

## Farm Financial Forecasts for 2015 – Webinar transcript, 8/25/2015

Good afternoon everyone and welcome to our webinar Farm Financial Forecast for 2015 August update. My name is Nancy McNiff and I will be your moderator. Our speaker today is Mitch Morehart, Mitch is a Senior Agricultural Economist in the Farm Economy Branch of USDA's Economic Research Service. He is responsible for establishing USDA's annual perspective about the financial status of farms and farm households including the degree of farm debt and vulnerability to changes in income, input costs and interest rates. Mitch is also responsible for developing and managing the Annual Agricultural Resources Management Survey or ARMS, USDA's primary source of information on the financial condition and production practices of America's farms and the economic wellbeing of farm households. I think we're ready to start so Mitch you can now begin your presentation.

Thank you Nancy and it's a pleasure to be here and thank you everyone for joining us today. Let me start with a few of the summary highlights from the release we just made at 11 am this morning. Both net cash and net farm income are forecast to decline for the second consecutive year after reaching recent historic highs in 2013. Net cash income is expected to fall by 21 percent while the 36 percent drop in net farm income would be the largest percentage drop since 1983. Crop receipts are expected to decrease by over six percent, that's about 12.9 billion in 2015 and that's largely led by three commodities a 7.1 billion decline in corn, a 3.4 billion drop in soybean receipts and a 1.6 billion drop in wheat receipts. Animals and product receipts could fall by over 9 percent that's 19.4 billion in 2015 due to a 29 percent drop in dairy and a 27 percent decline in hog receipts. Total production expenses are forecast to fall for the first time since 2009. Energy inputs in feed are expected to have the largest declines, fences our forecaster increase for labor interest, property tax and other farm overhead. Declining assets resulting from a modest decline in farm land values and higher debt are forecast to create a 4.8 percent decline in equity, that would be the first drop since 2009, and then for farm household income that rose about 12 percent in 2014 to 80,620 dollars, we're forecasting a slight drop in 2015 but remaining well above the median US household income. Okay let's take a closer look at the net cash income forecast, and this chart shows the trends in, recent trends in net cash income and also highlights the role in government payments in contributing to net cash income. Net cash income is expected to decrease by more than 26 billion in 2015 to 100.3 billion this is about a 21 percent decline from 2014 and follows on a 8.5 billion six percent decline in 2014. The 2015 forecast would be slightly above the previous 10 year average of 99.6 billion but this would be the lowest net cash income since 2010 and after adjusting for inflation the lowest since 20, 2009. Government payments which have represented about eight to nine percent of net cash income during the 2011 to 2014 period are expected to make a more significant contribution to net cash income in 2015. At 11 percent it would be the largest percentage share going back to 2010 which was 13 percent. Let's turn to the long term outlook for net farm income, net farm income is a key measure of farm sector profitability, it includes depreciation, inventory changes and other non money or non cash expenses. If we look at this chart it has nominal and real net farm income and both are forecast to fall in 2015. The 58.3 billion for nominal net farm income would be a 32.8 billion dollar decline from 2014 about 36 percent, that follows a 32.7 billion decline or 26 percent in 2014. After adjusting for inflation this would be the lowest net farm income since 2002, the 2015 forecast would also be about 25 billion below the previous 10 year

