Black Swan Economics and Agricultural Lending 2021, Featuring Dr. David Kohl

## FARMER **MAC**

January 21, 2021

## **BLACK SWAN ECONOMICS AND AGRICULTURAL LENDING 2021**

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Macro Clinic Video Blog: www.compeer.com/education Road Warrior of Agriculture: www.cornandsoybeandigest.com Ag Globe Trotter: www.northwestfcs.com Dave's GPS & Dashboard Indicators: www.farmermac.com

### Views From Cyberville for 2021 & Beyond

- a black swan usually occurs each decade with two babies
- a black swan accelerates change for consumers, society, and businesses
- black swans are disruptors and challenging but they also create opportunities
- the COVID -19 black swan accelerated the economic and financial divide for the decade of the 2020s



# 2020s- The Decade of Economic & Financial Divide

- economic volatility in extremes
- manage the controllables & manage around the uncontrollables
- adapt, innovate, focus & follow the process
- decade of management transition
- decade of the agri-entrepreneur

### **Commodity Super Cycle**

- BRICS & KIMT'S
- 2x emerging PPP
- weather
- declining interest rates
- ethanol

### Government & Central Bank Super Cycle

- government payment stimulus boom
- China effect, temporary
- export market, low value dollar
- weather climate change
- low, stable interest rates- Central Banks, moving investors out on the risk curve

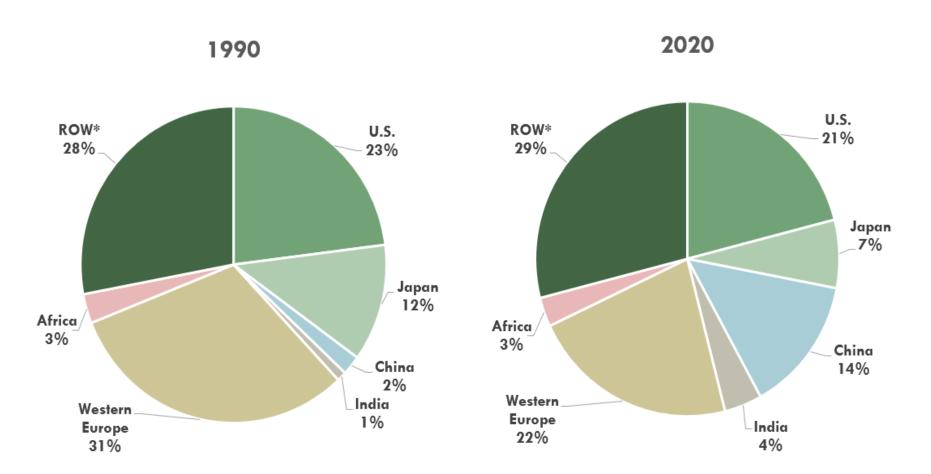
### Global Macro Economic Risk (1)

- globalization vs. deglobalization
  - 1995-2017 purchasing power parity, hyperglobalization
    - emerging nations 2x plus
    - rich nations 44%
  - 1990-2008 global trade share of GDP 39% increase to 61%
  - 2009-2017 global trade share down 9%
    - financial crisis
    - governments, businesses and consumers agendas
  - (ISI) import substitution industrialization strategy
    - supply & marketing chains
    - made in China 2025
    - India, Europe, & U.S. more self reliant
    - concentration vs. diversification

### Global Macro Economic Risk (2)

- disjointed U.S. & global recovery
  - 90% economy
  - 50-75% economy
  - 125% economy
- trade agreement uncertainty
  - Australia vs. China
  - rich nations vs. China
  - Belt & Road Initiative, medical innovation path
- central banks/government supports for ag
  - U.S./global support \$2 billion per day
  - duration of support & global competitiveness
  - government encroachment, taxes, regulations, other

