FARMER MAC

DAVE'S GPS

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<u>Perspectives from the Super Bowl of Banking</u>

By Dr. David M. Kohl

“Omaha, Omaha!” No, this is not Peyton Manning barking quarterback signals from yesteryear in the National Football League. Omaha was the center of focus for the 67th annual National Agricultural Bankers Conference hosted by the American Bankers Association. Four days of power-packed informational events with the opportunity for engagement with participants from over 30 states and Canada can easily be called the Super Bowl of agricultural banking. Let's provide a few highlights from this year's event where I enumerated over 25 pages of notes.

In discussion with one of the bankers, Todd from Oklahoma indicated that he had enrolled in a vocational program on business management with agriculture producers. Why would this seasoned banker with a university degree consider this a priority? He stated that it was because he wanted to unlock the mystery of how to teach and communicate financials to his agriculture producers. He stated that there was no better way to engage and improve financial well-being than working side-by-side with these producers on class readings and case studies. As a side benefit, he was able to wear his “business development hat” when attending classes. A funny story about this training was that the course instructor used an old video I made from 1987. How do I remember that date? Well, after filming the video it was discovered that the stock market had crashed on October 19, 1987. The bottom line is that working side-by-side with your customers in an educational process can have many side benefits.

Why are some producers more profitable than others? This was the topic of discussion for Dale Nordquist and Bob Craven from the Center for Farm Financial Management at the University of Minnesota. Both stated that it was about being a little bit better in many areas of the business. Their analysis found that the higher echelon of profitable producers was a little bit better in production management, which yielded five to ten more bushels per acre.

This group was a little bit better in marketing their crops and on average received $0.10 to $0.20 more per bushel. Another area of incremental benchmarking was cost control, specifically slightly lower fixed cost per acre or unit. The final attribute was capital efficiency and management as measured by the asset turnover ratio. The top group turned their land, machinery, equipment, and livestock assets faster than the lower profitability groups. What it all adds up to be is that they achieved the “five percent” rule, coined by Dr. Danny Klinefelter from Texas A&M University. They were five percent better in many areas of the business.

The makeup of this year's group demonstrated the evolving landscape taking place in agriculture and agricultural lending. My roll call on the final day found that nearly 40 percent of this year's group were first-time attendees. Less than ten percent of those in attendance represented baby boomer lenders that had experienced the 1980s farm crisis.

This year's Women in Ag Banking Leadership Breakfast was attended by nearly 80 female bankers and those associated with the banking industry. Natalie Bartholomew, from Bentonville, Arkansas, provided an energetic session on leadership and gave everyday practical tips in working in agricultural banking. She is a fifth generation family farmer and third generation banker that is an advocate for women in banking through her blog, "The Girl Banker." The ladies in attendance were asked if they had participated in FFA or 4-H; well over 80 percent of the group indicated that they had. The youth organizations in agriculture are great recruiting grounds for future employees and customers. Investments of both time and money in these programs and organizations can pay dividends in the future.

What was the biggest expense in business and lending? This may surprise you, but it was a lack of trust. David Horsager, the author of The Trust Edge, provided some critical thoughts on trust. He stated that as trust increases, output, morale, productivity, innovation, loyalty, and profits also increase. However, as trust decreases, costs, problems, suspicion, attrition, time-to-market, and stress result in reducing the bottom line. As farm and ranch businesses and banks consolidate and become more complex, the profit equation can be directly related to the culture of trust. Perhaps this component needs to be incorporated more into risk management equations in the business.

A theme throughout the conference was how technology and big data were going to be major disruptors in the agricultural landscape in the next decade. Whether it was the CEO of Land O'Lakes or academics presenting, the theme of change and disruption was well established. The consumer, both domestic and international, wants transparency, personalization, customization, and an organization that is customer-centric. Land O'Lakes has hired more statisticians to analyze data than any other management position. The discussion of blockchain technology from the producer, to the food companies, to the retailers, and finally to consumers will be a challenge to all commodities. Much of this is being driven by venture-capital funds outside of the agriculture industry investing in the food industry. This diffusion of the new concepts is now in the strategic planning of innovative companies and is ready to be moved forward to the early adopters in the 2020s in the agricultural industry.