average. Now we look at the trends in the major crop receipt categories for 2015, total crop receipts are forecast down about 6.2 percent to 195 billion in 2015, that would be their lowest level since 2010. Corn is expected to account for more than half of the 12.9 billion decline in 2015 crop receipts. Since peaking in 2012 corn receipts are projected to fall by over 25 billion or about 35 percent. The next largest declines are anticipated for soybeans at 3.4 billion which is in oil crops and wheat at 1.6 billion. We look at the animal and animal product receipts they're forecast to decline by 19.4 billion in 2015, that's about a nine percent reduction. The largest contributor to the expected declines are dairy at 14.3 billion and hogs at 7.2 billion. Cattle receipts are down slightly but still remain strong relative to their recent history. Now we look at the major categories for major farm production expenses and we have sort of a dual story here with some categories declining and some increasing in 2015. Fuel and energy related expense categories are projected to decline given the anticipated lower oil price outlook. Fuel has dropped by almost 28 percent and fertilizer a fuel related expense category by seven percent and even with higher expected demand for feed due to increases in the number of cattle and other animals on feed 2015 spending is expected to be almost five billion lower due to lower grain prices and soybean prices. The largest forecast increase in production expenses is for interest up significantly due to expanded farm debt and higher interest rates. Interest paid on debt secured by real estate is expected to increase by almost 23 percent to just under 12 billion dollars. Interest payments for non real estate debt is also expected to increase substantially to 7.5 billion a 25 percent increase over 2014. Labor costs are expected to increase in 2015 by over four percent with most of the increase driven by higher expected wage rates. This chart shows the long term trends in farm production expenses and we can see that the forecast decline in 2015 would be the first since 2009 this would end a string of five consecutive years of increases that resulted in a cumulative 42 percent increase since 2009 that's an average of about eight percent a year of increases during that time. This chart shows our forecast for government payments under the new programs of the Agricultural Act of 2014 most of these programs have shifted to crop price related payments such as the Price Loss Coverage or PLC program or the Agricultural Risk Coverage, ARC Program and as you can see the orange area is the amount of payments we expect to come from these new programs that are triggered by lower commodity prices. The other big shift in government payments since 2014 is a reduction in the supplemental and AD-HOC Disaster Assistance Payments which is the green category, that is going to decline about 3.4 billion dollars from 2014 and payments in that category have mostly to do with livestock for its disaster program payments that were triggered by weather and other events in 2012 and 2013. Switching to the balance sheet, since last declining in 2009 sector assets increased rapidly as low borrowing cost, high commodity prices and rising farm income lead to a strong demand for farm assets particularly real estate and vehicles and machinery however lower prices are expected to prevail in 2015 and a second year of declining farm income are expected to put downward pressure on farm asset values. As a result we're forecasting a 3.5 percent decline in farm assets in 2015, we're also projecting a 5.8 increase in farm debt. When you combine the two together to derive farm sector equity given the drop in assets and increase in debt the farm sector equity is forecast to fall by 4.8 percent in 2015. Historically farming values have really driven the changes in the total value of farm sector assets they account for about four fifths of the total value of assets and the projected decline in the total sectors is coming from the 2.1 percent decline in the value of farm real estate that is part of our 2015 balance sheet. Switching gear to examine how these broad sector forecast might impact particular regions of the country or producers that specialize in specific commodity production we look at the category we call Farm Businesses which are intermediate and commercial farms, about 850,000 and they account for 41 percent of farms but 93 percent of productions, 70 percent of assets and 85 percent of debt so we want to extrapolate these projections to this specific group we call Farm Businesses. This chart shows the impact of the lower cash receipts from many of the field crops and oil crops on the, at the Farm Business level in terms of average incomes. So in this case a corn farm is someone who would derive 50 percent or more of their total

value of production from corn and across each of these major crop groups you can see about an eight to 10 percent decline in average net cash income. The one exception is specialty crops where, that would be fruits, vegetables and nursery and greenhouse where we're forecasting about a 4.7 percent increase in average incomes for 2015. We do a similar analysis for the animal and products Farm Businesses and in particular you'll see that the average incomes are dramatically lower for dairy and hog farms and that's a direct result of the projected lower cash receipts and the fact that many of the expense categories that we highlighted earlier as increasing in 2015 such as interest expense and labor all are also prominent expenses for these two production specialties. Cattle average incomes are down slightly and poultry a little more in 2015 but the real affects are for dairy and hog producers. When you look at the regional impacts of these forecast it really highlights sort of what areas of the country have specific commodity productions or concentrations of commodity productions. So the largest declines are anticipated in locations where dairy and hogs are important components of the regions agriculture such as the northern crescent where we anticipate a 40 percent decline in average net cash income, another area the southern seaboard 20 percent decline, that's heavily dependent on hog production and to a large extent that's impacting the heartland as well where there's a fairly substantial contribution to the region from hog production. To a large degree the declines are offset in the fruitful rim area where you have the dairy reductions in income being somewhat offset by the more positive outlook for specialty crops particularly fruits and vegetables. Next we want to take the sector results and look at the impacts in terms of how it translates to farm household income and that part of the farm economy. If you look at total farm household income including both farm and off farm sources its forecast to decrease slightly in 2015 to 79,287 dollars and it's been increasing pretty steadily over the last five years peaking out in 2014 at over 80,000. Even with the slight decline in 2015 the average, excuse me, the median US household income remains well above the median for all US households. On farm income obviously with the decline we're looking at in the sectors net cash and net farm income will decline for many households but that's going to be offset by increases in off farm income and that's both from passive and active wage based sources of earnings. Nonfarm income is expected to rise about four percent between 2014 and 2015. The last chart illustrates the impact of the declining farm incomes on households and in particular shows that the bulk of the decline from farming income sources will impact those households of commercial size farms, those households get the majority of their household income from agricultural production and they can see decreases by 17 percent in 2015. Those same households also saw the large increases though in 2012 and 2013 as farm income was climbing. Let me stop there and take questions.

