

Financial Crisis Engulfs Agriculture

Agriculture had been on a roll in recent years. Record high grain prices stimulated record high incomes and surging land values increased the wealth in the sector. Crop producers, in general, were doing well as the prices of their crops outpaced rising input costs. Agribusinesses who provided cropping inputs often were the recipients of the good times as well. There were cracks in the system as the animal industries struggled with extremely high feed prices, and food consumers around the world had smaller amounts of basic food items and much higher prices. But, the current financial crisis has altered the generally optimistic direction of agriculture in just a few weeks.

In just 14 trading days between September 26 and October 16, futures prices for corn lost 30%, soybeans 26%, and wheat 23%. In energy markets, crude oil futures prices dropped by 34% and ethanol prices—a critical market for corn—fell by 24%. The declines for animal prices were not as extreme with lean hogs down 15%, finished cattle down 12%, and milk down 6%. As a consequence of these extreme price drops, prospects for a record high farm income just a few weeks ago have vanished.

The farm sector came into the current crisis with strong income. Net farm income across the country reached record levels in 2007 at \$86.8 billion. Until recently, prospects for 2008 looked even better. In August 2008, USDA forecast an even higher record for 2008 income at \$95.7 billion. However, the financial crisis characterized by falling energy prices, prospects for declining world food demand, and a strengthening U.S. dollar have caused agricultural prices and income prospects to plummet. By the end of the year, 2008 farm income is expected to be sharply lowered, and far below any records.

Now agriculture faces a downturn, but income is not the only measure of the sector's financial position overall. The greatest financial strength of agriculture lies in a record equity position due to sharp increases in land values in recent years and to very low levels of debt. Since 2004, the equity (assets minus debt) of U.S. agriculture has increased by \$712 billion dollars. This is a result of a \$741 billion increase in asset values, with farmers taking on only \$29 billion in additional debt.

What was the source of the asset increase since 2004? That answer is real estate, primarily as a result of land values increasing. USDA reports that U.S. farm real estate values rose from an average of \$1,360 per acre in 2004 to \$2,350 in 2008, a 73 percent increase.

The farming community has been cautious with the use of debt in the recent boom. The total dollars of debt have increased only \$29 billion since 2004 or 16%. If this amount is adjusted to real dollars, then the increased amount of debt represents an increase of only 3% in the past four years.

More importantly, the question is what does the future hold for the agriculture sector in the current downturn. Crop farmers have already locked in 2008 growing costs, and those costs now are higher than current crop prices. For 2009, it had been anticipated that input costs would rise sharply suggesting terribly negative margins with current crop prices. Either crop prices will have to rise or some adjustments in lower input costs will have to occur for 2009. Although the first stage of downward adjustments in the land market in financially stressful times are a lot of "no sales," the rapidity and magnitude of the changes in profit prospects this time might result in land values and cash rents adjusting downward by 2009.

The impacts on the animal sector are generally positive. Feed prices are now falling more rapidly than the prices of the animal products they sell. In general, the animal industries had already been reducing the sizes of their herds and flocks in response to losses, and that means animal product supplies will be in better balance with potentially reduced demand in the coming year. Food consumers around the world can look forward to moderation in food price increases. But those moderations in food price increases may be due to lower consumer incomes.

Land owners are in much better shape to weather the storm than are tenants. Land owners have had major increases in the value of land and have not generally borrowed against that wealth. Those who have purchased land generally have been in strong financial position with substantial down payments, and financial lenders have demanded strong repayment capacity. Tenants on the other hand now face lower crop prices with still high priced inputs. Some may have locked in these high input prices for 2009 and later such as by buying 2009 crop fertilizer at high prices or in multiple year cash rent contracts at high rent levels.

The big picture for agriculture is one of a strong financial position which will be a valuable cushion going into a downturn. But as always there are those whose timing have been unfortunate and have taken large positions at what turned out to be inopportune times. This applies not only to farmers but to some agribusinesses as well.

So, the fears of Wall Street have spread to Main Street and to RFD America as well.

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October 16, 2008