Critical Crossroads

2017 could mark big changes in land values and a continued sluggish economy, according to economist.

by ***Kindra Gordon,*** *field editor*

David Kohl has monitored the global ag economy for the past four decades. As a professor of agricultural economics for 25 years at Virginia Tech and now a popular ag industry speaker, he watches a plethora of indicators to predict where the economy is headed, but Kohl says a few simple signals can also provide insight. As examples, he points to airport shoeshines, backhauls by truckers and the price of copper.

Of shoe shines, Kohl says, "When the economy is good, people are sitting in the shoeshine chairs at the airport — and tipping."

Likewise, of copper he says, "Copper is used in everything. During the hot commodity prices a few years ago, copper was $4.25 per pound. Now it's below $2.25 per pound."

Also, Kohl says, "Truckers will tell you 6 to 8 months before what the economy will do based on their backhauls. Currently, they are slow, which points to a sluggish economy."

Kohl says each of these signals matches up with the more "technical" economic indicators he is watching on the global scene — all of which are keeping the United States and global economies skittish. He cites recessions in several international markets, oil prices, people's dissatisfaction with government — not only in the United States, but around the globe — and actions by the Federal Reserve, such as printing more money and uncertainty with interest rates. As a result, Kohl reports the U.S. economy is currently only growing at about 1%, when 3%-4% is what's needed to keep the economy stimulated.

Land value shift coming

Given this economic slowdown that is occurring, Kohl says he is commonly being asked, "Why haven't land values collapsed?"

His response, "We are in an asset bubble instead of a credit bubble [like we were in the 80s]." However, he says that is starting to shift. He believes most landowners have been burning through their core equity since commodity prices dropped the past few years, and to this he says, "Watch the year 2017."

He explains that his data indicates 2017 will be a crossroads year in land values.

"I don't see a crash, but adjustments will be made," he says. "Year-over-year land value changes have been single digit … we could go to double digits … Cash rents also need to adjust and come down."

Kohl believes because many landowners have burned through core equity, the second round of refinancing on land "is going to be tougher." He predicts many landowners may make the decision to sell their land. "Capital will dry up for some in 2017 and 2018. It is going to be interesting; it will also create some opportunities," Kohl states.

Economic indicators

Looking ahead, what course will the economy take? Kohl will continue to watch shoeshines, copper prices and backhauls, but he also suggests keen producers watch additional global economic indicators, specifically the following four.

1. Monitor international markets. With 95% of the world population living outside the United States and consuming American ag products, Kohl notes, "International markets are very critical because the majority of our ag commodities are shipped overseas." He notes that in the past five to seven years, many international markets were growing at 6%-10%. China was at 14% in 2009.

"They used more concrete and steel in 2011 and 2012 than the U.S. used in the 20th century," Kohl notes.

Today, China is at less than a 4% growth rate and, Kohl notes, Brazil, Russia and South Korea are amidst recessions and facing stagnant — even negative — economic growth rates.

Of the controversial Trans-Pacific Partnership (TPP) trade agreement, he adds, "We [agriculture] need it." He reports that if the United States elects not to join the trade agreement, the other countries will go forward, and that would likely restrict future international market opportunities for American agriculture.

2. Monitor actions by U.S. Federal Reserve. Kohl reports that the strength (or weakness) of the U.S. dollar, as well as interest rates, also has an impact on the economy inside and outside the United States. He notes that when the U.S. dollar is strong, it can inhibit exports and create unrest in other parts of the world.

For instance, he says, "China is potentially opening their market to U.S. beef, but if our dollar stays strong it limits opportunities overseas. So we've got to watch how long the dollar is strong."

He's also watching what may occur in 2017 in response to the Brexit vote. He cautions cattlemen to watch "to see if other countries leave the European Union … That could strengthen the U.S. dollar."

Kohl notes that government dysfunction, regulation, taxation and even aging demographics all affect the economy.

"As a population gets older, they focus on health and are concerned about running out of money — making them risk-averse and not investing," he says.

Government dysfunction is a phenomenon not only occurring presently in the United States, but in other countries around the world, he says. It's something that occurs every 50-60 years.

"People become dissatisfied with government, and go through a period when government is challenged," he explains. "It happened in the 1880s, 1930s, 1960s and is happening now." Kohl says the U.S. dollar is usually strong during these periods, as well.

Regarding interest rates, he says the feds are watching three things. The unemployment rate is right where they want it, according to Kohl. However, the growth of the economy and inflation rate are not where they want them.

"One factor says raise it; two say don't," he observes. As a result, he anticipates they may raise interest rates, but he adds, "If they do, it'll only be quarter of a percent, then they'll wait and see."

3. Monitor oil prices. Kohl says, "Every recession since [the] 1969 oil [price decline] was a lead indicator." He explains that the price drop "takes money out of rich pockets and creates unrest in the Middle East."