Finally, I would like to give a shout out to my academic contemporaries. This is the first time in over 30 years that Dr. Danny Klinefelter, Dr. Freddie Barnard, and myself have spent multiple days together at a conference. The three of us have been called "The Three Amigos." We were bonded with the start of the Farm Financial Standards Task

Force and the financial schools and conferences we have taught over the course of our careers. What a journey it has been for us with the support and guidance of the agricultural lending and producer community. Dr. Barnard received the Blanchfield Award for his distinguished service to agriculture banking, which was well deserved.

I would also like to recognize this year's Bruning Award winner, Fred Bruning. He is the CEO of Bruning State Bank in Nebraska. The award was named after his father, Frank Bruning. Fred was very instrumental in providing the leadership to start the student internship banking program with the Nebraska Bankers Association and the University of Nebraska. This program has been a tremendous success in bringing new bankers to the agricultural lending field.

Make sure to hold a place on your calendar for the second week of November for next year's conference in Dallas, Texas. This will be the first time the conference has been held there since 1993.

Global Economy

Political change is the main driver of economic trends worldwide. The political agendas of the new leaders of Mexico, Brazil, Germany, and the U.S. legislative branch could be a driver or foreteller of economic future.

China's economic growth is slowing due to the tariffs and the general extent of the economic cycle. The massive amounts of debt, particularly in real estate, that are encountered are also slowing economic growth. Japan and certain parts of the European economy, such as Germany, have had recent quarters of negative economic growth. The central bank of Europe is continuing to ease their monetary policy which results in a stronger dollar compared to the euro currency.

Overall, it will be interesting to see if the slower economic growth eventually comes to the U.S. In a global economy that has many political minefields with economic policies bouncing from populism to free market, it is very difficult to determine how the cards will fall.

Domestic Economy

The U.S. economy finished the year with an economic expansion of 113 months with the possibility of setting the all-time record in the fall of 2019. The economy is being driven by asset wealth in the stock market and real estate market, which results in consumption of consumer goods and services. Examining the leading and lagging economic indicators finds evidence to support the strong general economy.

The LEI, or Leading Economic Index, has been positive all year until October, when it was down three tenths of 1 percent, with a diffusion index of 45%. However, in November it jumped back to up two tenths of one percent with a diffusion index of 70%. Overall it is increasing at a slower rate. The price of oil has declined to the $50 per barrel range, which has translated to lower gasoline prices and has been a boost to the consumer's pocketbook.

The PMI, or Purchasing Manager Index, is still above 50 and is indicative of growth in the economy. This metric will need to be closely watched early next year to see if the tariffs and trade rifts will result in a slowdown.

Unemployment is at a record low of 3.7 percent. The U-6 unemployment rate, which includes discouraged and underemployed workers, is at 7.6 percent. These low metrics are now resulting in minor wage inflation in some sectors.

Housing starts still remain in the not so stellar range of 1.2 million units annually. The housing sector will need to be closely monitored as prices are coming down in areas such as southern California and the Bay Area of northern California. The “fix and flip” housing market segment is observing a buildup in inventories, according to reports from the Wall Street Journal.

Factory utilization remains high despite disruptions in supply chains and trade agreement issues.

Inflation, while increasing on the producer and consumer side, is still in a workable range. The growth of the economy has been strong at above three percent in the latter part of the year. Will this growth rate be sustained in 2019?

The variables to closely watch are the flattening and the inversion of the yield curve, continuation of trade tensions, the ratification of the USMCA, and the downdraft in the stock market. Also, keep an eye on how many times and how fast interest rates increase.

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

Indicator	Current	Green	Yellow	Red
Leading Economic Index - LEI	111.8	✓		
LEI Diffusion Index	70%	✓		
Purchasing Manager Index - PMI	59.3	✓		
Housing Starts (millions)	1.256		✓	
Factory Capacity Utilization	78.5		✓	
Unemployment Rate	3.7%	✓		
Core Inflation	2.2%		✓	
Headline Inflation	2.2%	✓		
Oil Price ($/barrel)	$58.09		✓	
Yield Curve	0.64		✓	

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