FARMER MAC

DAVE'S GPS

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Views from the Road
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The agricultural landscape here in North America is now into full harvest mode with a hint of fall in the air, despite some unusual warm temperatures. The summer months were full of banking and lending schools, conferences, and young farmer and producer events. It was enjoyable being able to conduct face-to-face events again. Many individuals have asked, “What are some of your views from the road, insights, and perspectives?”

Event perspectives

Attendance at agriculture producer events, including young and beginning farmer and rancher events, has been 20 to 30 percent above normal, in many cases. The mood of the farmers and ranchers at these events can be summed up in one word: anxious. Participation at banker conferences and schools has been down 20 to 30 percent. Participants have been very engaged and there has been an acceleration of senior lenders retiring.

Emerging entrepreneurs

A new segment of agriculture producers, often in the range of 25 to 45 years of age, is emerging. These individuals are more likely to be women, very entrepreneurial, and often bring skills, passion, and ideas from other professions. They are multitaskers with dimensional revenue streams from agricultural and nonagricultural endeavors. This group is lacking in collateral, particularly land, when compared to the older, more vintage producers. However, the creditworthiness of this segment includes profits, cash flow, and a strong business and financial IQ. This group of producers has commented that they slip through the cracks of the credit risk rating models of traditional lenders because they lack equity and collateral. This has resulted in nontraditional lenders and suppliers providing credit and financial services to this segment.

Land values

The land market is hotter than a pepper sprout! Farmland values are up 15 to 30 percent in some regions. Baby boomers positioned with cash and equity are making land purchases. In some cases, outside investors such as doctors, lawyers, dentists, and institutional investors are attracted to land purchases, particularly with the possibility of solar, wind, and carbon payments spurred by the green movement. Cash rents are up 10 to 20 percent, which may be a precursor of the margin squeeze that will come in 2022 and 2023.

Yields

Some areas of the country are experiencing historical yields in the top five percent. Seed technology in drought-stricken areas is allowing crops to still yield. Very little new and used equipment is available, which should make for an interesting November and December tax season.

Financial risk: 2022 - 2023

The number one risk on the list is inflated costs with a wider variation of uncertainty in prices received. Inflation, whether it is fuel, energy, or fertilizer, is becoming a major concern for the agriculture industry. Availability and cost of inputs will challenge cash flow projections next year.

Weather conditions in the southern hemisphere favor a classic case of margin compression. The possibility of low snowfall and rain levels this winter could play a major role in hindering transportation on the major rivers, which is very critical for the agriculture industry. Coupled with supply, port, and marketing chain challenges, extreme revenue and expense volatility could be a producer's greatest challenge for 2022 and 2023. Cash flow projections with wider parameters on revenue and cost adjustments will be necessary. Close attention to the debt service coverage ratio will need to be an emphasis during the renewal season. Producers that have a nest egg of working capital and equity will have a fallback position if cash flows and profits are in arrears for a period of time.

In the art of agriculture lending, the assessment of your customers' marketing and risk management program will be a high priority. Whether it is commodity marketing, value-added, or contracts with vertical integrators, close attention must be focused on the plan that has been developed, executed, and monitored. The speculative psychology that has been evidenced over the past two years may result in potential issues as some producers will have to adopt a more disciplined marketing approach.

Will the chickens come home to roost for individuals who financed long-term capital investments based on non-recurring revenue streams such as government payments or the aforementioned speculative profits? 2022 and 2023 will be the years of government payment reductions and shifts in compensation for green initiatives. Close attention to the amount of government support payments and whether they are recurring or nonrecurring must occur in your analysis. What will be the costs and benefits for each producer concerning the green payment initiatives?

Be aware of the senior generation's land purchases for the next generation that will be taking over. In the credit assessment, is there a management and estate transition plan in place? This is becoming a bigger credit issue as family farms consolidate with numerous family members.

Finally, the tax man will arrive next year in full force. Larger tax bills will impact cash flow plans. Estate taxes and the sale of capital assets will place more emphasis on a term called deferred taxes that has been historically emphasized by the Farm Financial Standards Council.

As you gear up for the renewal season, many portfolios are strong, but are they sustainable? This is where an assessment of the business IQ and aligning the producer's risk appetite with your institution’s programs are going to be very important. As you examine your end results, remember that good and bad decisions compound and manifest themselves over time. Inflation and volatility only exponentiates the numbers. See you at my next event or possibly at the Agricultural Bankers Conference in November in Cincinnati, Ohio.

