FARM CREDIT EAST

KNOWLEDGE EXCHANGE PARTNER

VOLUME 15 | ISSUE 4 | APRIL 2021

THIS ISSUE:

Editor: Chris Laughton
Chris.Laughton@FarmCreditEast.com

Contributors:
Chris Laughton
Jeremy Forrett
Tom Cosgrove

> **Across the board, as the United States emerges from the COVID-19 economic crisis, prices are rising.**

Farm Credit East Production Cost Index Reaches New High

If you're seeing rising input costs on your farm, it's not just you. Across the board, as the United States emerges from the COVID-19 economic crisis, prices are rising. While overall inflation (Figure 2) may remain fairly low by historical standards, prices for many common farm inputs have increased substantially recently. Availability is also an issue as supplier lead times hit a recent high last month.[1]

The Farm Credit East Production Cost Index, after experiencing a plateau in 2019-2020, shifted to an upward trajectory in 2021, as seen in Figure 1.

This is being driven by a combination of factors. One is that COVID-19 shutdowns and restrictions have taken a bite out of the supply of many goods across the country and around the globe. Many factories, plants and other facilities either shut down for a period or reduced their capacity to keep workers safe, and in some cases because of anticipated reduced demand. Figure 3 shows the dramatic dip in U.S. manufacturing output in the first half of 2020. However, for many goods, demand has returned to pre-pandemic levels, and even higher, in some cases. Inventories are low, and many suppliers are now rushing to meet a surge of demand.

For products that are imported, a lack of available shipping containers in places like China has slowed down supply chains, and the increased demand for containers has bid up their price to the point where some are being sent back empty, hampering U.S. exports.

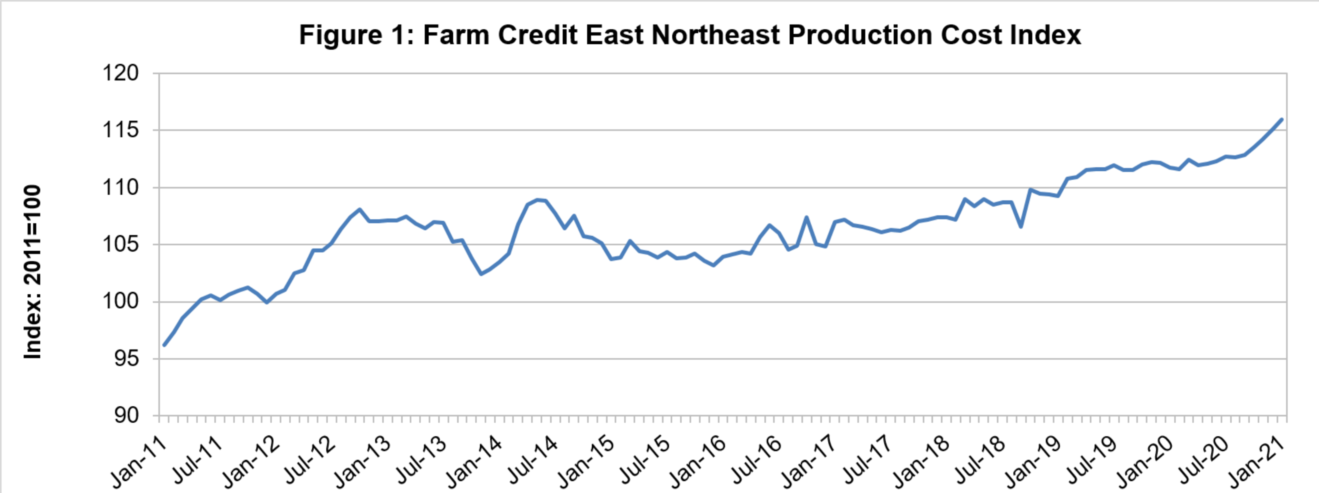
At our recent Customer Service Council meetings, we heard a great deal from our customers about costs rising and tight availability on all kinds of items, including:

- Cardboard and boxes for packing and shipping
- Tractors, machinery and spare parts
- Trucks
- Fertilizer and lime
- Peat moss and other growing media
- Lumber, glass, steel and other building materials
- Animal feed and other ag commodities
- Plastics – sheeting, pots, crates, etc.
- Fuel and energy costs

