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This is one of a series of articles written by Dr. David Kohl for the Minnesota State Colleges and Universities Farm Business Management Education Program. Vol. 56

The Economic Winds of Change

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The economic winds of change are analogous to an Alberta clipper combining with moisture from the South to cause winter warnings on the Minnesota and upper Midwest landscape. This kickoff to the Minnesota Farm Business Management newsletter series does not necessarily forecast a major economic storm, but one that requires close watch and proactive management to navigate potentially adverse conditions.

The winds of change are blowing in the agricultural economy. The great commodity super cycle, which has bestowed record profits and paper wealth gains particularly on the grain industry for a decade, is starting to subside. A convergence of events including slowing of the emerging nations' economic growth, an easing of ethanol and biofuel mandates, and favorable weather patterns in the southern hemisphere are resulting in increased crop inventories which in turn are reducing prices of commodities. Producers who have not developed and executed risk management plans using forward pricing, options, or puts are now experiencing the possibility of negative margins for the first time in many years. Analogous to a baseball game, the grain industry may be in the seventh, eighth, or late innings of the economic cycle.

Switching gears to livestock and poultry, resurgence is now starting to occur. Recent years with more prosperity in the grain industry resulted in resources flowing out of the livestock and poultry industries. The result has been reduction of production numbers, which is now shedding a favorable economic light on this side of the agricultural industry's ledger. With the possibility of strong prices combined with reduced input costs for feed and fertilizer, top managers in this segment could be in a position to garner some profitable years. Drawing on the baseball analogy again, this side of the industry may be in the economic third or fourth inning or early innings of the cycle.

The winds of economic change could affect land values and cash rents. Record year-over-year land value appreciation of as much as 50 percent to 60 percent in some Midwest states could indicate an asset bubble ready to pop. If farmland values and cash rents were to decrease, the crosshairs will be in the Midwest and the upper Midwest with much less decline on the East and West Coasts and in the South. The reduction of land values will have a "delay button," requiring back-to-back years of losses to force behavioral change amongst producers, and particularly landlords. In other words, eventually reality will trump hope with reduced prices and suppressed margins, which in turn will diminish working capital, equity positions, and the ability to operate in a profitable manner.

Another critical variable that is affected by the winds of economic change is interest rates. Expect even less economic stimulus from the Federal Reserve if unemployment subsides to less than 7 percent, economic growth measured by GDP increases to 2.5 percent, and inflation is above 2 percent or increases rapidly. If all three were to occur, interest rates would increase, which is a key variable affecting profit and prosperity in American agriculture.

While the winds of economic change are blowing, some current trends in agriculture will continue. The youth movement with more young people, women, and minorities will bring new energy, critical thinking, and a sense of entrepreneurship to agriculture. The convergence of information, engineering and bio-technology is in full bloom on the American agricultural landscape. The retail entrepreneurial movement of local, natural, and organic agriculture, which links to consumer niche markets and segments, is alive and well. A disconnect between the general public and agriculture will continue with a more urbanized nation and public officials, which requires the agriculture industry to work together to demonstrate the importance of agriculture to the economy, public, and society.

The bottom line is that the winds of economic change will be very unpredictable in their severity and duration. The great commodity super cycle is moderating which may cause average and below average managers to struggle. It will be imperative to schedule periodic meetings with your lender or farm management educators to assess operations, risk management, financial management, marketing strategies, and execution. One Nebraska banker recently stated that producers are often like a deer in headlights with the impending economic Alberta clipper, and they just "lock up." Being proactive in planning and execution with goal setting and focus will be critical regardless of the industry for economic viability and sustainability.