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Impact Of Rising Inflation & Interest Rates On Farm Businesses

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Farm Debt on The Rise

- ✓ After a decade plus of low inflation and low interest rates, farmers have invested aggressively, and the price of farmland has risen significantly.
- ✓ As a result, farm debt has been rising significantly in recent years with total outstanding farm debt in Ontario up 131% between 2007-2021

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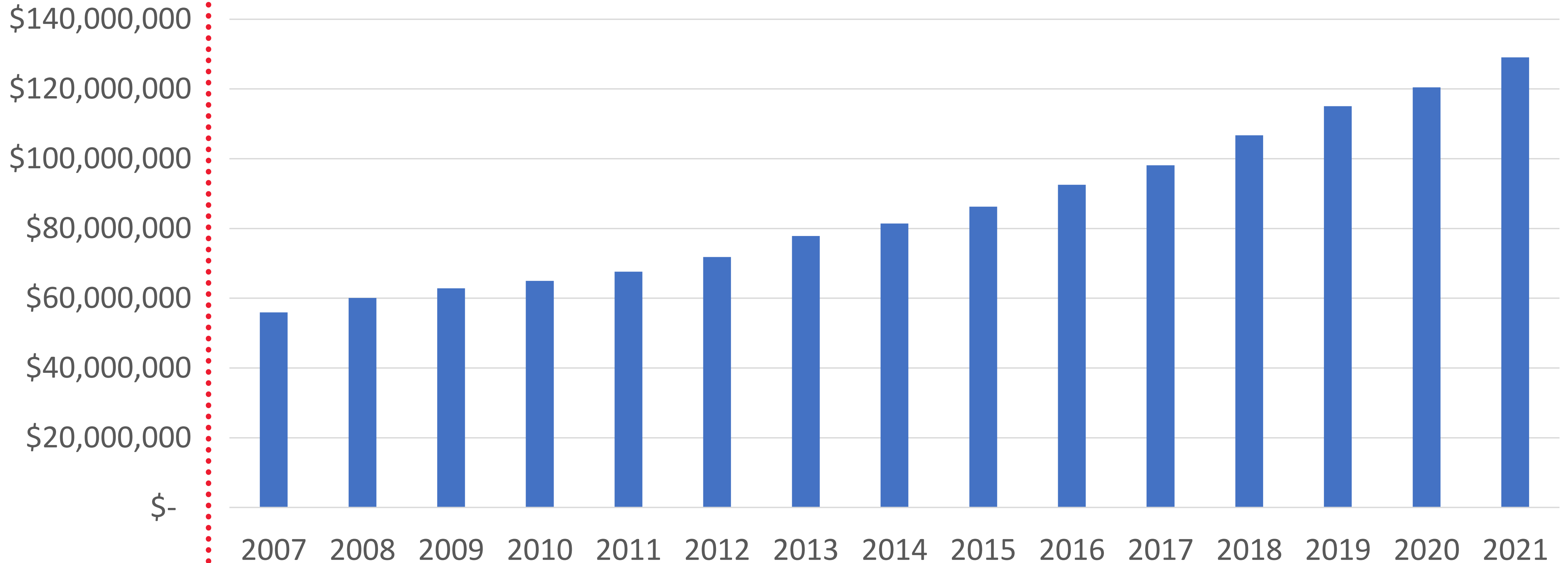
Farm Debt on The Rise



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Interest Rate on The Rise

- ✓Servicing larger debt loads is easily manageable during a time of flat or declining interest rates

- ✓Bank of Canada (BOC) lifted its overnight rate by 2.25% in the first half of 2022, moving from 0.25% in January to 2.5% in July.

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Why Are Interest Rates Rising?

- ✓To combat high inflation.
- ✓High inflation which is having significant impact on farm operating costs.
- ✓According to FCC, in the past year farm input costs have risen dramatically.
- ✓ Fertilizer up 50%
- ✓ Farm fuel up 35%

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Why Are Interest Rates Rising?

- ✓The agricultural sector is not the only sector impacted by high inflation with inflation up 7.7% year-over-year as of May.
- ✓By increasing the overnight rate, the BOC increases the interest rate at which large banks borrow money, short term, among themselves.
- ✓Banks pass these higher rates down to borrowers which slows aggregate and (hopefully) inflation along with it.

