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The Pulse of the Economy

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As the cold winds sweep in from Canada, the time has come for an annual checkup of the agricultural economy. In this examination, the interconnection of global and domestic economies requires producers and agribusiness persons to think globally and bring key perspectives to everyday decision making for success.

The new normal in this world of global economics has some critical elements. Volatility in prices and input costs are extremes that require using a wide range of scenarios when budgeting. Volatility will present tremendous opportunities to succeed, but the downside will be failure for those who lack the discipline to plan and execute, take action and accept the consequences. The new normal is a world of “black swans” or tail risk. For example, the tinder keg of the Middle East with oil dominance could result in abnormally high input expenses, since 80 percent of farm and agribusiness costs are linked to oil. Also a looming risk is potential for cyber-attack, which could knock down our electrical systems.

Supersized Super Cycle

American agriculture has been in an unprecedented super cycle. In the last century there have been four major commodity super cycles: World War I, post-World War II, the 1970s, and the current super cycle. All three of the earlier commodity super cycles lasted 2 to 4 years; however, when the ball hits the bottom at Times Square, this super cycle will have lasted a record of 10 years. This supersized super cycle has resulted from the demand for commodities ranging from grains and oil seeds to steel by the emerging nations, i.e. the BRICS (Brazil, Russia, India, China and South Africa) and the KIMT (South Korea, Indonesia, Mexico and Turkey). These emerging nations, when combined, are equal to the size of the U.S. economy. A key point is that these emerging nations, with China as the fulcrum, have represented 50 percent of the world’s economic growth since the year 2000. The population is demanding food, fiber and fuel, which is produced by many of the 60 million people in rural America.

Combine these elements with the increase of biofuels standards, increased exports with Federal Reserve accommodative action to suppress the value of the dollar, low real interest rates, and the result has been profit and wealth for many sectors in rural America.

The Swiss Cheese Agricultural Economy

The unfortunate result of the super cycle is that profit and wealth have not been evenly distributed. Grain, oil seed, and fiber sectors have experienced long profit windows, with minimal shallow downturns. Specialization and concentration have been rewarded. Unfortunately, some managers are becoming complacent in a time of margin compression as a result of high input costs and accelerated fixed costs due to high land rents and appreciating land values. A downturn in the global economy, particularly in emerging nations, or export or public policy changes could result in negative margins. This could quickly cause a large amount of working capital and equity to be extracted from the balance sheet of U.S. agriculture.

Let's contrast this to the livestock industry, to which the supersized super cycle has not been as kind. Short profit windows have been followed by extended, steep downturns. Specialization has been risky. Environmental, consumer, food, and animal welfare-related regulation have been an increased burden on this side of the agriculture industry. The result has been a shift of resources from livestock to grain for those seeking enterprises with profit opportunities, a less intensive lifestyle choice, and reduced management intensity throughout the year.

Global Pulse

The global factors and indicators to follow are GDP growth rates in emerging nations. In the zenith of the super cycle, these emerging nations' GDP growth was well above 10 percent. Recently the combined growth was below 5 percent. This needs to be closely monitored as a prelude to possible changes in commodity prices. If the growth rate drops below 3 percent, it is a sign of recession in the emerging nations, which would be a major factor in the correction of the super cycle.

Europe, which is China's largest customer, is now in recession. Watch the German election in 2013. If Chancellor Merkel is not reelected, the result could be the breakup of the euro, impacting the value of the dollar and possibly resulting in the Yuan becoming a reserve currency.

The fiscal cliff or slope in the U.S. bears watching. If the U.S. economy goes over the cliff, it could result in 2.6 to 3.6 percent GDP reduction, placing the U.S. in recession. The most likely outcome will be some resolution, and adoption of a version of the Bowles-Simpson bi-partisan recommendation which includes tax increases and budget cuts. The political posturing by both parties is suppressing an already slow economic recovery.

Pulse of the Business

Now that we have covered the pulse of the ag economy via domestic and global economics, let's bring it down to the producer level. How can you apply this information to your business?

- First and foremost, conduct a financial audit of your business with your ag lender and/or farm management instructor. Carefully examine debt levels and working capital to revenue as a financial cushion.

- Next, analyze potential tax liability increases for 2013 with changes in tax laws and reduced depreciation write-offs. Deferred tax liability is going to be an important variable in cash flow planning.

- Form your advisory board. Included could be your lender, farm management instructor, crop consultant, and livestock consultant. A trusted advisory team is very critical in navigating the economic whitewater and positioning your business for success.

- Finally, monitoring the pulse of your business can be intimidating to many. However, surrounding yourself with good set of advisors who assist you in building on your strengths and finding your blind spots for improvement can be a very valuable planning tool.

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