**Sure, reminding everyone that if you have some questions for Mitch you can enter them into the chat feature and we will have him answer them in turn. I have one question to start off. What impacts do you expect the decline in farm income to have on farm land values?**

Okay so farm land values, the way, the relationship between farm income and farm land values is farm land values as an asset reflect expectations about the long term returns that agriculture production can bring to the land so when you have short term fluctuations either increasing or decreasing incomes they shouldn't automatically trigger a comparable change in asset values so our forecast does suggest some down turn in real estate values but it's fairly 2., just over two percent so it's, it's pretty small compared

to the change in income because expectations for long run incomes haven't adjusted to a different level yet it would take continued trends in a downward direction to have that effect.

**Okay, we have a question from Grant, does the strength in cattle in plains regions offset some losses in row crops in those same areas?**

Yes certainly, you saw in that region map that the projected income declines were less severe in several areas of the plain states and that's exactly what's going on is that cattle remains fairly, a fairly positive story in 2015 compared to many other commodities and that is offsetting some of the row crop and particular in that region we, some of the down turn in wheat.

**Okay, we have a question from Carrie, how is the continued draught in California and other areas affecting the 2015 farm income forecast or is it?**

Sure, yes it is but it's kind of a mixed story because it, it affects individuals dramatically different than, than it would when you add things up at a state or a sector level and what happens with the draught is you get reduced production for particular commodities but because of the change in supply prices somewhat offset that reduced production so for example in the citrus industry the actual production in California is down slightly or we expect it to be down slightly in 2015 because of draught, draught conditions and availability of water but the prices have offset some of that decline in production.

**We have a question from Edward, loan deficiency payments and marketing loan gains are back this year, which crops are eligible for those payments?**

It's, it would be the traditional what we call program crops that would potentially benefit from lower prices triggering those payments. I think in many cases we're at or near some of those price triggers and that's what makes forecasting government payments now or in this new environment a lot trickier than it used to be when we had what we call direct payment which was a line item in the Federal law that wasn't too hard to forecast now a lot of these price dependent programs require us to figure out what triggers are going to be set over the course of the entire year to, to, to get the fore, to get that counted in our forecast.

**Okay we have a question from Stephen, there were significant revisions to the farm income components going back to at least 2011 could you discuss those revisions and what was the basis of the revisions?**

Most of those revisions involved either new or changes in available source data so, and there are many examples but the main one I can illustrate was in terms of what we were able to report for cash receipts many people will notice that we collapsed a lot of the commodity detail starting last December and that had to do with our ability to show confidential data from, from the National Ag Statistic Service but we went back and re-configure the way we estimate cash receipts for a lot of these minor commodities or confidential commodities in order not to get into any disclosure problems with the data, as a result that changed some of the underlying numbers that were in our database and in fact all of the revisions that are driven by source data went back to 2008 not just 2011.

**Okay we have a question from Julie, do you expect increase defaults on loans or have farmers saved enough cushion do you think from the last few years?**

Right, that's a good question, that's why I tried to illus, or highlight the difference between net cash income and net farm income so when we look at net cash income that really indicates what funds farmers have available to repay loans and make other obligations and the cash income decline is quite a bit less severe than what we're forecasting for net farm income in fact it's settling back at or near the ten year average for net cash income so that suggests to me that people are managing their cash flow in order to comply with the funds they need to make payments. I think in some instances if its, those operations that are experiencing more severe income declines may be a dairy or hog they can re-negotiate or, or alter the loan terms to make sure the payments are met.