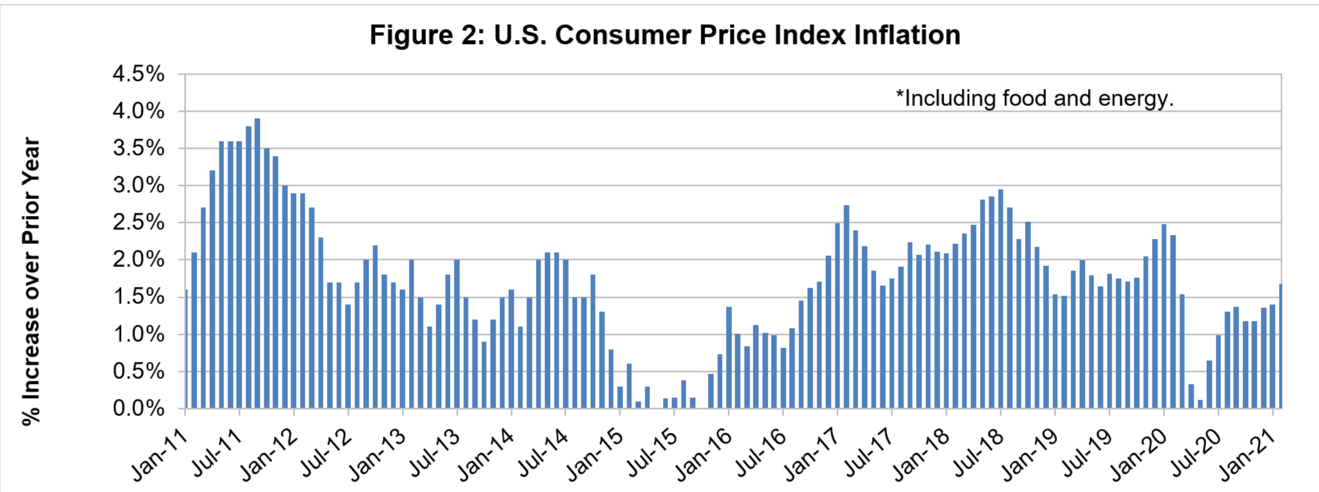
Continued on next page

[1] J.P. Morgan/HIS Markit Global Manufacturing Report

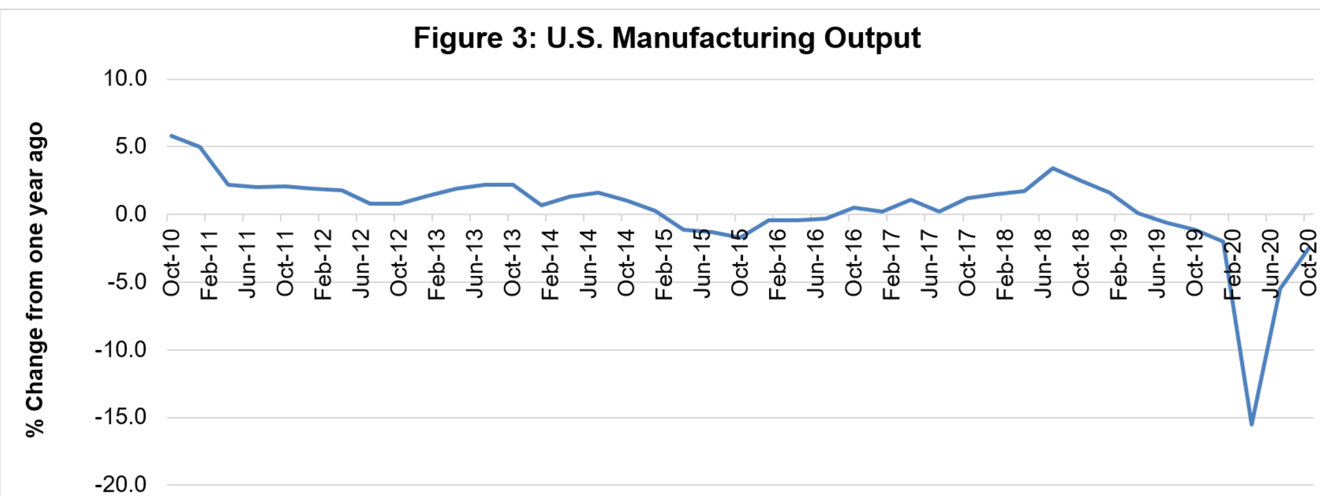
Continued from previous page



Source: USDA Census of Agriculture, NASS Prices Paid Index, Farm Credit East estimates



Source: U.S. Bureau of Labor Statistics; Including Food and Energy



Source: U.S. Bureau of Labor Statistics

Continued on next page

Continued from previous page

Not only have many input costs risen, but tight supplies seriously limit the negotiating power of most producers as they scramble to get the materials they need for their businesses.

In addition, as spring begins to break and hiring ramps up, wages are higher for many types of workers, including workers on H-2A visas whose wages increased by 4-5% this year depending on the state's Adverse Effect Wage Rate (AEWR). Minimum wages increased this year as well in most Northeast states. CDL truck drivers are particularly hard to find, according to many of our customers.

