Will Agriculture's Boom Turn Into A Bust?

'This isn't going to be a year for the faint of heart.'

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If you think the cost of planting a crop in 2008 was one for the record books, hang on to your hats. Whether it is seed, chemicals, fuel, or fertilizer, you can expect to pay substantially more to plant almost all crops in 2009. Some sources predict that the cost of planting corn will be at least $200/acre more next year, compared to 2008.

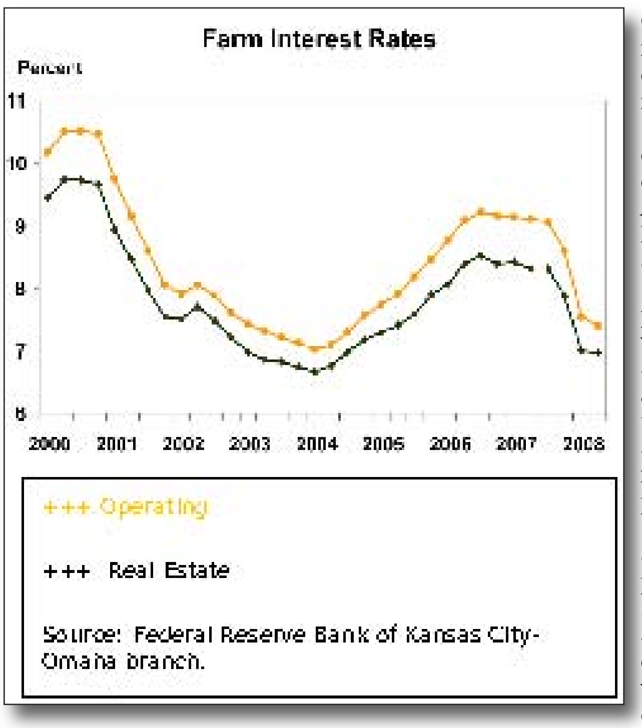
The good news is that, unlike many other industries across the country that are suffering, agriculture is booming. USDA's Economic Research Service projects that net farm income this year will be $95.7 billion. That's 10 percent above the $86.8 billion farmers earned in 2007 and 57 percent above its 10-year average of $61.1 billion.

Yet, some folks wonder if this boom could be setting growers up for another bust, reminiscent of the early 1980's. There's a lot of nervousness in the market as commodity prices have trended back down from record levels. Given the cyclical nature of commodity prices, there's a lot of discussion about the potential squeeze play, when the prices farmers receive for their crops come back down, and major input costs stay high or even continue to increase.

Strong credit conditions

However, in conversations with lenders around the country, the outlook for at least the next twelve months is still pretty bright.

"The credit conditions for most of our customers are some of the best we've seen in 20 years," says Jay Penick, President and CEO of Northwest Farm Credit Services in Spokane, WA. "We expect agriculture will still enjoy a pretty good run over the next 12-18 months." Only the timber and nursery sectors, which are being hit hard by the housing crisis, are really struggling in his area, he adds.



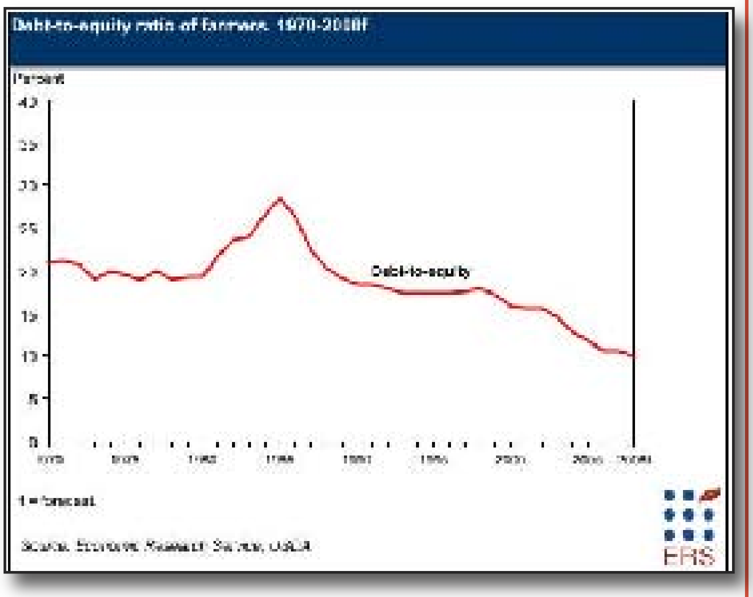
Even the largest cattle feeding area in the U.S. seems to be holding up pretty well. Wade Easley, president and CEO of the First National Bank of Hereford, TX, says that cattle feeders are back to breaking even or making a little money, after losing a lot of equity in the cattle market in recent months. Easley says vegetable and grain farmers in his area are enjoying a pretty decent year, despite increases in input costs.

"If the weather cooperates and we can get a good harvest, we should finish 2008 in good shape," he emphasizes.

As farm incomes have improved in recent years, more and more producers are paying down debt; while a select few are paying cash for inputs and skipping their lenders altogether.

"Even though some producers are being squeezed in terms of margin, there's a lot of liquidity in this market," says Kent Siltman, President of Citizens First State Bank in Walnut, IL. "In the past two years, our borrowers have gone from borrowing 80 percent of their input costs to maybe 40-50 percent, and many are also paying down long-term debt.

As the ERS chart to the right shows, debt-to-equity levels nationwide have dropped from almost 30 percent in 1985 to below 10 percent in recent years. Farm business equity is expected to continue rising in 2008 as the increase in farm asset values exceeds the rise in farm debt. Sector net worth is expected to reach over $2.1 trillion in 2008, up about $133 billion from 2007.



Interest rate bargains

Compared to other input costs, the price tag associated with borrowing money is still a relative bargain, says Gene Charville, CEO, Ag-Carolina Financial. He says that more and more borrowers in the eastern North Carolina region they serve are locking in fixed rates.

"Ten years ago, only about 30 percent of our agricultural loans were fixed, but now over 60 percent are locked in," he explains. And many of those borrowers were able to lock in more favorable fixed rates this spring, he adds.

Lenders report that interest rates are expected to increase slightly in 2009, but this week's action by the federal government to shore up Fannie Mae and Freddie Mac may add some stability to what has been an extremely volatile financial market. In the short-term, some sources predict that the federal government's action may actually provide some rate relief.

But even if the Federal Reserve Bank starts to tighten its grip on inflationary pressures and interest rates increase in 2009, lenders believe the range will likely be 50-100 basis points over the prime rate on operating loans. At that level, interest rates will still be at historically low levels. (See chart on page 6.)

The biggest problem, lenders report, is the uncertainty and the level of risk facing many producers.

"Now, whenever there is a problem with a crop, the size of the problem is significantly different than in the past," adds Penick. "That's created this underlying nervousness that seems to be part of the new paradigm in agriculture."

Rod Hebrink, who serves as senior vice president and CFO for AgStar Financial in Minnesota says his bank is advising customers to "be cautious and don't spend all of their earnings from 2008 because they'll need it to deal with the volatility that's in this marketplace."

The breakeven on corn next year might be up to $5.00/bu., Hebrink explains. At the same time, it's tough to find local marketing options that will cover those costs plus margin.

The bottom line, says Hebrink: "This isn't going to be a year for the faint of heart." Δ

Editor Sara Wyant publishes a weekly e-newsletter covering farm and rural policy called Agri-Pulse. For a four-week free trial, go to www.Agri-Pulse.com