FARMER MAC

DAVE'S GPS

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<u>Reflections</u>

By Dr. David M. Kohl

Wisconsin, the “Cheesehead State,” was the site of the 65th annual National Agricultural Bankers Conference. This year, a record number of vendors, government representatives, agribusiness professionals, producers, and over 700 bankers were in attendance. Actually, because of the four days of information-packed sessions, this event is often called the Super Bowl of Agricultural Lending. As in years past, the perspectives from sessions, networking and hallway discussions proved very valuable.

Both in demographics and background, agricultural lenders are in a state of transition. Actually, of those who attended my final session, over 50 percent were concluding their first conference, while less than 15 percent had memory from the 1980s farm crisis. Fifty years ago, most agricultural lenders not only understood agriculture but were familiar with the nuances of a customer’s specific enterprise. In addition, both the production and lending sectors were predominately male. However, many from that era lacked the understanding of financial and credit analysis that led to the issues of the farm crisis days of the 1980s.

By contrast, today’s lenders are trained in the assessment of financial information and analysis. Of course, an increasing number of current and incoming lenders must also learn about the agriculture industry, in addition to their customers’ businesses. Indeed, this new group must be quick-studies in order to accurately assess the risks and rewards of individual customers and enterprise operations, because issues often start outside of the numbers first.

At the conference, Curt Covington, Senior Vice President of Farmer Mac, gave a powerful presentation on imperative elements of the upcoming renewal season. As Curt pointed out, the customer has to develop a reason why the lender should approve the loan. Next, he stated that lenders need to look at the success factors of the loan. Specifically, in businesses with multiple entities, lenders must determine who owns the repayment source. Curt further pointed to the fact that today’s agricultural businesses are often complex, which requires the lender to identify the specific purpose of the loan, where the funds will be deployed, and in which entity.

Next, Farmer Mac joined with FINPACK to address the issues lenders face when dealing with customers in financial difficulty. From their presentation, the following should be on the lender’s watch list this season: lack of customer cooperation; high employee turn-over (with larger businesses); and returned checks or a delinquent payroll. Of course, whether it is a family business or larger corporation, management should be monitored for visible signs of discord. Finally, deteriorating assets such as cattle, machinery, land and buildings can be a sign that credit repayment problems may follow.

The Farm Service Agency session discussed the possibility of extending limits on direct loans and government guarantees as agricultural businesses grow. The delinquency rate as reported by FSA is not unusually high, despite the prolonged economic reset. Overall, it was agreed that the FSA Preferred and Certified Lender Programs with banks and Farm Credit Associations have been a success. Monies are still available for young farmer and rancher programs and one of FSA's top priorities is integrating technology into the loan process. FSA is also proud of their over 500 new employees, and expect that number to grow with coming retirements.

The FINPACK team gave a detailed presentation on the widening gap of profitability in farms. When separated into segments, farm records show a noticeable, widening trend in profitability between the top and bottom one-third of producers, regardless of commodity. In addition, the greatest losses were amongst the small producers on one end, and the larger producers on the opposite end, providing a goalpost type of chart image. These profitability trends will be important for lenders to watch, particularly this winter.

As FINPACK shared their analysis, it became apparent that accrual adjusted accounting was an exceptional foreteller of potential financial issues. On the balance sheet, accrual adjustments are made in the beginning and ending balances for inventories, accounts payable and receivable, accrued expenses, prepaid expenses, as well as yield predictions for crops growing in the field. As a result, one can gain insight and direction into the true earnings of the business.

The refinancing of agricultural debt will be a significant task this year. Accordingly, several sessions at the conference covered questions regarding refinancing requests. For example, lenders must determine the cause behind the refinancing need. Are the borrowed monies going to support the borrower's lifestyle, or is there a lack of lack of budgeting, or poor business or marketing management? Many producers are doing a commendable job at living within their means; of course, some still need to improve. Lenders will also undoubtedly consider the trend of multiple refinancing requests over time. Lastly, when examining the requests, lenders will assess the impact of today's prolonged economic reset on working capital and equity losses.

Other tidbits from the four days of sessions included the confirmation that a branded image is still important in doing business, whether it is banking or small business. Additionally, the ease of doing business either through technology, the process, people, or some combination of the three, is very important in attracting and retaining good employees and business relations.

From the various sessions and presentations on commodities, it was generally projected that market volatility will increase in 2018, both for crops and livestock. Forecasts put corn prices in a range of $2.40 to $3.80 per bushel; wheat's range was $3.00 to $9.00 per bushel, with the price of soybeans in the $8.00 to $10.00 range per bushel. Fat cattle prices were predicted in the $75.00 to $100.00 range, with feeder cattle ranging from a low of $0.65 to a high of $1.50 per pound. On the dairy side, milk prices are expected to trend a bit higher, but not enough to free the industry of its current economic plight.