**Okay and we have a question about government payments, the chart for government payments is there any calculation on what kind of crop insurance premiums could be paid out this year on the variable crops we're seeing? Also how much higher ARC and PLC payments will be paid out compared to government payments in the previous Farm Bill or what was projected?**

Right, we didn't, I haven't seen a, or we haven't done any analysis to compare what might have occurred under the previous legislation to what now occurs so I can't answer that part of it, in terms of insurance indemnities or insurance pay out that is not part of government payments, we report that as part of farm related income and I think our forecast for 2015 is about 11.6 billion which would be up from our 2014 estimate of 10.4 billion so we are forecasting more insurance payments to occur in 2015.

**Okay we have a question from Marsha, she's surprised grain incomes are only down six percent, why is overall net farm income down so precipitously, inventory values?**

Yeah, part of managing cash flow is the timing of sales so we have a, in our forecast we're assuming people sell more of this year's production in this calendar year and as a result the end of year inventory change will be high, will be negative so that's that detracts from net farm income and again that's part of trying to anticipate how people react to cash flow management in terms of timing of sales is that's what we have in our forecast models now, we'll see as we get towards the end of the year whether people trade 15 income for 16 income and how that actually shapes out.

**Okay we have a question from Paul, how about the bio technology sector, how is the demand and supply?**

We don't have much in our, I think the bio technology sector is outside the realm of what we're forecasting here.

**Okay, were you, were you surprised at the net farm income revision 58.3 billion versus the February forecast the 73.6 billion?**

Right, right, well the two contributors to that revision beyond the change in livestock receipts that was one of the big drivers of the revisions since February but the other has to do with two of the non cash adjustments one of which we just talked about is inventory change and our assumption about the timing of this year's production, how much of this year's production gets sold this year so that, our modeling of that says there's going to be a large negative inventory change if a lot of people sell more production this calendar year to keep their cash flow strong. The other big component of that adjustment between cash and net farm income has to do with depreciation or what we call capital consumption and again our models are being driven by the turn over rates in capital replacement that were stimulated pretty strongly over the last six to 10 years and resulted in a really high value for the inventory as well so the capital consumption charge is assuming that people will replace capital in value and in frequency the same way they did back in 2010, 2011, 2012 when it comes we're much stronger, again they don't have to that's a noncash charge that just says you know you have to replace capital but it doesn't say how frequently or at what value so that, those are the two kind of non cash adjustments that result in that difference.

**Okay, we have another question from Edward, the sums forecast for deficiency payments and marketing loan gain assume payments under which crops?**

I don't have that detail in front of me we can get that though, I mean we can provide that, I don't have the amounts per crop in front of me, I don't we provide that in the write up but I can check.

**Okay, if Edward can put in his email address...**

I have a, I don't want to guess I'd rather look the exact number up, yeah.

**Okay, Ben is asking is there any indication of farmers being at risk of over leveraging themselves by using cheap debt rather than equity for farm expansion?**

There's not a lot of evidence of over leveraging in terms of the relationship between current values of assets in current debt levels even if you sub categorize it for real estate and non real estate separately at the broad sector level there's no indications of that, however for individual producers or producers groups, say for dairy and hogs as an example they tend to be more prominent users of debt and I, and you can see where decisions to expand say a year ago or even this year, you know, could result in some, some pressure on there, on their leverage.

**Okay, Marsh is asking, Ag economists are predicting 100 dollar per acre cuts are needed for corn growers to break even in 2016 what would a third poor year in a row mean to farm financials and grain agriculture?**

Well if you have a third year in a row then that starts to affect people's long term expectation about what's, what's a reasonable return from production to that asset which is in this case land so that's what I was indicating earlier about our predictions for lower values of farm real estate and how that's somewhat muted by a longer term view but as you get a longer term trend reemerging that is a downward adjustment then that will, that will affect people's long run expectations.

**Okay I think that's all the questions we have thank you all very much for joining us and thank you Mitch...**

You're welcome.

... And everyone have a wonderful rest of your day.