Farm Foundation Forum
How the Financial Crisis May Impact Agriculture and Food Systems
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Thank you for this opportunity to share with you today about this very important subject. It is truly an understatement to say that these are challenging times. The volatility and uncertainty on the part of all the stakeholders in agriculture today is enormous, if not unprecedented.

I want to set the context of my remarks by sharing with you about the background from where I am coming. As was said in my introduction, I am a senior manager with First State Bank, headquartered in northwest Tennessee. My responsibilities include the management of the Ag Services Division of First State. This is the division in which all our substantial ag lending relationships are housed, both ag production and ag related businesses such as elevator and farm supply business loans.

The western part of Tennessee is the seat of traditional production agriculture in the state. Within a 50 mile radius of my office are the top counties in Tennessee for corn, soybean, wheat, cotton, and swine production. Although Tennessee appears in none of the top 10 production lists among states in the U S for these commodities, the financial challenges faced in West Tennessee by farmers and ag related businesses are no different than the challenges faced in most any other state. So I am going to be using my experiences from West Tennessee, but speaking, I believe, about the experiences of farmers and ag businesses across much of the U S.

Today I will touch on just three areas of impact of the financial crisis on farmers and ag related businesses.

First, our farmers and ag businessmen are wanting to know about the strength and ability to survive of their local banks and lenders. I have spent significant time in the last three months talking to customers about the safety and soundness of First State Bank and, by extension, the safety and soundness of all community banks. My experience has been shared by bankers all across the U S. It seems that the regulators have tended to close the few banks they have closed over weekends. When this happened, I knew my phone would begin ringing on Monday morning and my expectations have not been unmet.

The facts are that community banks are strong. Very few of them made the sub-prime loans that are being charged with precipitating this financial crisis. And they are very different animals than the investment banks that have been the focus of much publicity and mergers and even bankruptcy.

As is most of the 8,000 community banks of the total of 8,300 banks nationwide, First State Bank is strongly capitalized and is making money. Yes, we have had some ripple effects that have caused us to shore up reserves. For example, many banks across the country owned preferred stock of Fannie Mae and Freddie Mac. When that stock turned to having $0 value overnight with the takeover of Freddie and Fannie by the government, the banks that had bought it for their investment portfolios had to take losses. There are very few banks today that have not experienced some impacts of the financial crisis. But, by and large, they are still strong and should be able to persevere this crisis.

Yet the questions from our customers have persisted. Commonly asked questions have included:

- Is it safe for me to put my deposits or leave my deposits in your bank?
- Are you going to be making loans next year? Do I need to find another lender?
- Are you tightening your standards so much that I will no longer qualify for a loan?

These questions reflect the significant uncertainty and anxiety that exists among farmers and farm related businesses. Access to credit is just as important as access to many other inputs that are critical to their operations. These questions also reflect the repeated references of the press to the credit markets being closed down which is referring to the commercial paper markets mostly used only by the largest of companies in the U S. There has been little restriction in credit availability for most of the creditworthy firms that are customers of community banks today.

The crisis that is leading to the anxiety and uncertainty is coming at a time when agriculture is in at least its third year of experiencing strong profits. Even with the increased costs of inputs, farmers are making excellent profits if they have been able to harvest at least average yields. The profitability of agriculture is being reflected in the continued march upward of land prices.
Under normal circumstances, agriculture should not be experiencing this level of uncertainty and anxiety. Yet the financial crisis has precipitated this environment.

The concerns about the safety of deposits have been addressed significantly by the increases in the levels of FDIC coverage. As to the credit related questions, banks with the staff expertise to understand agriculture and analyze ag credits are aggressively seeking good farm loans. This is very different from the perception that banks are curtailing credit because of the financial crisis. As long as the numbers make sense, I feel this will continue.

My first 13 years of work experience were with the Farm Credit System. From our recent experiences competing with Farm Credit, I can vouch that Farm Credit certainly is not going to the sidelines in being ready to meet the credit needs of farmers. Farm Credit has been caught in the back lash of uncertainty regarding the future of government sponsored entities after the takeover of Fannie Mae and Freddie Mac. This has caused Farm Credit’s costs of short term funding to increase some and it has had some difficulty selling longer term securities. But those blips are expected to be only short term as investors realize the strength behind the farm sector in which both banks and Farm Credit operates.

Next, I want to turn our attention to an area that may seem in conflict with my comments about lenders' willingness to lend to farmers. The question as to what crops farmers will be planting next year is still very much unanswered. And the lack of an answer has to do with the volatility of costs of inputs and the prices of crop futures. Phosphate and nitrogen fertilizer that sold earlier this year for $1,100 or $1,200 per ton can now be bought for $800 per ton or even less. Though they are coming off of their peaks, these prices are still significantly more than they were this time last year. Other input and land costs are up and staying up.

So what are farmers planning to plant next year? Many of them do not know yet because budgets will not breakeven with today's input costs and today's commodity prices. As lenders, we are just as hesitant as our farmer customers are to commit production dollars where loan repayment and profits, even on paper, are still very much a hope. And we all know hope is not a strategy.