On the revenue side, the incidence and amount of price increases is more variable. Some Northeast producers have benefitted from being able to charge higher prices, but certainly not all. For many producers, the prices they receive have been stagnant, even as their costs rise sharply.

Consumers may see inflation increase later in 2021 as a result of these producer-level increases. Overall inflation, as measured by the Consumer Price Index, is expected to increase slightly, to about 2%, up from 1.6% in 2020. However, as with producers, consumers will see significant variability by type of expenditure. Gasoline prices, while remaining below 2019's peak, increased by 6.6% in February, year-over-year. Housing costs have increased significantly as well — the National Association of Realtors forecasts annual median home prices to jump 8.0% in 2021.

Some factors that may mitigate some of these price increases for Northeast producers are food inflation and rising truck costs. Overall, the cost of food increased by 3.6% in February, year-over-year (of course, how much of that increase flows to the farm level will vary substantially by type of product). Rising trucking costs are a double-edged sword — while these increases will add to supply costs, they can also give Northeast producers with proximity to markets some competitive advantage over distant competitors: The rate for a full refrigerated tractor-trailer from California to New York is now averaging over $9,000.[2] This gives Northeast producers at least a slight advantage over West Coast producers in terms of freight costs.

The gap between low consumer inflation and rising costs for agricultural producers puts many farms in a tough position — trying to pass on these rising costs in a market resistant to price increases. Meanwhile, raw material shortages, labor force disruptions and higher freight costs are squeezing profit margins.

So, what does the future hold? It's likely that the current surge in business input costs will flow through to bring higher prices for consumers, and higher headline inflation. However, as supply chains begin to normalize, we should see price increases begin to taper somewhat. The Federal Reserve recently released projections that the U.S. economy will grow at its fastest pace in more than 40 years in 2021, and with that will come an increase in consumer prices. The Fed has increased its inflation outlook to 2.4%, a significant increase from its previous forecast of 1.8%. It expects inflation to slow to 2.0% in 2022. In the meantime, agricultural producers will have to pay higher prices for inputs, and hope that market prices for their products will keep pace.

[2] USDA Agricultural Marketing Service

Federal Crop Insurance Programs: A Good Deal for Northeast Producers

Ask any farmer, anywhere, and they will tell you that farming entails a great deal of risk. There are a number of types of risk ranging from production and weather risks, market risks, legal risks, and more. Thankfully, the USDA's Risk Management Agency (RMA) has established a number of insurance programs that can help American farmers manage production and weather risks, and even some market risks.

Continued on next page

Continued from previous page

The RMA was created in 1996 to help America's agricultural producers through market-based risk management tools. The development of RMA programs represented an attempt to move away from ad hoc disaster relief funding that Congress approved, and USDA delivered when severe weather events or conditions caused crop losses. The crop insurance model is an innovative public-private partnership between USDA, approved insurance providers, and independent crop insurance agents such as Crop Growers.

Unlike the former ad hoc disaster programs which failed to provide widespread and predictable coverage for all farmers, crop insurance:

- Is reliable and predictable
- Is available in all 50 states and Puerto Rico
- Requires farmers to share in the cost of protection
- Is available for an extensive range of crops and livestock
- Involves private insurers to help manage risk in an actuarily-sound manner

In the crop insurance partnership, agents like Crop Growers advise farmers and sell policies, private insurers such as Rain & Hail and RCIS collect premiums and pay indemnities, and RMA subsidizes crop insurance premiums to make policies affordable for farmers.

An analysis of indemnities paid over the past 10 years in Farm Credit East states shows the value of these programs for Northeast producers.

While the premiums and indemnities paid vary by state and from year to year, Table 1 clearly shows that all Farm Credit East states had a significantly positive balance of indemnities paid relative to producer-paid crop insurance premiums. Overall, across the region, indemnities exceeded producer-paid premiums by nearly half a billion dollars over the 10-year period.

Table 2 looks at the causes of crop insurance losses. Precipitation, whether too much or too little, is the top cause of loss, collectively representing more than half of all losses. Interestingly, too much moisture is the problem far more often than drought.