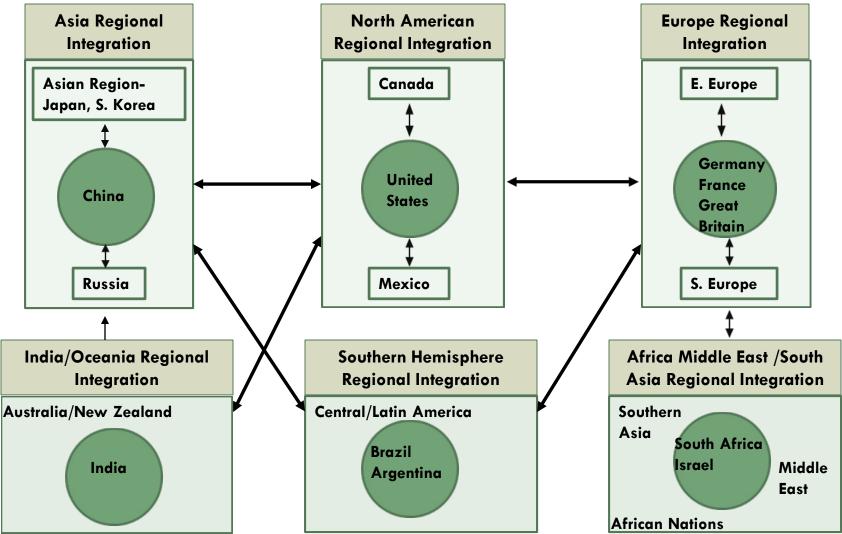
#### **Rising of Asia**



#### \* ROW- Rest of World Source: Global Insights, August 2018

#### Trade Paradigm Shifts Globalization Vs. Regionalization

#### **China's Dual Circulation Strategy**



China's Belt & Road Initiative- 68 countries, \$1 trillion in loans and now a shift to a medical innovation path

#### **Global Trade Perspectives**

<u>Trade Agreement</u>	<u># Countries</u>	<u>Population</u>	<u>GDP</u>	<u>Trade Value</u>
RCEP <sup>1</sup>	15	2.7 Billion	\$25.8 Trillion	\$12.5 Trillion
CPTPP <sup>2</sup>	11	508 Million	\$11.1 Trillion	\$7.6 Trillion
USMCA <sup>3</sup>	3	493 Million	\$24.4 Trillion	\$7.8 Trillion

 <sup>1</sup>RCEP- Regional Comprehensive Economic Partnership (15 Asian Countries)
<sup>2</sup>CPTPP- Comprehensive & Progressive Agreement for Trans-Pacific Partnership (Canada & 10 countries in the Asia-Pacific region).
<sup>3</sup>USMCA- United States-Mexico-Canada Agreement (North America)

#### Grain Marketing Setback Five Years

- money left on the table
- government programs stimulus
- China effect
- weather- South America
- weakening of the dollar



#### Livestock & Other

- access to markets & marketing changes
- concentration, cannibalization
- competitive products
  - non-meat alternatives
  - non-dairy alternatives
- regulation
- Iabor, immigration
- health of the U.S. economy



#### **Poll Results From Lenders (12/20)**

As a lender, what do you think is the greatest threat to net farm income and cash flow for 2021 and beyond? Select the top three.

Threats:	Percent
Reduction of government supports	55%
Inflating expenses	50%
Ability to restructure, refinance for working capital, cash flow, etc.	15%
Producers' management (production, marketing and financial)	41%
Weather in extremes – locally, U.S. and globally	24%
Trade issues impacting export potential	53%
Loss of non-farm revenue/income	15%
Supply and marketing chain disruptions	35%
Other	2%

### Land Value Resilience

- Iow interest rates
- T.I.N.A.
- refinance/restructure cycles
- baby boomer farmers will be investing another decade
- rural property renaissance
- 79% rule
- 88% rule



#### Factors That Could Collapse Land Values

- rapid rise in interest rates
- knee jerk reaction of restructuring/refinancing of working capital, credit needs with regulators/lenders
- investment sentiment
  - BBB's
  - urban migration
  - Iand investment groups
- regional or local economics spiraling downward
- U.S. & global debt & liquidity crunch
- downward trend of commodity prices, global trade contraction, government payments

#### Factors That Collapsed Land Values in the 80s

- rapid rise in interest rates, rapid decrease in inflation
- knee jerk reaction to regulators/lenders
- collapse global trade
- collapse commodity prices
- debt of baby boomer farmers/ranchers
- government assistance on the credit side, but not the cash flow side

#### **Economic Indicators Dashboard**

<u>2020 Monthly</u> Indicators	Jan. 2020	Feb. 2020	Mar. 2020	Apr. 2020	May 2020	June 2020	July 2020	Aug. 2020	Sept. 2020	Oct. 2020	Nov. 2020	Dec. 2020
Leading Economic Index	112.0	111.8	103.5	96.9	99.8	102.9	105.0	106.7	107.5	108.5	109.1	
LEI Diffusion	70	35	10	20	70	80	80	70	70	85	70	
Purchasing Managers Index (PMI)	50.9	50.1	49.1	41.5	43.1	52.6	54.6	56.0	55.4	59.3	57.5	60.7
Unemployment Rate (U-3)	3.6	3.5	4.4	14.7	13.3	11.1	10.2	8.4	7.9	6.9	6.7	6.7
Unemployment Rate (U-6)	6.9	7.0	8.7	22.8	21.2	18.0	16.5	14.2	12.8	12.1	12.0	11.7
Housing Starts (millions)	1.617	1.567	1.269	0.934	1.038	1.265	1.487	1.373	1.459	1.530	1.547	
Index of Consumer Sentiment	99.8	101.0	89.1	71.8	72.3	78.1	72.5	74.1	80.4	81.8	76.9	80.7

