The FDIC Podcast – Banking down on the Farm

BRIAN SULLIVAN: Welcome back to the FDIC Podcast where we talk about our banks and *your* money. I'm Brian Sullivan with the Federal Deposit Insurance Corporation.

Today, we're going to talk about our bankers and our farmers. The agricultural sector is a big piece of our nation's economy...and the fortunes of farmers are also tied very closely to the health of the global economy.

The FDIC *just* released research on the banks that support our farmers—agriculture banks. These community banks have experienced a number of ups and downs over the past several of decades…and through it all, they remain a steady and resilient presence in rural America.

Joining us to talk about the health of our nation's farm banks are John Anderlik and Rich Cofer with the FDIC's Research Division that focuses on national and regional risk. Gentlemen, thank you for joining us.

JOHN ANDERLIK: Good to be here.

RICH COFER: Great to be here.

BRIAN SULLIVAN: John, let's begin with you…tell us about this research that you and Rich put together…

JOHN ANDERLIK: Sure. Brian, the paper takes a long-term look at the performance of the U.S. agricultural sector and the farm banks that support it. We cover two main issues first, how the sector is fared since 2004 and then how farm banks performed over that same timeframe. We talked about a farm income boom that occurred between 2004 and 2013 when commodity prices soared to historic highs and farmers benefited from strong incomes and farmland appreciation.

But then the story takes a turn and we talk about how the sector struggled from 2014 through 2019 after a sudden sharp drop in prices and incomes was followed by a slow weak recovery. The swings of farmers forge both positive and negative during these periods, are far more pronounced in the middle of the country than elsewhere. And so, we talked about that quite a bit.

And then 2020 was interesting. It was a continuation of the weak trends over the prior five years. That's how it started. And then the pandemic hit and it hit the sector hard, but in the end, 2020 actually ended up as a fairly strong year for farmers.

BRIAN SULLIVAN: So, Rich, let's get our definitions straight, not everybody knows what an agriculture bank is. What *are* agriculture banks exactly and why is FDIC, in particular, so interested in them?

RICH COFER: You bet Brian. So, the FDIC we define farm banks, and you can call them agriculture banks or farm banks. I typically say farm banks out of habit. But, but these are banks that concentrate 25 percent or more of their lending in agriculture. And historically these banks have represented about one of every four or five institutions. And today there's currently more than 1,100 of them.

And so, as far as the FDIC's interest in them, it's really not so much the dollar risk to the insurance fund that grabs our attention, but it's the facts that, you know, there's more than a thousand of these farm banks and there's really a close relationship that interplays between them and the agriculture and rural America. You know, strong community banking supports agriculture and helps hundreds of small communities and in turn, a strong ag sector bolsters the conditions of farm banks

BRIAN SULLIVAN: John, you mentioned the farm income boom in your overview of your paper. Why was there a farm income boom? And why did it come to an end?

JOHN ANDERLIK: Sure. So, Brian as a baseline to get started, U.S. net farm income averaged about $77 billion a year from 1987 through 2003. But then when we had this boom from 2004 to 2013, net farm income averaged a $102 billion a year after adjusting for inflation. So, you can see it's, that's a pretty big difference. And what's interesting is this period is not only marked by the magnitude of the farm incomes, but also by the unusual length of the period. Rarely has a sector seen 10 straight years of such prosperity.

So, why did this boom occur? It was fueled by significant price increases across many important agricultural commodities, including corn, soybeans, wheat, cattle, dairy and hogs. We saw strong growth in U.S. agricultural exports, tight global supplies, and also we had a rapid growth in U.S. biofuel demands. We make ethanol out of corn and that all served to drive prices higher.

We had, on the offset, we had higher production expenses during that time. Inputs such as seeds and fertilizer, also became more expensive and also, farmland became more expensive to rent but commodity prices rose so quickly that even though the expenses were higher, farm incomes are much higher too, but eventually all booms eat themselves to come to an end. And because you had high prices, farmers all over the world continued to increase their production and finally, we had an excess supply of all these commodities and the result was, starting in 2014, prices dropped precipitously. By 2016, average annual prices farmers received for corn and wheat were down nearly 50 percent below their peaks, price for hog's milk and soybeans were down roughly a third and cattle prices were also lower.

From 2016 to 2019, we hit the bottom in 2016, we showed some general improvements in farm incomes between that time, but still we were well below the price levels that we were during the boom and the 2019 inflation-adjusted net farm income remained well below the average that we've seen since the start of the boom.

BRIAN SULLIVAN: Rich, tell us about 2020, last year. How did the farm sector fare during the nation's public health crisis?

RICH COFER: Well, we entered 2020 thinking it would likely fall somewhere between the continuation of the past couple years and maybe we'd see a gradual improvement. There was, there was some optimism out there, but then the COVID pandemic struck in March and by April and May, it looked like the wheels were falling off for the agriculture industry.

We had schools and universities close, entertainment venues closed down, dine-in at restaurants came to an abrupt stop. And all of this created a sudden drop in commercial demand for food. And at the same time, there was a shift in food consumption back into the home, right? People were staying home.

On the supply side, we had outbreaks among workers at meat processing plants and that caused a lot of shutdowns and created some processing bottlenecks and backlogs of a market-ready animals. And so, the outcome of all of this was a consumer saw some isolated shortages of some products and higher prices at the grocery stores. But for the farmers, they were seeing significant declines in the prices for their products.

BRIAN SULLIVAN: Did government step in on some level to assist these farmers? I know the government routinely has some support of the agriculture sector generally but during this time, was there something different about the support farmers received in 2020?

