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Perspectives from the ABA National Agricultural Bankers Conference

By: Dr. David M. Kohl

The 2011 ABA National Agricultural Bankers Conference held in Indianapolis, Indiana, was stellar. Through the leadership of John Blanchfield and his able associates at the ABA, an outstanding event with record attendance and a diversity of topics was on the menu for people seeking information and networking opportunities. The following are some thought provoking perspectives from this year's conference.

Jeff Simmons, a former student from my class at Cornell University, was the kickoff speaker. Jeff, who is president of Elanco, did an eloquent job discussing food production in a growing world. He stated that by 2050, the world will require 100 percent more food, and 70 percent must come from efficiency-improving technology, defined as practices, products, and genetics. This will be accomplished by using innovative tools, doing it better, and incorporating genetics to enhance plant and animal traits. In turn, these technologies will reduce water and land usage, economic impact, and carbon footprints.

Dr. Ron Hansen, professor at the University of Nebraska, discussed an innovative internship program with the Nebraska Bankers Association. With high transition occurring in ag lending personnel, they have developed a successful internship program to groom future ag lenders. The internship program allows banks to “test drive” or “red shirt” interns for a period of time to determine if they are adaptable to the culture and to assess the work attributes of the intern. This is an innovative approach that any ag lender might consider implementing in their institution’s strategic plan.

An interesting session focused on how the FDIC views ag banking, presented by regulators. Regulators are placing special emphasis on concentration risk and sensitivity analysis of income, cash flow, and collateral. The most common causes of financial difficulty they noted were collateral-based lending, improper use of working capital, fraud, and excessive family living and dividend withdrawals. Earned net worth and accrual-adjusted financial statements on growing accounts needing capital, or marginal cases, were stressed. Of course, lending limits on red-hot farm real estate are top-of-mind and being examined very closely.

Mike Swanson of Wells Fargo did an excellent job discussing global and domestic economics impacting agricultural portfolios. Trade disputes and currency disruptions along with a slowdown in the Chinese economy were factors identified that could impact cash flows and land values.

The first day ended with Dr. Dwight Armstrong, CEO of FFA. By polling the audience he demonstrated that over half of the attendees at the conference were former FFA members. The number of former state and national officers and award recipients was impressive as well. Surprisingly, 18 of the 22 largest cities in the U.S. have FFA chapters, and now there are over 500,000 members, nearly half female. A point that was interesting is that FFA is making every attempt to incorporate recommended farm financial standards into contests and the classroom.

Highlights from the Second and Third Days

- Milk prices may be suppressed by reduced demand from China for powdered milk and whey, and increased supply from New Zealand and Australia.
- The ethanol industry has gained much efficiency in recent years. A speaker indicated that the U.S. is exporting ethanol and many plants in the industry could survive without any subsidies.

My good friends and colleagues, Dr. Barry Flinchbaugh of Kansas State University, and Dr. Mike Boehlje of Purdue University, enlightened us concerning farm policy and the future of agriculture's structure. The bottom line is to expect reduced direct farm program payments and possible adjustments in other programs. With the extreme views of political parties dominating the political landscape, there could be a stalemate. According to Dr. Boehlje, banks will be required to align with the characteristics of a CFO producer. Production will concentrate and producers will seek a lender that is a solutions provider who regularly conducts purposeful communication with the customer.

The final day focused on a discussion of farmland values by Dr. Mike Duffy of Iowa State University, Don McCabe of Soy Capital Ag Services, and R.D. Schrader of Schrader Real Estate and Auction Company. Here are some of their perspectives regarding trends in land.

- Ten percent of farmland is owned by single females over the age of 75 and nonresidents show a higher profile of ownership than in the past.
- Land quality, water availability, and mineral rights are influencing land values.

I addressed the conference for the 34th consecutive year. How did this year's conference compare to my first one in Nashville? One similarity is that land values were hot and attendance was a record. A difference is that at my first conference, loan demand was high, with collateral based credit. Today, demand for credit in many agricultural regions of the country is down. The banker audience had less gray hair, and the atmosphere was much more social at the first conference. Today, bankers and lenders in attendance are lifelong learners, very serious about gaining information and networking. My general observation is that this bodes well for the future of our industry.

Lender Tip

Many producers are becoming complacent because of robust land values that establish new records almost daily. Some are shelving risk management programs and becoming lax in financial management. Maintain a close eye on producers' bottom line margins through scenario testing and variance analysis, that is, comparing actual to projected results. In today's world of high input costs, your customers can shed a lot of liquidity and equity very quickly.

Global Economics

To describe the global economic scene as the "wild world of global economics" would be an understatement. European sovereign debt issues are dominating the landscape. There is a strong likelihood that the European sector could go into recession, possibly a deep recession, depending on how converging economic and political events unfold.

China has a strong trade interest with Europe, and particularly due to this, China is seeing a notable slowdown in its economy. The Chinese central bank has instituted reduced capital requirements to stimulate growth and avoid an overcorrection from three years of increasing capital and interest rates for banks to keep inflation under control. The *Economist* magazine predicts that the BRICS nations' (Brazil, Russia, India, China, and South Africa) economies will slow down next year. This could hinder demand for food, fiber and fuel produced in the United States. A special note is that the Indian and Brazilian economies are facing headwinds, which bears watching.

On the Home Front

The leading economic indicators, i.e. the LEI, diffusion index, and purchasing manager index (PMI) have been robust as of late. The LEI was up by 0.9 percent and 0.5 percent in October and November, respectively, with a current diffusion index of 70 percent. The PMI surged approximately two points last month. Oil prices are creeping around $100 per barrel NYMEX which is worth noting, with no signs of slowing down. With a large percentage of farm and ranch expenses connected to oil, this variable must be sensitivity tested in any agricultural cash flow projection. Also, keep an eye on Iran and military and political events in the Middle East.

Inflation, while tame under Federal Reserve standards, has shown a stubborn trend of ascent more than normal. An increase from 1.0 percent core inflation in January 2011 to 2.2 percent in November bears watching. This, along with household incomes down 1.7 percent in the last year, results in a mini-stagflation feel for the economy. It is interesting to note that the energy index which contributes to headline inflation decreased, which offset increases in food and other items.

Factory utilization is below the 80 to 81 full capacity metric, but still shows a positive trend. Two drags on the economy are housing starts and the unemployment rate. Housing starts are suppressed by stringent underwriting standards, inventory build-up, and suppressed household incomes due to wage pressure and unemployment.

The unemployment rate dropped to 8.6 percent for November. The U-6 measure of unemployment is 15.6 percent, which includes discouraged and displaced workers and those who have dropped out of the workforce (U-3 to U-6 workers). While this is good news, the figures may have been influenced by reduced numbers in the labor force. There is an old saying that “one month does not make a trend.”

The bottom line is the U.S. economy is in a period of economic moderation with potential sovereign debt issues on the horizon. How we handle these will basically determine whether our economy stays stable or, with the possibility of a black swan or unusual event, enters a recession.

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

Indicator	Current	Green	Yellow	Red
Leading Economic Index - LEI	118.0	✓		
LEI Diffusion Index	70%	✓		
Purchasing Manager Index - PMI	52.7	✓		
Housing Starts (millions)	0.685			✓
Factory Capacity Utilization	78.0%		✓	
Unemployment Rate	8.6%			✓
Core Inflation	2.2%		✓	
Headline Inflation	3.4%	✓		
Oil Price ($/barrel)	$109.74			✓
Yield Curve	2.06		✓	

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