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RightRisk™

RightRisk News

How Much Risk is Right for You?

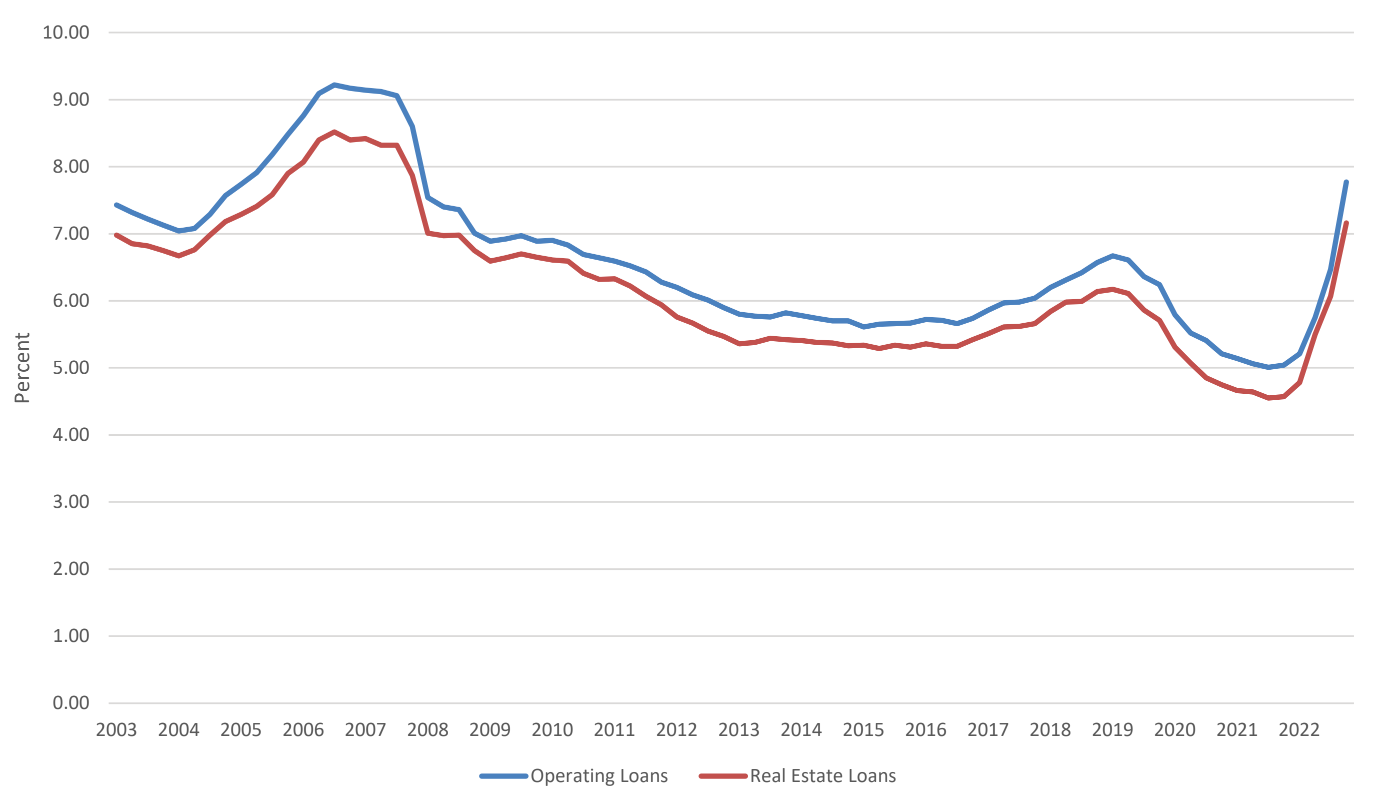
Interest rates: Where do we go from here?

The May 2022 issue of RightRisk News considered the implications of rising interest rates on farm decisions. At that time, the United States Federal Reserve had just raised the target range for the federal funds interest rate by 0.5 percentage points to a targeted range of 0.75 to 1 percent. At the time, this half a point increase was the largest one-time increase since 2000. In March 2023, the Federal Reserve increased its federal funds target rate for the ninth time since March 2022 by raising it 0.25 percentage points to a targeted range of 4.75 to 5.00 percent. This steep climb, from rates near zero to nearly five percent in just 12 months, is the most aggressive Federal Reserve rate hikes since the 1980s and it has many managers feeling anxious about the road ahead.

Interest Rate Concerns

Farmers are becoming increasingly concerned about rising interest rates, according to the March Ag Economy Barometer released by Purdue University and the Chicago Mercantile Exchange (CME) Group on April 4, 2023. Twenty-five percent

Figure 1: Average Fixed Interest Rates on Agricultural Loans in the Tenth Federal Reserve District*.



Source: https://www.kansascityfed.org/agriculture/ag-credit-survey/.

