factor.

The surprise was the report on unemployment rate, which dropped from 8.1 percent in August to 7.8 percent in September. This is the first time in 44 months the indicator has dropped below 8 percent; however, remember that one month does not make a trend. The U-6 unemployment rate still stands at 14.7 percent, which includes discouraged workers and people leaving the workforce. Workforce participation continues to be at record lows.

Overall, the economy has some positive attributes, but it will be interesting to track after the elections as the U.S. gets closer to the fiscal cliff.

**Lender and Business Dashboard Economic Indicators** (for the month of September)

| Indicator | Current | Green | Yellow | Red |
|---|---|---|---|---|
| Leading Economic Index - LEI | 95.9 | ✓ | | |
| LEI Diffusion Index | 65% | ✓ | | |
| Purchasing Manager Index - PMI | 51.5 | ✓ | | |
| Housing Starts (millions) | 0.872 | | | ✓ |
| Factory Capacity Utilization | 78.3% | | ✓ | |
| Unemployment Rate | 7.8% | | ✓ | |
| Core Inflation | 2.0% | | ✓ | |
| Headline Inflation | 2.0% | ✓ | | |
| Oil Price ($/barrel) | $108.21 | | | ✓ |
| Yield Curve | 1.54 | | ✓ | |

**Lender and Business Dashboard Economic Indicator Benchmarks**

| Indicator | Green | Yellow | Red |
|---|---|---|---|
| The Conference Board Leading Economic Index® - LEI | Increasing | Flat to Decline | Decline 0.3% for 3 consecutive months AND >1% over the period |
| LEI Diffusion[1] | >60% | 40%-60% | <40% |
| Purchasing Manager Index - PMI | >50 | 41.7-50 | <41.7 |
| Housing Starts (millions) | >1.5 | 1.0-1.5 | <1.0 |
| Factory Capacity Utilization | >80% | 70%-80% | <70% |
| Unemployment Rate | 5%-6% | 6%-8% | >8% or <5% |
| Core Inflation | 0%-2% | 2%-4% | >4% or <0% |
| Headline Inflation[2] | 0%-4% | 4%-5% | >5% or <0% |
| Oil Price[3] ($/barrel) | <$50 | $50-$100 | >$100 |
| Yield Curve[4] | Steep | Flattening | Inverted |

[1]Ten indicators make up the LEI - measures % that are increasing; [2]Includes food & energy;
[3]Consumer's perspective; [4]3-Month Treasury Bill rate to 10-Year Bond rate