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Q & A with Dr. Dave
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In this column we will use the GPS to "zero in" on some of the most common questions I am asked by lenders, producers, and others who have an interest in agriculture. This is not an exhaustive list by any means, but it could instigate discussion and thought over the summer season, which is frequently a time for board and management strategic planning. Let's conduct a question-and-answer session in this edition of Dave's GPS.

Will Interest Rates Rise and Continue to Rise?
This is a "million dollar" question that really has no answer concerning timing. General uncertainty related to economic and geopolitical risk has recently caused longer term rates, specifically the 10-year Treasury rates, to increase. However, there are clear signals established by the Federal Reserve that may provide an early glimpse of a change in the federal funds rate on the short term end of the yield curve.

Within the last year, the Federal Reserve, in an attempt to become more transparent, established metrics for possible withdrawal of stimulus and a rise in the federal fund rate. The first signal to watch for is the trend in reported unemployment rate. The current rate is 7.6 percent, and the Federal Reserve has established a 6.5 percent marker. If one observes the reported unemployment rate declining toward 7.0 percent, the Federal Reserve most likely will become less accommodative or taper off bond and mortgage-backed security purchases, followed by a possible interest rate increase.

Second, focus in on core inflation, which excludes food and energy, and headline inflation, which includes food and energy. The benchmark established by the Federal Reserve is 2.5 percent. Both measures of inflation are currently well below the benchmark, at 1.7 percent and 1.4 percent, respectively.

Finally, observe the growth of the economy in the form of gross domestic product (GDP). A sustained rate above 2.5 percent GDP growth annually would be a sign the economy is gaining strength and able to sustain growth without stimulus.

As a side note, analyze the Federal Open Market Committee's (FOMC) meeting minutes. Usually members of the committee and the regional Fed presidents will send a trial balloon to the markets and the public for their reaction two to four months before action. The question becomes not only when, but how quickly interest rates and stimulus will change. To what degree will change occur in the U.S., and will other

central banks follow our lead? Watch the Fed as well as Treasury rates closely going forward.

The Great Commodity Super Cycle: Will It End?
Yes, all cycles eventually come to an end. This commodity super cycle in particular has brought great prosperity to the grain and energy sectors of rural America. Four factors need to be observed to gauge a slowdown or an end to the great super cycle with duration 2.5 times longer than any of the three previous super cycles in the past 100 years.

First on your watch list should be economic growth of emerging nations, i.e. the BRICS and KIMT's, including Brazil, Russia, India, China, and South Africa as well as South Korea, Indonesia, Mexico, and Turkey. Growth is slowing in these regions, particularly in China. These nations export consumer products to the European region, which is in recession, and to Japan, which is pulling out all stops to inflate its economy's anemic economic growth.

Second, observe bioenergy policy. Currently the administration's stance is in support of energy initiatives that lead the U.S. to energy independence. This positioning will be a critical element for the commodity super cycle to sustain itself, particularly on the grain side.

Previous discussion on the first question about interest rates is critical to the sustainability of the commodity super cycle. Recent academic papers suggest that low interest rates were critical in this cycle of farm prosperity. Reduction of stimulus, the rise of interest rates, or a combination of the two factors will be a major game changer in the commodity super cycle.

Finally, Mother Nature is still in control. Excess or a deficit of moisture or growing degree days, or critical weather patterns during pollination periods can alter supply and demand balances in the U.S. and abroad. The result is extreme volatility which requires very keen, astute managers of agricultural enterprises.

What is the Future of Agricultural Lending and Capital Needs?
This is another "million dollar" question that is top of mind for strategic planners. To provide some insight, I will draw upon the opinions of lenders in the Interpreting Economic Change class I taught at the Graduate School of Banking at LSU. This senior class consisted of 175 individuals representing 19 states and Mexico.

Using anonymous clicker technology, these future bank leaders were asked how many of the 7,000 commercial banks would be remaining by the end of the year 2020. Two-thirds of the class indicated between 4,000 and 5,000 banks would remain, while 20 percent indicated as low as 3,000. Whether you agree or disagree with these findings from the future bank leaders, this provides a reference point to ponder.

With more regulation and many family-owned community banks in which the next generation is not embarking on banking, consolidation is a likely result over the next seven years. Similar trends will most likely be observed not only in banking in general, but also in the Farm Credit System and other institutions that serve agriculture as well.

In recent times, more equity capital from institutional and private investors is appearing in selected agricultural areas of the U.S. where reasonable rates of return can still be garnered. It will be interesting to observe whether these monies will remain if agriculture goes into a corrective stage of the economic cycle.

