FARMER MAC

DAVE'S GPS

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Dallas Discussions

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The 70th Annual American Bankers Association's Agricultural Bankers Conference was held in early November in downtown Dallas, Texas. Agricultural bankers, industry leaders, government officials, consultants, and academics were engaged in information-packed sessions and networking opportunities with sponsored booths. This year's conference did not disappoint. The following are some of the discussions and hot topics from the four-day event.

Government payments

Government payments are now playing a larger role in net farm income since the tariff and trade negotiations have heated up. Some estimate that these payments, which are available in a wide variety of forms and methods, comprise up to 50 percent of net farm income and even higher for some individual farms. The major question will be whether these payments will be non-recurring income should next year's election results change political leadership. The image of American farmers receiving subsidies does not sit well with the nonfarm public and trading partners around the globe. One banker stated that one of his best, most conservative producers had just upgraded his pickup truck. He further indicated that this producer received considerable ribbing by the town folks for using subsidies to upgrade his truck, which really upset him.

Profits lower, balance sheets larger

In the pre-conference educational workshop, the FINBIN team from the University of Minnesota brought an interesting perspective. Current median farm profits are very comparable to numbers at the turn of the century. However, the balance sheets and income statements are approximately three times larger. With lower profits and a larger asset and liability base, the financial situation of producers is very fragile. A small change in prices or expenses can change risk dramatically.

Ownership versus leasing

One banker from the upper Midwest stated that farmers are much like college students choosing to rent versus owning an apartment. When renting, this banker said he was less careful of activities that may deteriorate the property. However, in his senior and graduate school days, he bought an apartment. This ownership led to much more careful scrutiny of his roommates and their extracurricular activities. This is analogous to producers. Once they take ownership of a property, good business practices and a sense of pride in the operation often improve performance. Other producers who have a "renter's mindset" may disregard some good business and financial practices. This mode of operation takes a toll in the short run and particularly in the long run.

The three C's

In the Sunday afternoon session, sponsored by FINPACK and Farmer Mac, the speakers had a very interesting discussion concerning problem credits. They grouped these problems into three distinct categories: **c**onsolidation, **c**ollateral, and **c**redit scores.

When a producer requests a loan to consolidate or restructure a number of split lines of credit, this often is a sign of poor management and improper credit use. Low margins and insufficient cash flow could also create a situation where consolidation is considered.

A single commodity producer with specialized assets that have low contributory values is another risk factor to consider. Many issues and problems center on collateral, specifically if the producer has repayment or working capital issues.

Credit scores do indicate the possibility of credit risk issues in agricultural lending. However, one has to dig deeper into the details of the credit report for the rest of the story.

U.S. diminishing competitive power

Ambassador Darci Vetter, Former Chief Agricultural Negotiator for the U.S. Trade Representative, provided some very candid insight concerning trade. First, passing the United States-Mexico-Canada Agreement (USMCA) is critical for the agriculture, manufacturing, and energy industries. Second, bowing out of the Trans-Pacific Partnership (TPP) was a mistake. Other countries within this agreement are moving on without the United States. Third, the current riffs with our trading partners around the globe are creating distrust of America. These factors are driving other countries to seek relationships with other trading partners. Overall, the U.S. influence has diminished throughout the globe, which is critical because one in five dollars of net farm income resides in export markets. While some of the bankers did not enjoy her comments, she definitely had some valid points which directly impact credit risk.

Business IQ

In a session designed to aid bankers in developing ways to improve their customers' business IQs, three bankers from different size institutions and geographic locations provided some real nuggets.

Shan Hanes, President and CEO of Heartland Tri-State Bank in Elkhart, Kansas, uses spreadsheets to analyze the financial statements and develop breakeven scenarios. He stated that this analysis has been invaluable to get his customers to utilize and execute marketing and risk management plans.

Tony Hotchkiss, Director of Agricultural Banking at Regions Bank in Clayton, Missouri, introduced podcasts as a tool for education and marketing. Some of the 20 to 30-minute podcasts are developed by his team members, which has been empowering. Customers can listen to the podcasts in their tractors, combines, and pickups to learn while being mobile.

Scott Hauseman, Senior Lender at Fulton Bank in Wyomissing, Pennsylvania, has found that his bank's educational sponsor meeting with other agribusinesses has been a hit with their customer base to improve business IQ. After attending this and other sessions, one can quickly see that educating bank employees alongside customers is a wave of the future.