We anticipate that as we go further in this quarter and the first quarter of next year, the demand for certain commodities will buy acreage by increasing future prices. As prices exceed breakeven levels, farmers will commit to what they will plant. We as lenders will look at their marketing plans, their risk management plans, and their cost structures, and make our financing commitments accordingly.

You may be questioning how this is related to the financial crisis. We know that a lot of the volatility in prices received and paid by farmers has been due to a complex brew of tangible factors such as the value of the dollar, the impact of index fund speculation in commodity markets, and world and local politics. Both contributing to and resulting from the financial crisis has been a list of non-tangible factors such as emotion, greed, and fear.

As always, farmers and their ag related business partners are being pulled both ways by these crisis generated factors. When corn was on its way to $8 per bushel and soybeans on their way to $14 or higher, crop farmers were smiling. But others were showing other emotions also—like those manufacturers of chemicals and fertilizers who were dealing with $130 oil and the livestock growers who were locking in the future costs of their feedstuffs at levels that are very much above today's market.

Any good businessman knows that there is value to having some stability so that there can more of an orderly environment for planning. I sense in talking to my farm customers that they have become much more apprehensive about their ability to manage in these times. I do not think that is good and I think the financial crisis, with its myriad of both tangible and non-tangible drivers, is causing a very different environment in which decisions must be made. The risks of failure are much higher than they have been in a long while.

Last, I want to talk about the impact of volatility caused by the financial crisis on our ag-related businesses. In many ways, they have been even more impacted than have local farmers. They are often the first line of risk management for local farmers. The elevator or cotton gin that goes to the commodity markets to hedge the forward pricing contracts they have entered into with their farm customers has been a great source of expertise relied upon by farmer after farmer in local communities. Coming into this year it was not unusual for local elevators to be carrying contracts on behalf of their customers that they had hedged on the futures market for this year, next year, and in some cases, even longer periods.

Then when commodity prices began to increase, things got serious fast. Every dollar increase in futures prices meant that a dollar times the number of bushels contracted had to be sent to Chicago *that day*. This separated the marginal managers from the real managers and it separated the fair weather bankers from those that are really, really committed. Of course in recent months this has worked in reverse as those livestock feeders who bought futures to hedge their feed costs saw prices start to fall down the limit almost every day and they were sending a dollar to Chicago for every bushel they had hedged.

This volatility has significantly and permanently altered the capital requirements and the management practices of both farm product buyers and farm supply businesses. Access to capital is paramount and the pockets need to be deep. It is not uncommon to find farm related businesses that need access to six, eight, or even ten times more capital than needed just three years ago. And even though they may not in actuality really need to use six or eight times the capital, they must have its availability lined up in advance and lenders are limited in what they are willing to do. No one has an open check book.

In response, lenders have sharply changed the terms and conditions of lending to their ag business borrowers. Few elevators are now able to hedge risks beyond the near term crop year because their lenders will not allow them to do so. This will force many farmers to move into finding alternate ways to hedge their risks or be more exposed to the markets in ways that may not be agreeable to their lenders. I think it will also lead to further consolidation among local buyers of ag commodities.

This risk, this uncertainty, this volatility, is also causing more of a jaundiced eye to be cast from farmer to supplier today than has been the case in previous years. For example, farmers in previous years have spent much management time in planning their pre-buying of supplies before the end of the year. This was motivated by the management of taxes and opportunities to lock in prices.

This year it will be different. There will be fewer inputs pre-bought this year than in many of the past years. Some of the motivation for this change is the fact that with falling oil prices, farmers sense that chemicals, fertilizers, and fuel that are tied to the cost of oil may be less costly later than now.

But there is also a growing undercurrent in concern about the stability of their suppliers. They are more reluctant to put dollars in the hands of someone with a promise to deliver later than there has been in the past. It is not just limited to concerns about the smaller suppliers. Who would have thought that Wachovia, Lehman Brothers, and Bear Stearns—long time household names that everyone assumed would be around forever—would be gone in the wink of an eye. Can we really trust the big names in any industry, including agriculture? We are all becoming more cautious and less trusting—another result of the times in which we live today. This will be addressed in some way but today it is still a factor that must be recognized and managed.

In conclusion, I will summarize my comments by reminding you that through the eyes of farmers and farm related businesses:

- There is concern about the viability of the banks and other financial institutions that have been traditional suppliers of financial capital
- There is heightened uncertainty about plans for the future
- The impact of both tangible and non-tangible factors have contributed to the financial crisis.
- Volatility has placed a premium on the value of strong capital and earning positions
- The quality of managers of both farm and farm related businesses is being tested to an extent that is beyond what has been seen in several years.
- Relationships among ag related businesses and their farmer clients and customers are being significantly changed due to the pressures of this uncertain environment.

I look forward to our discussion which will follow.

Joe Brasher