* The area of the Tenth Federal Reserve District includes Colorado, Kansas, Nebraska, Oklahoma, Wyoming, the northern half of New Mexico, and the western third of Missouri.

of the respondents to their March survey listed rising interest rates as their top concern. The number of farmers identifying interest rates as their top concern has climbed steadily from 14 percent, while the number of farmers reporting input costs as their top concern has steadily declined from 53 percent to 34 percent since last summer.

This shift in sentiment also shows up in their survey responses to the question, "Why is Now a Bad Time to Make Large Investments?" Increases in prices for farm machinery and new construction topped the list of reasons by a wide margin in all their surveys completed since the summer of 2022. However, the March 2023 survey indicated that 34 percent of respondents identified rising interest rates as their top concern, compared with 32 percent citing increasing prices.

Why Are Rates Increasing?
The Federal Reserve is actively raising interest rates to combat high inflation. This results in an increase in interest rates charged by banks and other lenders. When interest rates are high, borrowing becomes more difficult and repayment of loans becomes more challenging; this can lead to a decrease in economic activity and put downward pressure on inflation.

The annual inflation rate in April 2022 was 8.3 percent. After peaking at 9.1 percent in June 2022, it has steadily declined to a year-over-year rate of five percent in March 2023. This has many economists speculating that the end is near in terms of the current trend of increasing interest rates. Nevertheless, many feel it may be early 2024 before we know for sure that inflation is under control.

What does this mean for agricultural producers?
When the U.S. Federal Reserve raises interest rates, it trickles down to affect the interest rates paid by producers. Figure 1 depicts the average interest rates paid by agricultural producers from 2003 – 2022 in the Tenth District of the Federal Reserve Bank (Kansas City). Current rates have not been seen since early 2008. However, early 2008 also marked the pinnacle of the subprime mortgage crisis that led to the 2008 stock market and housing market crashes. After steadily increasing interest rates from 2004 – 2006, the Federal Reserve reacted to the financial crisis of 2008 and the subsequent Great Recession with unprecedented full percentage point slashes to interest rates to stimulate the economy. That low interest rate environment persisted for the following fourteen years.

Any interest rates increase can lead to increased interest costs on any new loans or existing loans with variable interest rates. Existing, fixed-rate loans taken out prior to the rate hikes are safe from these effects. For example, a real estate loan taken out at five percent interest in early 2020 would essentially have interest costs equivalent to or below the rate of inflation over the past year. When inflation rates are high, there is less incentive to make accelerated payments on real estate loans with low fixed interest rates.

Strategies to Consider Looking Forward
High commodity prices and government stimulus money (COVID and trade relief payments) have left some producers with ample cash reserves. A question heard frequently these days is what to do with these cash reserves. If now is not the best time to focus on paying down low fixed rate real estate loans, what is the best use of the money? Hence, the question offered by the Ag Economy Barometer survey in relation to "Why Now is a Bad Time to Make Large Investments," becomes even more important.

Strong cash flows in the agricultural sector drove up investment demand for land and equipment in 2021-2022. Demand outstripped supply and high prices resulted.

Producers are reluctant, at this point, to finance new purchases with continuing high prices and high interest rates. That is good because now is not the time to purchase assets at inflated prices, using credit that creates greater exposure to high interest rates for an extended period.

Perhaps the best risk management strategy, given the current market conditions, may involve investing cash reserves in short-term instruments that offer higher yields than those typically available. Many money market accounts and short-term Certificates of Deposit (less than 12 months) are currently paying four to four and a half percent interest. Keeping cash liquid to avoid the need to take on new debt at high interest rates to cover expenses is important. However, it is no longer necessary to keep it in a low or no interest-bearing account.

Most producers recognize that agriculture is a highly competitive business in which it can be tough to succeed. Carefully managing cash flow, exposure to interest rate risk and keeping an eye on cash availability when investment opportunities arise are a few of the ways to gain a competitive advantage. Current volatility has some people anxious but change also creates opportunities for managers to position themselves for future success.

~ Other RightRisk News ~

News Release - March 15 | RightRisk

Federal Reserve Beige Book Summary on the Agricultural Sector

OVERALL economic activity increased slightly in early 2023. Six Districts reported little or no change in economic activity since the last report, while six indicated economic activity expanded at a modest pace.

News Release - March 22 | RightRisk

Growth in Farmland Values Slows Amid Higher Interest Rates

FARM real estate values increased considerably in 2022 but showed signs of softening during the final months of 2022 as interest rates rose sharply.

For more see: RightRisk.org\News

Highlighted Publication:
Evaluating Risk Strategies

An eBook designed to accompany the *Evaluating Risk Strategies* online module. Over 30 pages provide an introduction to risk strategies and sources of risk, risk terminology, and how is risk estimated, risk management strategies, what a strategy is, risk management goals and objectives, policies and plans, evaluating risk strategies, evaluating decisions, recognizing strategic decisions, changing strategies, and quantifying variations in outcomes, as well as evaluating decisions looking in the rear-view mirror, and how to tell if a strategy successful.

To read more or to access the text, see: **RightRisk.org > Courses > Evaluating Risk Strategies**

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¿Cuál es la Ley de Normas Justas de Trabajo en agricultura y cómo se aplica a mí?

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