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The Economic Radar Screen for 2022 - 2023

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The economic radar screen is blinking with signs of incoming disruptors that will be felt in the U.S. and global economy. How will these variables impact business and household decisions this fall and next year? What are the strategies and actions that will be necessary to circumvent or take advantage of the economic forces in play?

Inflation

Public enemy number one is the "i word" or inflation. After being in remission for a number of years, inflation is back to 1970s levels as a result of accommodative monetary and fiscal policies of governments around the globe. These policies were implemented during the financial crisis 15 years ago and again most recently during the global pandemic. Two years ago, the primary metrics that measure inflation, that is the Producer Price Index (PPI) and Consumer Price Index (CPI) which measures core inflation and headline inflation, were all under two percent. Fast-forward to today when all of these inflation metrics are between five and ten percent in the U.S. and are in double digits in Europe.

The inconsistent policies of central banks and governments around the globe are creating a prolonged inflation issue. On one hand the central banks are raising interest rates (monetary policy) while many governments are fueling inflation through fiscal programs and strategies that promote spending. This situation is analogous to driving down the road with one foot on the gas pedal and one on the brake, which could lead to a disaster.

Interest rates

How high will interest rates go? Historically, when the Federal Reserve has raised interest rates the average increase is 293 basis points or 2.93%. Of course, we have already exceeded this average with an increase of 375 basis points. An informal survey of bankers nationwide indicated that this group projected the federal funds rate for this year and next year to be between 4.25 and 5.50 percent. This would equate to a prime rate between 7.25 and 8.50 percent. The prime rate often exceeds the federal funds rate by 300 basis points. This in turn will equate to higher interest rates and possible double-digit interest rates for operating and production loans, depending on your financial risk profile. A financial shock test of three, four, and five percent interest rate increases on variable rate operating and production money may be in store for this fall and winter renewal season.

How long will interest rates and inflation remain elevated? Usually, it takes up to one year after interest rate increases to impact economic growth and inflated asset values. Concerning inflation rates, this can take two to four years as some costs are permanently baked into the economy.

Central banks in the U.S. and abroad are experiencing difficulty controlling interest rates because of the saved government stimulus, energy policy shifts, the war in Europe, and de-globalization issues with labor shortages and, more importantly, lower labor productivity. Labor productivity in the U.S. has been negative 7.4 and 4.1 percent in the first half of the year, the lowest since 1948. Hospitality, airlines, and experiential activities relating to social experiences, weddings, etc. are enjoying a boom due to the stimulus savings, which are being spent at about $110 billion to $250 billion per month. The party may be over after the savings have been burned through and credit card limits are reached, which may occur in 2023.

Dollar, deglobalization, and trade

The strength of the dollar due to interest rate increases and the strength of the U.S. economy is great for cheaper imports, but is challenging for those exporting commodities or products such as the agriculture industry. Be prepared for geopolitical and military issues "flipping the switch" and creating abnormalities in international trade. De-globalization is now in progress which will impact the flow of commodities, goods, and services worldwide. More countries in North America, Asia, and Europe are moving supply chains to trusted trading partners within their respective regions. Countries that depend on authoritarian economies, such as Russia and China, as trading partners are finding that they can impact economic policy and create a rocky road for prices and input costs. Trade policy, particularly agriculture trade policy, will be nebulous at best and at the whims of political and military agendas.

Energy transition

Lessons learned from quickly flipping the switch from fossil fuels to green energy are being played out. This is important to the agriculture industry because 80 percent of farm and ranch expenses are linked directly or indirectly to oil and energy. While green energy is admirable, the transition will take decades with many unintended consequences. Europe is experiencing these lessons first hand and the effects are rippling through the rest of the globe with high inflation and food nationalism. For example, 50 countries are dependent on Ukraine and Russia for over 30 percent of their wheat imports. Turkey, where inflation is over 80 percent, depends on Ukraine and Russia for 60 percent of imported wheat. The Philippines and Indonesia have seen cuts in their wheat and rice imports from India due to a drought in the Asian region. Sri Lanka's leaders flipped the switch and banned synthetic fertilizer and pesticide imports, essentially converting to organic farming in totality and creating a food shortage in that country.

Growth recession

Over the course of these newsletters, we will be observing global economic growth. The European region, which is 20 percent of the global economy, is in a recession. China, the second largest economy in the world, is in a growth recession with positive economic growth of 3.6 percent. Emerging nations are struggling with inflation, debt, energy, and food shortages, which is creating social unrest. Economic growth in the U.S. has been negative up until recent reports which showed a modest 2.6 percent growth rate.

While this kickoff newsletter may seem negative, it is a reality of the times. Similar to managing a business in the 1970s and 1980s, high business and financial IQ applied to strategies and actions can lead to profitable outcomes. What are some of the actions to focus on in the coming months?

- Monitor financial budgets and cash flow projections more than once per year for tax purposes. Monthly and quarterly cash flow projections compared to actual results can assist you in tweaking your strategies and actions in these volatile times.

- Ownership of the numbers and linking your production outcomes to marketing and risk management plans and then to the financial plan is critical. A broad range of price, input costs, and interest rate scenarios will provide you with the financial guard rails for objective decision making.

Step back and take a deep breath. Some of the best decisions were made in the 1970s and 1980s during challenging economic times. Manage the controllable variables and manage around the uncontrollable ones, as previously discussed. The economic radar screen is full of signs indicating possible headwinds. However, as one famous weather forecaster says, "Do not be scared, be prepared!"