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Now and After Now: 2018 to 2030

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Recently, at a future planning meeting for a major agricultural organization, the discussion segment was entitled, “Now and After Now: 2018 to 2030.” While the subject raised some eyebrows from those focused on today, it is essential to assess the current and future agricultural landscape. Just as the Board did, let’s examine the economic forces shaping today and into the third decade of the 21st Century.

Now

For most agricultural sectors, the elongated economic reset is now moving into its fifth year. Frequently, people ask me about how and when economic fortunes will turn. A candid response is that a turnaround of any magnitude or duration is not likely anytime soon. Currently, there is a surplus of commodities worldwide, which is in part due to the accelerated capital investment in technology and research that took place during the recent supercycle. These technologies, bio-engineering and Big Data are being implemented by stronger managers worldwide in a drive toward systems efficiency. Abundant supplies to meet soft demand from the emerging nations (Brazil, Russia, India, China, South African, South Korea, Indonesia, Mexico and Turkey), and the maturation of the ethanol industry resulted in soft commodity prices for grains and fiber. And while the U.S. Dollar has weakened as a result of uncertainty in fiscal and governmental policy, the impact has not been enough to boost prices. The lower prices combined with higher fixed costs such as land rents have suppressed margins for many, making the refinancing of operating debt a common practice.

Of course, a Black Swan or unexpected event such as international trade and immigration reform could sway the course for agriculture. For example, one out of every five dollars of agricultural net income is the result of exports. That makes America’s stance on trade agreements such as the TPP (Trans Pacific Partnership) where China has filled the void left by the U.S., along with the NAFTA (North American Free Trade Agreement) critical to both the short and long term economic health of agriculture. Trading negotiations with our first and third largest trading partners, Canada and Mexico, as well as others partners like China, dictate thoughtful, careful and intentional negotiation in order to establish good policy and direction for trade and the future of agricultural profitability.

In addition, immigration reform is quite a variable for agriculture, especially for those operations less suited for mechanization and more dependent on hand labor. In addition, the market disruption that could occur as the result of geopolitical or military event would be significant. For example, North Korea tensions could spill over into trade with Asia and China drawing agriculture into the mix, which would be a formidable market force.

Globally, the world economy is in growth mode. Led by Europe and Japan, world economic growth is projected to be about 3.7 percent. Certain parts of the emerging nations like China and India are in also in growth mode; though Brazil, South Africa and Russia are still in the recession part of their economic cycle.

The U.S. economy is now closing in on record territory as it moves into its 103th month of consecutive expansion. This is the third longest rally in history, rivaling the 106 months in the 60's and 80's, and of course, the 120 months in the 1990s. There is an old saying that economic expansions don't die, but are killed off. In the past, an economic growth cycle quickly met its demise when the Federal Reserve tightened economic policy, or raised interest rates too rapidly. Other headwinds to a growth cycle include oil shocks, financial bubbles, and of course, stock market declines. Actually, the red-hot stock market combined with the possibility of new appointees at the Federal Reserve may be cause for concern. At the least, the evolving situation must be monitored to avoid the possible derailment of the world's large economy. A decline of 30 percent or more in stock market values could be a catalyst for an economic recession in the U.S. and possibly throughout the world.

In examining domestic economic growth, one needs to note the bifurcation taking place. Specifically, the Coastal regions and urban corridors are growing, yet the rural areas are stressed. Of course, the opposite was also true when the agricultural and the rural economies thrived during the great commodity supercycle, and the Coastal regions struggled as part of the Great Recession.

Another factor to monitor closely is interest rates not just because of their economic impact, but because of their relation to cash flows and the balance sheet values. The two factors that typically indicate the rise of interest rates are low unemployment and strong consumer confidence. However, inflation and economic growth are subdued, but projected to accelerate. Thus, producers should shock cash flows for next year's projections with three interest rate increases on any variable interest rate debt.

Concerning land value adjustments, a recent survey of agricultural lenders shows that in the Midwest region 84 percent stated values have declined by 1 to 10 percent. Approximately 20 percent responded that the drop was more than 10 percent. The drop in value is most predominant with land that is marginal in productivity (fertility or water), and water access. Lands that are not well laid out for increased use in advanced technology are also declining in value. However, highly productive land in areas with stellar demand boasts stable values, with some slightly increasing. Agricultural lenders on the Coasts are experiencing booming economies and agriculture that is more diversified in markets. Of those surveyed, 83 percent indicated land values are increasing or stable. Less than one in seven Coastal lenders surveyed had seen land values decline.

<u>Beyond now</u>

This agricultural cycle is quickly changing the structure of the industry. Commodity agriculture is consolidating in a drive towards efficiency. And as farms become larger, the management and systems are also evolving. For example, in a merged family business, the future farm may look like cousins managing with cousins, and new members (inside or outside the family) interspersed.

Another future trend will be the entrepreneurs aligning with markets such as, organic, local and natural. Some of these businesses will be well-diversified within agriculture with multiple enterprises. Yet, some businesses will operate entities outside of agriculture that fit their resources, skill sets, and align with their agricultural interests.

Another segment is the “tweeners.” In some cases, there is no next generation for succession, or perhaps farm resources or management mindset are not conducive to a continuing the operation. This segment commonly faces negative financial margins, and many times a partial or total liquidation becomes the best way to preserve the wealth that remains. While a difficult situation, this can present expansion opportunities for others that may have better resources and capabilities to make those assets profitable again.

In the next decade, the consumer marketplace (food, fiber and fuel) will be splintered, and create new paradigms. For example, one of the fastest growing trends in Europe is the demand for electric vehicles (EV) as tied to the reduction of internal combustion engines. The Millennials and Generation Z will transform the food and fiber markets with capabilities to track from the gate to the plate. This trend in particular will be challenging for the larger processes and agribusinesses, but is a reality as they try to stay ahead of the changes in the marketplace. If proactive managers can align with these markets, they will realize profit. In addition, the growing non-farm population as well as the increase in number of NGO (nongovernment organizations) will also play a role in transforming how food and fiber is produced, processed and distributed.

Yet, today's economics are already calling for innovation and creativity which will lead nicely into opportunities of the future, like specialized markets and premiums for consumer preferences. The "after now" period will present opportunities much like spring provides renewal after winter. Like the Board of Directors looking into the trends of the future, those in agriculture that can practice foresight and perceptual acuity will lead agriculture by capitalizing on change. Of course, the choice to move forward will be up to each individual.