Where are the capital needs? Debt and production are very concentrated with 270,000 farms and ranches nationwide generating 80 percent of revenue, and owing 60 percent of the total debt. Debt capital is being demanded by these growing agricultural producers and the agribusinesses that serve them. Other segments demanding credit are the young and beginning producer segment in the growth phase and the entrepreneurial segment which includes local, natural, and organic markets as well as large, complex agricultural operations and rural businesses.

Will Land Values Continue to Rise?

The question of land values invariably surfaces at almost all the seminars I attend. Land prices and cash rents are still quite hot in concentrated production regions of the country. Can they sustain a 10 percent to 30 percent annual increase? Probably not. As a result of the increase in land prices and cash rents, margin and profit compression is being observed. Another observation is that fewer individuals are writing large checks for cash purchases of land. Equity is being used as a down payment along with more borrowed money and less cash options. This could be a pending sign that U.S. land values are late in the prosperity cycle.

Lender Tip: Ask a Question

Good lenders are well-read and inquisitive. You have read responses to some of the most common questions I am asked. If you have additional questions you would like answered, please send them to me to address in future editions. I would like to compare your questions to those received at lending schools around the country this summer.

Global Economics

Let's embark on a quick trip around the globe. Our GPS starts out in Europe, where much of the European region remains in recession. Nearly 20 million workers are unemployed with rates for young people as high as 50 percent in some European countries. With this region of the world generating over one-quarter of the world's economy, debt levels and austerity programs by many of the leading economies' governments do not bode well for economic growth in the next few years in this important region.

A quick trip to Asia finds Japan, the third largest economy in the world, has embarked on a stimulus program similar to the U.S. The impact has been a rising stock market, up nearly 50 percent. Also economic growth has been reported around 3 percent, up considerably for an economy that has had virtually zero GDP growth for a number of years.

China's economy continues to moderate as its manufacturing and housing sectors stabilize after rapid growth for three decades. Overall, the emerging BRICS and KIMT countries' composite growth rate is slightly below 5 percent. As a side note, the potential purchase of Smithfield Foods of Virginia by a Chinese company was a surprise to many. China's strategic objective is to purchase brand and food safety to accelerate its ability to provide safe products to its populace. This deal was negotiated over the past two years.

Work with the Mexican bankers finds that the new Mexican president, Nieto, who has a background in economics and finance, has been very aggressive in economic and business reform. However, in recent months, Mexico, our major trading partner, has had a slowing economy. As a side note, former Federal Reserve Chairman Dr. Alan Greenspan has been a consultant to the government to assist in economic reform.

Domestic Economics

Overall the status of the U.S. economy is bifurcated, that is, many lead and lag indicators illustrate a split sense of direction. The lead economic index (LEI) has moved in both positive and negative directions in recent months with the LEI diffusion bouncing above and below 50 percent. Diffusion measures the percentage of the LEI's 10 factors that are positive.

Oil prices have stabilized in the $90 per barrel range despite gasoline consumption being down 2 percent as a result of energy efficient new vehicles with higher gas mileage and people driving less. This illustrates distribution and refinery issues, not necessarily production issues, are the limiting factor in our energy sector.

The purchasing manager index (PMI), a leading economic indicator, broke below 50 for the first time in several months, which is a possible sign of a slowing economy. Unemployment, a lagging indicator, increased slightly to 7.6 percent, but has remained fairly steady over the past several months. The U-6 unemployment rate remains just below 14 percent.

Housing starts, which increased 6.8 percent month over month, have stabilized at around 914,000 annually. Factors to consider going forward include higher long-term mortgage rates and household income being reduced by tax increases and uncertainty in healthcare costs.

Factory utilization, a metric of the manufacturing industry, remains in the high 70s, near capacity. Watch the 10-year treasury yield. The current rate is above 2.1 percent and has increased quite substantially in recent months. If this rate increases to 3.0 percent, this may foretell a slowing economy.

Core and headline inflation remain at 1.7 and 1.4 percent, respectively. Economic growth in the form of GDP growth has been revised down to 2.4 percent for the first quarter of 2013. Overall it will be interesting to see if the U.S. economy slows, and when the Federal Reserve tapers stimulus and increases interest rates.

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

Indicator	Current	Green	Yellow	Red
Leading Economic Index - LEI	95.2	✓		
LEI Diffusion Index	45%		✓	
Purchasing Manager Index - PMI	49.0		✓	
Housing Starts (millions)	0.914			✓
Factory Capacity Utilization	77.6%		✓	
Unemployment Rate	7.6%		✓	
Core Inflation	1.7%	✓		
Headline Inflation	1.4%	✓		
Oil Price ($/barrel)	$99.77		✓	
Yield Curve	2.09	✓		

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