Shout out!

This year closes out my fifth decade of presenting to this agricultural lending conference. Over the years, I have had the pleasure to work with many professional lenders, three of which were recognized at this year's event.

For the first time, this year's Bruning Award went to a husband-and-wife lending team, Gary and Hanna Canada from the Bank of England in England, Arkansas. Whether it is the energy with their customers at agriculture events or interacting with their team, one can always find a productive family-oriented culture at the bank. The couple is always seeking to improve the situation for both the bank and their customers. It is amazing how Gary was a teller one day and the bank president the next. They have had an amazing journey and are well deserving of the Bruning Award for banking leadership.

The Blanchfield Award recognizes non-bankers who have made major contributions to the banking industry. This year's recipient is Jim Radintz, who recently retired as a senior executive at the USDA's Farm Service Agency (FSA). I have worked very closely with Jim over the years. While both of us have a love for and actively farm, Jim's service to agriculture has been his high priority. Jim was very instrumental in the development of the USDA Microloan Program and the FSA Certified and Preferred Lender Programs. He was one of the original members of the Farm Financial Standards Task Force and was behind the national training with Web Equity to upgrade agricultural lender's computer skills, particularly those with FSA. I am proud to say that Jim earned his master's degree from Virginia Tech and is a fellow Hokie!

Domestic Economy

As we close down the second decade of the 21st-century, the U.S. is in the longest economic expansion in history at 126 months and counting. Very few people could have imagined the length and duration of this expansion at the height of the Great Recession one decade ago. Where does the current U.S. economy stand?

The Leading Economic Index (LEI) is showing very few signs of storm clouds on the horizon and has been flat in recent months. The diffusion index measures the positive or negative movements of the ten indicators that make up the LEI and has remained around 50 percent.

Oil prices have been stable, which encourages consumer spending and travel. Despite OPEC making cuts in production, supply and demand have been balanced with no major changes in inventory.

The Purchasing Manager Index (PMI) has been below 50 for four consecutive months. This is a sign of a manufacturing recession, both here in the U.S. and abroad. The passage of the USMCA could put some steam into the manufacturing industry as supply chain integration with Mexico, Canada, and the U.S. is critical for many manufacturers.

Both U-3 and U-6 unemployment rates are at record lows. Low unemployment is resulting in stronger housing starts. Some of the best housing start numbers have been posted since the Great Recession and are nearing the favorable target of 1.5 million units annually.

Factory utilization has been soft as a result of global trade disputes which are impacting the cost of supplies and lowering overall demand.

Consumer sentiment has remained strong this year and during the holidays. This is partly due to the strong job market and the wealth effect in both the stock and real estate markets.

Inflation is at a level that both producers and consumers would consider very tame. Low inflation is causing us to employ a wait-and-see strategy on whether the Federal Reserve will increase or decrease interest rates.

The growth of the economy has been slow and steady at approximately two percent. As we close out the decade in the coming weeks, the U.S. and global economies will be one of the leading indicators of election outcomes around the world. It will be an interesting start to the next decade!

Global Economy

One must be vigilant to monitor trade negotiations and the status of Brexit. With the election outcomes in Great Britain favoring Brexit, it will be interesting to see if they execute an agreement over the next few months.

China's economy is in a slowdown, reporting reduced growth at around six percent annually. The country's exports are down considerably due to trade disputes worldwide.

It is interesting to note that as a result of the U.S. not being a part of the Trans-Pacific Partnership (TPP), Europe has shifted their strategy to provide products in Southeast Asia, a very rapidly growing segment of the world economy.

Low, negative interest rates in major world economies have resulted in gains in equity markets worldwide and increased consumer spending through the wealth effect.

To sum up the decade, it is only the beginning of constant uncertainty in trade. This, political volatility, and the intensification of competition are major economic shifts that are not only occurring here in the U.S., but worldwide.

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

Indicator	Current	Green	Yellow	Red
Leading Economic Index - LEI	111.6		✓	
LEI Diffusion Index	65%	✓		
Purchasing Manager Index - PMI	48.1		✓	
Housing Starts (millions)	1.365		✓	
Factory Capacity Utilization	77.3		✓	
Unemployment Rate	3.5%	✓		
Core Inflation	2.3%		✓	
Headline Inflation	2.1%	✓		
Oil Price ($/barrel)	$63.94		✓	
Yield Curve	0.19		✓	

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	<6%	6%-8%	>8%
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