Almost without exception, experts and speakers warned that these prices were predicated on weather and international trade agreements. Dry weather in the growing areas of South America and the Southern Plains region of the U.S. needs to be closely monitored in the next few months. Of course, the NAFTA trade agreement in the spring is critical to the future outlook of agriculture.

To usher in its 65th anniversary of delivering progressive and pertinent information, this year's conference featured a session focused on women in agriculture. As a first for the conference, the session was attended by over 80 individuals, almost 95 percent women. This packed hour included tips on leadership, and learning from failure. Yet, the overarching message was "you don't have to do it all." From professional careers, to family and personal life, women sometimes struggle to find balance and then, take on too much. The message on this session was that not only is it O.K. to seek a work-life balance, it is good! A great quote from the session was, "Every time you say 'yes,' you must say 'no' to something else." And that's a powerful message regardless of gender.

Management Tip:
My tip from this year's conference is to be sure to sign up for next year's conference. To be held next November, the 2018 conference will travel to Omaha, Nebraska. Get signed up early to enhance your knowledge and skill set in the agricultural lending field.

Global Economy

There is no doubt that the world economy is in a synchronized growth pattern. Economic growth and leading world economies are on a decade high. This is a result of the economic stimulus, loose monetary policy by central banks around the world, and record-long low interest rates. The major question now becomes how much longer this growth in GDP, earnings, and the stock market can be sustained. The stock market earnings as well as those of all the indices throughout the world are perpetuating the wealth effect syndrome. That is, every time the stock market increases by one dollar, according to the DJIA or S&P 500 indices, the consumer on average spends four cents more.

In Germany, although Chancellor Merkel won the election, she does not have the full endorsement of all parties. This is creating political friction and a stressed agenda that could carry over into growth of the world's fourth largest economy.

As the world's third largest economy, Japan is experiencing economic growth and a bounce in the equity markets, but still struggles to reignite inflation in their economy. Of course, their incumbent leader was just re-elected, which will undoubtedly impact the economic stability of the country.

China's economy is still projected in the 6 to 7 percent GDP growth rate range. It is interesting to watch as the Chinese President takes measured steps towards becoming a trusted global leader forging alliances and initiatives with countries throughout the globe.

Since the U.S. withdrawal from the Trans Pacific Partnership (TPP), others have formed the CPTPP, or the Comprehensive and Progressive Agreement for the Trans Pacific Partnership. Without the U.S., the CPTPP partners, which include Mexico and Canada, are developing trade agreements, some of which involve agriculture. Thus, it will be dependent upon Mexico and Canada to integrate these agreements into the NAFTA negotiations. Only time will tell how all of these variables will combine.

Domestic Economy

The U.S. economy has just reached its 102nd consecutive month of business expansion; currently, the third longest in history. The Leading Economic Index (LEI) indicates a continuation of this robust growth at least for the immediate future, despite hurricanes and federal political friction.

Although the Purchasing Managers Index (PMI) fell slightly from its last recording, it is still well over 50 and closer to 60. Like the LEI, this indicator also forecasts strong economic growth moving forward.

Oil prices have remained quite stable regardless of three hurricanes, OPEC cutting production, and a strong world economy. This consistent price point is a reflection of alternate sources of energy, as well as the movement towards public and mass transportation, spurred in large part by consumer demand.

Motivated by high demand for certain exported goods and services, blue-collar jobs are making a resurgence in America. This is illustrated in the strong factory capacity utilization numbers.

Up slightly, housing starts are still in the 1.2 million annual range. Growth in this sector continues to be suppressed by the lack of labor to build houses and building supplies.

Unemployment numbers are very strong with U-3 in the low 4 percent range, and U-6 right at 8 percent. This continuation of strong numbers begs the question whether unemployment in the high 3 percent range will be a reality of 2018, bringing the possibility of wage inflation, which in turn, places upward pressure on interest rates.

The growth of the economy last quarter was in the 3 percent range. In addition, consumer sentiment numbers are above 90 as reported by the University of Michigan. If current numbers persist, the possibility of three rate increases in 2018 is highly probable.

I expect the incoming Federal Reserve Chairman, Jerome Powell, to continue policies in line with those of Dr. Yellen, who leaves the Federal Reserve early next year. Key appointments by the President in Federal Reserve positions will be critical to forward growth.

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

Indicator	Current	Green	Yellow	Red
Leading Economic Index - LEI	130.4(Oct)	✓		
LEI Diffusion Index	90% (Oct)	✓		
Purchasing Manager Index - PMI	58.2	✓		
Housing Starts (millions)	1.290 (Oct)		✓	
Factory Capacity Utilization	77.1		✓	
Unemployment Rate	4.1%	✓		
Core Inflation	1.7%	✓		
Headline Inflation	2.2%	✓		
Oil Price ($/barrel)	$61.14		✓	
Yield Curve	1.15	✓		

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