Kohl says new technology is helping lower the cost of oil because it can be mined cheaper — a cost of just $6-$8 per barrel to get it out of the ground. However, Kohl says, many foreign countries need higher oil prices to support their social programs. He points to Saudi Arabia as an example, saying, "They need $72 to $92 per barrel for social programs because nobody works. If oil goes to $30-$40 per barrel, Saudi Arabia could be out of money by 2018-2019."

Kohl says the benefit of lower oil prices for American ag is that fertilizer and transportation are cheaper. Still, he says, "Keep your eye on oil. It should settle out at $40-$50 per barrel, but could go to $100 or drop to $20."

As an aside, Kohl says the ethanol industry has matured, and he sees no growth there to impact future commodity prices.

4. Watch the weather. Given the above factors, Kohl notes that weather could trump any of them. He explains, "Current factors indicate commodity prices will remain down, but extreme weather could change that at any time — at least for a short time." He advises that producers pay attention to weather and resulting production yields not only in the United States, but also in other important commodity production regions of the world.

Steps to prepare

As producers ponder preparing their business for these economic possibilities ahead, Kohl has more words of wisdom. Foremost anything can happen. Based on history, he says, by 2025 anticipate two recessions, a major assassination and two black swan events (an abnormal event that is difficult to predict).

Says Kohl, "The first adjustment in preparing for the future is to establish your goals." He advises both short-term (one-year) and long-term (three- to five-year) goals and goals that look at business, family and personal.

"As we go through the upcoming tough times," Kohl states, "producers have got to think about getting to next year and still being a viable business in five years."

He also notes the 80-16-4 rule, saying, "Eighty percent of people have no goals, 16% have goals in their mind, but only 4% write goals down. If you write goals down, you are more likely to achieve it."

Before discussing your goals with family and multiple generations, Kohl suggests each person involved put their own individual goals on paper. He explains that this prevents the family patriarch or matriarch from overshadowing (or controlling) the goal-setting process and direction. From there, goals should be shared with spouses, families and the generations involved. Business goals may need to be discussed and fine-tuned to ensure that everyone concurs.

All that said, what should a producer's No. 1 goal be? Kohl notes that profitability is certainly important, but he concludes, "Don't get too carried away. It's also important to have a life and family. That's why having business and personal goals help bring in balance."

While the economic forecast is not exactly optimistic, Kohl emphasizes, "There is a future in farming and ranching. By 2050, the world will need 70% more food with 70% less resources."

To producers he says, "Get better before you get bigger. Use the resources you have today better, and never forget the most important crops are people (i.e., kids, neighbors, etc.)."

AJ

Editor's Note: *Kindra Gordon is a freelance writer and cattlewoman from Whitewood, S.D. Kohl shared his remarks Sept. 28, 2016, in Deadwood, S.D., during a program hosted by Farm Credit Services of America.*

Additional insights from David Kohl

Ag economist David Kohl has devoted his career to following the ag economy. An energetic and engaging presenter, he covers an array of topics and doesn't shy away from sharing his perspective. Here are some additional sound bites in his own words:

- 80% of the economy is based on emotional behavior. It's not about logic.
- As minimum wage increases, we've got to automate to cut labor costs.
- Watch Senate, Congress and Supreme Court and the direction it goes [Democrat or Republican]. That's going to have a lot of impact on our [ag] businesses and lives.
- Ag producers need a written marketing plan that fits on one page — you must think through production, marketing, finance, risk management. If the plan is more than what fits on a bar napkin, it's too complex.
- Producers have got to bring their 'A' game, step it up for the future and know their financials. In the next few years, producers have got to stay financially liquid on the top half of the balance sheet. Working capital will be more important. Know your working capital position. Do a burn rate, which is working capital divided by projected loss. That tells you how many years until working capital is gone.
- Should someone buy land? From 1910 to today, 84% of the time land values increased. However, if you're going to buy land, you should keep working capital around. Calculate your burn rate; if it is above five years, do it. If it is less than 2.5 years, hold and wait.
- Manage risk. Don't get into a risky situation.
- Avoid people who blame others, or know-it-alls who forgot how to learn. They'll drag your business down. The younger generation will need to have people skills.
- Check your credit score. 800 is real good; 700 is good. Less than 650 means a 33% chance you won't pay your loan back. Also check your credit reports. There is lots of false information out there, so know them, and check the reports of your spouse and kids, too.
- You need $40,000 to $70,000 of new income to bring a new family member back to the business. If their spouse supplements the income, discuss how long and how much.
- As a professor for 25 years, to free tuition I say, "Absolutely not!" Kids have got to have skin in the game.
- We used to tell kids, "Clean your plate, because there are starving kids in Africa." Now, I tell youngsters to go to class and pay attention because there's a kid in India who wants their job in the future.