RICH COFER: Yes, there was Brian. Yes and no. The government doesn't, like you said, the government does have a long history of stepping in and helping agriculture. But what set 2020 apart was the magnitude of the help that was given to the industry. In total, just in pandemic related assistance, we're looking at roughly $30 billion in 2020. And, and that's on top of the already existing federal programs so, in total, the industry received about $46 billion in 2020, which was an inflation-adjusted record. So that was very instrumental in helping these farmers get through in 2020.

BRIAN SULLIVAN: John, in the paper, both you and Rich discuss "highly leveraged farmers." Who are they and why are you worried about them?

JOHN ANDERLIK: We spent a lot of time as analysts studying, you know, the overall, the aggregate farm sector. We also monitor farmers who might be struggling financially. Many farmers own their farms outright or large enough to have massive efficiencies to scale. By and large, these farmers do well regardless of the overall health of the agricultural industry, but at the other end of the spectrum are highly leveraged farmers who have much less margin of error from year-to-year.

These farmers don't have high amounts of equity in their farmers to rely on and also rent quite a bit of their operation, which increases their operating costs. They tend to be newer farmers who haven't yet had years and years to build up the equity cushions that longtime farmers might enjoy. Not surprisingly, the number of farmers with high debt burdens has increased as the farm income boom ended. The bust that followed the boom was certainly tougher on those farmers than the more established farmers. According to the USDA, the percentage of crop and livestock businesses that are "highly or very highly leveraged," according to their definitions, jumped sharply starting around 2012 and remain at levels seen before the farm income boom.

BRIAN SULLIVAN: Now, there are farmers all over the country, right? But you focus right in the middle of the country, the nation's bread basket, right?

JOHN ANDERLIK: Right. So, you know, we look at agriculture as a whole, but we hone in on where it's most important. And even before the farm income boom, the center of the country was where the action's at and it's more sensitive to changes in agricultural income than other areas.

So, swings and farm income in three of the USDA's economic regions…you have the Corn Belt, the Lake States and the Northern Plains, which is pretty much makes up the center of the country. We collectively referred to those in our paper as the Upper Midwest and the swings were much more pronounced than in any other USDA region. The Upper Midwest had among the lowest net farm income of any region throughout the early 2000s. But then quickly rose to among the highest during the boom.

During the farm income boom, the Upper Midwest often led all regions in income performance. And then as the boom ended, the Upper Midwest again, experienced a sizable swing and felt among the lowest performing regions. Given all this it's not coincidental or surprising that the Upper Midwest has a disproportionate share of the nation's farm banks. Rich talked about farm banks earlier, more than 77 percent of all farm banks in the nation are headquartered in the Upper Midwest.

BRIAN SULLIVAN: Rich, John just mentioned the price of land…farmland values in the Midwest rose more dramatically than in other areas during the boom. I recall that farmland values fell rather dramatically during the ag crisis in the 80s. How have farmland values been holding up in recent years?

RICH COFER: Oh, Brian, your memory's correct. Nationally, farmland values fell by more than 40 percent during the ag crisis in the 1980s and even far greater than that in some states. And if you think back in the 1980s, the Federal Reserve was trying to tame inflation and interest rates were driven very, very high, and we have the exact opposite story now. We have historically low interest rates. And so that's been a major benefit for farmland values today. The farm crisis in the 1980s, we had thousands of distress farms and failures that pushed a large amount of farmland into a market that was generally broadly weaker than what we see today.

BRIAN SULLIVAN: John, in a previous podcast, we looked at how banks, particularly community banks and minority depository institutions, are working with their customers and small businesses to weather this pandemic. How are farm banks doing in working with farmers, seeing them through this period?

JOHN ANDERLIK: You know, Brian, farm banks almost by their very nature work closely with their farm customers. Farm banks tend to be small and located in rural areas. And by definition, they make a lot of loans to the farmers and farm loans are, tend to be really are relationship-based. These banks know their customers well and work closely with them fairly constantly. This question though, does another, it allows you to bring up the concept of carry over debt, which in the banking world is specific to farm lending because agriculture is so volatile, it isn't unusual at all for a farmer to have a poor year and not be able to pay off his or her entire operating loan for the year. What banks can do in those instances is carry over the unpaid portion into the next operating year while taking some additional collateral, which is usually equity in their farmland.

BRIAN SULLIVAN: Let's sort of wrap this up if we could, last question: what's the outlook for farmers and farm banks in 2021? Do we forecast at all in your paper?

RICH COFER: Well, the FDIC is not really in the business of forecasting, but we do, we do make some forward-looking observations. And before I jump into 2021, I want to circle back real quick and kind of wrap up what happened in 2020, because it's pretty relevant for 2021 as well.

You know, we talked about the pandemic and all of the carnage that that caused for agriculture. We talked about the strong government supports. And on top of that, we had a really strong rally in our exports, agricultural exports, especially to China. And that really caused a rally and in many of the important commodity prices. And so that buoyed the results for 2020 and that's spilling over and continuing into 2021.

As far as banking performance, we think that they will continue to do well as well, but we do see some challenges on the earnings front and we are also seeing reduced demand for agricultural credit. That massive government support and these better pricing fundamentals have lowered some of the demand for credit. That could be a drag potentially on earnings as well. But the flip side of that is that helps improve bank liquidity positions and, and so that's a good, you know, a good thing for credit availability easily.

BRIAN SULLIVAN: Well, we can trust that John Anderlik and Rick Cofer will be watching very closely the ag sector and gentlemen, I just want to thank you so much to talk about that connection between our banks and our farms.

JOHN ANDERLIK: Alright Brian, thank you.

RICH COFER: My pleasure.