Domestic Economy

As the United States economy moves into the holiday season, there are some positive and negative signals according to the leading and lagging economic indicators. The Leading Economic Index (LEI) has continued along a positive path with a strong diffusion index of 70 or above in recent months.

Oil prices have increased to the mid-$70 to low-$80 per barrel level as supply chain issues, strong demand, and the transition from fossil fuels to more green energy have accelerated prices. The price of oil has ripple effects for associated commodities such as fertilizer and chemicals, which are very critical to the agriculture industry. Remember, too high or too low oil prices are usually a leading indicator for a possible downturn or recession.

Copper is a leading indicator of global economic growth and is still strong with prices above $4.20 per pound. Zeroing in on manufacturing, the Purchasing Manager Index (PMI) has been above 50 for nine consecutive months, indicating potential growth in this sector. In recent months, the PMI has been close to 60, which bodes well for this sector of the U.S. economy.

The unemployment rate, a lagging economic indicator, is now at 4.8% for U-3 and 8.5% for U-6, which includes underemployed and discouraged workers. The shortage of productive workers has resulted in wage inflation with some industries rapidly moving toward automation. Will there be a shortage of jobs mid-decade as the movement to use capital to replace labor accelerates?

Housing starts are still strong with 1.555 million units annually, which is slightly above the benchmark of 1.5 million units. A scarcity of raw materials has created housing shortages in many areas of the country. Of course, low interest rates, strong employment, and wage growth will be critical for this component of the economy to be sustainable.

Factory utilization continues to be in the mid-70s range as supply chain issues for critical technical components continues to plague the industry.

Inflation is the 800-pound gorilla that continues to challenge businesses and is now rippling into the rest of society. Core and headline inflation, both here in the U.S. and in Europe, are at the highest levels in a decade. Core inflation is at 4% and headline inflation is 5.4%, which are both well above targets established by the Federal Reserve. The question becomes, will inflation accelerate possible interest rate increases and the action of tapering, meaning the Federal Reserve would scale back asset purchases? Either action could create headwinds for the stock market and the Index of Consumer

Sentiment, which is already at a questionable level in the low 70s. Behavioral economics and the wealth effect are alive and well!

Global economy

Geopolitical transitions based on elections have been spotlighted in recent months. Election results in California, the sixth largest economy in the world, Canada, Germany, and Japan would suggest a movement toward socialism with more government involvement in the economy.

China's movement from authoritarian capitalism to a more traditional socialist stance appears to be a high priority of President Xi and his agenda. The theme of common prosperity and redistribution of wealth for the second largest economy in the world appears to be well on its way. Individual businesses that have generated copious amounts of wealth are being urged by the government to redistribute their wealth for the common good. This government crackdown is being seen more in the Chinese headlines. Weather issues and dry weather are contributing to power outages that are challenging the manufacturing segment in China. As discussed in recent columns, China has made a formal application to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) to gain trading power globally. Expect resistance from members such as Australia and Canada for acceptance into this trade agreement.

Trade issues with China will be a fourth quarter issue with the United States and others around the world. As agriculture lenders, this may creep heavily into the agricultural sector if tariffs are implemented. If supply can be generated from Brazil or Eastern Europe to meet China's needs, this could also be a factor impacting commodity prices in the future.

Election results from Germany, the fourth largest economy in the world, would suggest business as usual for Germany and the European community. It will be interesting to watch how the United States, Europe, and other supporters such as Japan take a stance against China's aggressive trade and military strategies. Pay closer attention to France, where national elections will occur next year. This could be very critical in the dynamics of the European economy and political forefront.

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

Indicator	Current	Green	Yellow	Red
Leading Economic Index - LEI	117.5	✓		
LEI Diffusion Index	60%	✓		
Purchasing Manager Index - PMI	61.1	✓		
Housing Starts (millions)	1.555	✓		
Factory Capacity Utilization	75.2		✓	
Unemployment Rate	4.8%	✓		
Core Inflation	4.0%			✓
Headline Inflation	5.4%			✓
Oil Price ($/barrel)	$77.13		✓	
Yield Curve	1.48		✓	

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