Table 1. Crop Insurance Premiums and Indemnities, 2011-2020

State	Producer-paid Premiums	Indemnities Paid	Balance
Connecticut	$21,827,800	$33,098,194	$11,270,394
Maine	$31,996,909	$67,995,546	$35,998,637
Massachusetts	$12,336,917	$28,968,686	$16,631,769
New Hampshire	$1,856,207	$3,581,399	$1,725,192
New Jersey	$18,220,712	$41,888,935	$23,668,223
New York	$171,502,279	$548,565,290	$377,063,011
Rhode Island	$278,440	$1,464,614	$1,186,174
Totals	$258,019,264	$725,562,664	$467,543,400

Table 2. Top Causes of Crop Insurance Losses in Farm Credit East states, 2011-2020

Cause	% of Total Losses
Excessive Moisture	40.4%
Freeze	12.2%
Drought	11.5%
Hail	9.8%
Decline in Market Prices	6.3%
Cold Wet Weather	3.2%
Excessive Heat	3.1%
Frost	3.1%
Plant Disease	3.0%
County Yield Loss	2.9%
All Others	4.6%

Continued on next page

Continued from previous page

Freeze, frost and cold weather is another major cause of loss. Hail represents about 10% of losses, and finally, price declines in the market represent just over 6% of losses.

While major row crops such as corn and soybeans have some of the highest participation rates, crop insurance is available for more than 100 crops and livestock products. While the exact products that can be insured vary by county, here are some of the most important crop insurance programs for the Northeast.

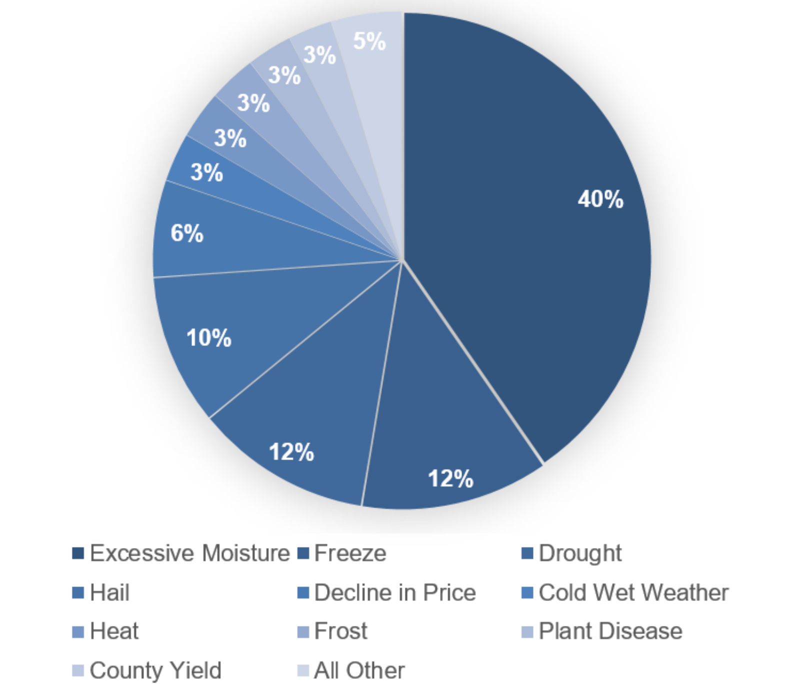


Table 3: Causes of Crop Insurance Losses

Dairy Revenue Protection (DRP): The DRP policy provides protection against declines in quarterly revenue from milk sales.

Yield Protection (YP) and Actual Production History (APH): These policies insure producers against yield losses due to natural causes such as drought, excessive moisture, hail, wind, frost, insects and disease.

Revenue Protection (RP): This plan gives you all the coverage of Yield Protection (YP) and Actual Production History (APH), plus protection against loss of revenue caused by yield and/or market fluctuations. It allows you to "lock in" or guarantee a pre-determined price.

Crop Hail Coverage: Particularly important for fruit and vegetable growers, Crop Hail provides farmers protection against any yield or quality reduction caused by hail. This coverage gives you acre-by-acre protection that can be up to the full value of the crop.

Whole-Farm Revenue Program (WFRP): The WFRP can protect your farm's overall revenue from losses. It uses a producer's 5-year historical farm average revenue as reported on the IRS Schedule F and an annual farm report as a base to provide a level of guaranteed revenue for the insurance period. This program is particularly useful for diversified farms growing multiple crops.

Livestock Gross Margin – Dairy (LGM-Dairy): This policy provides protection against the loss of gross margin (market value of milk minus feed costs) on the milk produced from dairy cows. LGM-Dairy uses futures prices to determine the expected gross margin and the actual gross margin.

Pasture, Rangeland & Forage Insurance (PRF): The PRF insurance plan is designed as a risk management tool to insure against a decline in the Rainfall index for a geographic area.

For additional information on these policies and other coverage options, visit CropGrowers.com.

CONTACT INFORMATION

We look forward to your questions about Knowledge Exchange Partner and your feedback:

KnowledgeExchange@FarmCreditEast.com

KNOWLEDGE EXCHANGE PARTNER