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3 primary ways interest rates impact farm businesses

1. Cost of borrowing money
2. Investment decisions
3. Farmland values

- Farming is a very capital-intensive industry; these three factors have tremendous impact on a farm operations ability to compete in the modern agricultural sector.

- Higher interest rates increase the cost of borrowing, lower the amount of on farm investment and put negative pressure on farmland values.

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Farmers capacity to service debt

- A farmer’s ability to service debt is critical to the financial viability of the farm and is measured by the revenue of the farm for ever dollar of debt principal + interest it owes.
- The key variable FCC monitors is the Interest Coverage Ratio (ICR) which measures a farms ability to pay interest on outstanding debt.
- ICR= Net Income (excluding interest payments) ÷ interest costs
  - This tells us how many dollars of revenue a farm operation has for every dollar of interest payments it must make.
  - The higher the ICR the better a farm can manage its debt.

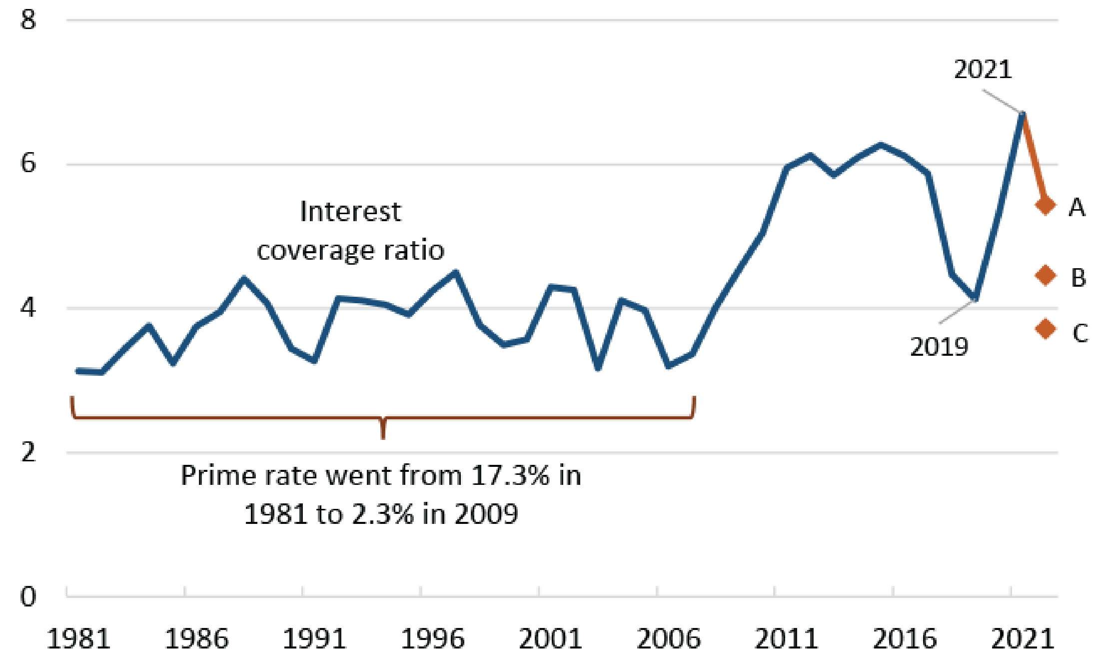
Interest Coverage Ratio Over Time

- During the pandemic ICR rose to record high as interest rates hit record lows and farm income hit record highs.

- FCC modeled three scenarios of farm ICR in 2022
- Point A keeping farmers in a comfortable position to manage debt
- Point C returning farmers to the average ICR and ability to service debt we saw from 1981 to 2009.

- Chart from FCC

Figure 1. Ability of Canadian agriculture to cover interest payments on farm debt climbed in 2021



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What can local government do?

- There are three factors that impact a farms ability to manage debt.

1. Total interest costs
2. Farm income
3. Farm expenses (other than interest rates)

- Of the three variables, local governments have the most impact on farm expenses. Grey county has been supportive of local agriculture in this regard by lowering the farm tax ratio from 0.25 to 0.218 and exempting farm buildings from the county development charge by-law.

- This show of support is appreciated during this difficult time for farm businesses.