#### Stock Market Bubble

- global event
- rally around technology
- investors movement out on risk curve
  - central bank
  - fiscal policy
- wealth effect
- institutional investors- day traders



#### **Radar Screen for 2021**

- minimum wage
  - automation
  - business consolidation
- oil & energy complex
  - supply & demand
  - technology, electric, etc.
- taxes
  - income taxes
  - wealth tax

- deurbanization
  - commercial real estate values
  - rural renaissance
  - broadband internet
- regulation
  - swagger in existing regulations
  - environmental
  - Iabor
  - banking



#### <sup>21</sup> Management Mindsets for the 2020s



#### Lenders Wish List for 2021 For Producers

- projected cash flow
- accrued adjusted statements
- break evens cost of production
- marketing risk management plan
- personal family living budget
- written goals



#### Management Tests for Farms/Ranches/Businesses/Households

- volatility
- agility
- resiliency
- opportunity



#### Passing the Test for Volatility

- working capital 20-25% of expenses
- cash in household budget, 4-6 months of expenses
- marketing program
  - commodity
  - value added
- risk management program
  - crop insurance
  - health insurance, disability
  - coverage, equal to or greater than debt levels



#### Passing the Test for Agility

- working capital/cash
  - Is it business driven?
  - Is it lender driven?
- optimization versus diversification
  - resources
  - talents, skills
  - marketplace
  - plan B, C, and D
- non-farm/ranch gig income/revenue
  - find the balance



#### Passing the Test for Resiliency

- competitive cost of production
  - break evens and benchmarking
  - trend analysis, positive



- modest to low family living withdraws
- family business needs to prepare for the next generation 6 year rule
- startup mentorship
- term debt/EBITDA < 6 to 1</li>
  - EBITDA includes farm/non-farm income

#### Passing the Test for Opportunity

- manage the controllables & manage around the uncontrollables
- goal focused
  - 80-16-4 rule
- process focused
  - follow fundamentals
  - plan, strategize, execute & monitor
- team of advisors
- strong Business IQ
  - <26 = adversity, >35 = opportunity



#### Dialogue with Dr. Dave

- What are the top three areas that ag bankers and bankers in general need to concentrate on in 2021?
- How have the fundamentals of lending changed as a result of the pandemic?
- Any tips for young and beginning farmers entering the family business?
- What is the best advice you can give a new banker?
- How has the pandemic changed university education and banker education models in general?
- Agility is a key component of success. Will the "profitability" look different, especially with larger farms that are "generally" more profitable due to size of scale?
  - What does the crystal ball say about farm size? Will it reach a ceiling and decline due to meeting consumer and environmental needs?
- How have I seen business practices evolve during the pandemic?
- In development of cash flows, what are some of the financial sensitivity shocks?

#### **Farm & Ranch Rates – 1.21.2021**

Products	Term	Amortization	Standard Rates	Choice Rates
AgEquity VRM	25   30	15   20   25	1.95%	N/A
1-month VRM	15   20   25   30	15   20   25   30	1.94%	1.59%
1-year VRM	15   20   25   30	15   20   25   30	2.21%	1.86%
3-year VRM	15   20	15   20	2.61%	2.26%
3-year VRM	25   30	25   30	2.65%	2.30%
5-year VRM	15   20	15   20	2.68%	2.33%
5-year VRM	25   30	25   30	2.73%	2.38%
10-year VRM	15   20	15   20	3.04%	2.69%
10-year VRM	25   30	25   30	3.12%	2.77%
15-year VRM	20	20	3.16%	2.81%
15-year VRM	25   30	25   30	3.38%	3.03%
7-year Fixed	7	15   25	2.82%	2.47%
10-year Fixed	10	10	2.90%	2.55%
15-year Fixed	15	15	3.14%	2.79%
15-year Fixed	15	25	3.26%	2.91%
20-year Fixed	20	20	3.45%	3.10%
25-year Fixed	25	25	3.62%	3.27%
30-year Fixed	30	30	3.73%	3.38%

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