

# Inflation lies ahead

By JOHN OTTE

**W**ITHIN the next six years, the land price rate of gain will slow or the inflation rate will accelerate.

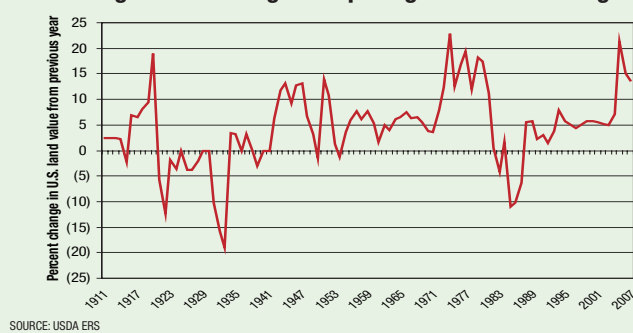
“Land’s earning capacity is one component of land value,” says Kevin Dhuvetter, Kansas State University economist. Sharply higher gross crop revenues are boosting return to land and land value.

“Other contributing factors include: recreational opportunities, potential for development and expectations land may rise in value,” he adds. “Because land is a bundle of attributes, earnings from production are rarely high enough to allow land to pay for itself.”

### A bit of history

Strong ethanol-related crop earnings helped U.S. land values mark double-digit gains three years in a row. Your

Strings of double-digit land price gains don't last long



SOURCE: USDA ERS

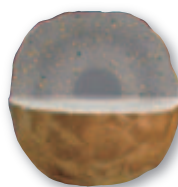


Sometimes close isn't good enough.

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Cutaway view of MicroEssentials SZ granule

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expectations for future earnings and inflation both bear on how much you might be willing to pay for land.

From 1973 through 1981, U.S. average farmland values grew at double-digit rates nine years in a row. You may recall that's when the Soviets began buying grain in a big way. Production cuts by the Organization of Petroleum Exporting Countries drove oil prices higher. Inflation accelerated. Some observers trace the roots of inflation to efforts in the 1960s to finance both the Great Society Program and the Vietnam War at the same time.

Grain prices rising to a new plateau, accelerating inflation, plus the nine consecutive years of double-digit land price gains made a convincing argument that land values had no way to go but up in the 1970s.

President Richard Nixon's Phase I, Phase II, Phase III and so on plan to control inflation failed. President Gerald Ford's Whip Inflation Now effort had no more success. Americans, including farmers, had reason to believe inflation would persist.

Farmers "buying land now because it will cost more next year" became a self-fulfilling prophesy, for a while.

The Federal Reserve tightened monetary policy in 1979, which did wring inflation out of the economy. However, the cure for inflation was excruciatingly painful in some sectors. Agriculture was one. Land values plummeted.

In the 1970s, borrowing single-digit interest rate money to buy land that was rising at a double-digit rate seemed a no-brainer. How long you expect current interest rates to stay low influences how much you should be willing to pay for land.

Interest rates on 30-year U.S. treasury bonds are around 4.5%. "If the market expected inflation to accelerate, people wouldn't be willing to lend money for 30 years for 4.5%," notes Iowa State University economist Dennis Starleaf.

### Interest cuts

The Federal Reserve's January interest rate cuts are a mixed blessing. "This policy change now sets up conditions for inflation later," says Dan North, economist for Euler Hermes ACL, Owings Mills, Md. "Plus, the Fed has created excess liquidity that could easily recreate the conditions that formed the housing market asset bubble.

"The Fed has created a moral hazard — an expectation that the Fed will come to the rescue every time significant instability occurs in the financial markets," he adds. "Investors will then seek too much risk in investments such as subprime mortgages, a condition which could also contribute to the formation of another asset bubble."

