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It Is What It Is!
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Welcome back to the farm management newsletter for the fall and winter season. As with previous years, the first newsletter will examine some of the macro-economic forces that will impact agriculture and producers' business plans. In this article, we will take a "low beam" approach for 2018 and 2019. In later articles, we will use the "high beam" approach to examine major megatrends that will impact the future of the agricultural landscape from 2020 to 2030.

This past summer, I visited my home region of upstate New York to address lenders and producers. After attentively listening, two of the participants indicated that my comments, while not all doom and gloom, were rather solemn. My response was that it is not my role to sugarcoat the economics and it is what it is.

International trade is the 800-pound gorilla for agriculture and some other components of the general economy. The agriculture industry is at the "point of the spear" taking much of the brunt of the trade negotiation strategies. After months of uncertainty, the new trade agreement known as the United States-Mexico-Canada Agreement (USMCA) is set to replace the old NAFTA agreement. Canada and Mexico are our largest and third largest trading partners, respectively, with over $40 billion of agricultural trade, so this is a very important step in international trade. The unfortunate point is that renegotiation was needed. The timing and how the trade negotiations were handled has hindered the United States' long term image concerning reliability and trust.

Public perception of these trade agreements can be interesting. I spoke with some urban consumers at our creamery's 10th annual farm day in October, which had over 9,000 visitors. A gentleman from Miami, Florida, and his family indicated that the dairy industry had received a big boost with the new trade deal with Canada. My response was that U.S. dairy farmers produce more milk in 33 days than Canada produces in one year. Secondly, the agreement with Canada only amounts to an estimated $70 million dollars in net additional benefit over the Trans-Pacific Partnership agreement for the dairy industry and will have little impact on milk prices. One can quickly see how news headlines and mainstream media can distort the public's perspective. The passage of USMCA in 2019 will need to be high on every producer's radar screen.

The administration's strategy for international trade is quite clear. First, close a deal with Mexico and Canada. In the next few months, watch for trade agreements with Japan and Europe. If these agreements are accomplished, then the focus will be on a trade deal with China.

Speaking of China, they are planning for a long-term future that could impact the competitiveness of U.S. producers. Strategically, the second largest economy in the world wants to increase trade to most of Asia, Eastern Europe, and the Southern Hemisphere. China's Belt and Road or Silk Road Initiative is a long-term infrastructure project with as much as one trillion dollars earmarked in the coming decade. This ambitious initiative is taking a page out of the Marshall Plan, which helped reconstruct Europe and Asia post-World War II. While the U.S. invested approximately $120 billion in today's dollars, China has already invested over $150 billion in 68 countries along the ancient Silk Road that linked China with the rest of the globe. This is one example of what the agriculture industry needs to monitor from a competitive standpoint.

The agriculture industry is now in the sixth, going on seventh year, of razor thin margins with extreme volatility. It could be possible that the "old normal" will be the "new normal." Economically, this "new normal" would be similar to the years leading up the great commodity super cycle.

From a macro-economic standpoint, farmland values have been the saving grace for the agricultural economy. According to the latest USDA ERS figures, farmland represents $2.8 trillion of the $3.5 trillion U.S. farm balance sheet. With this segment being over 80 percent of the balance sheet, very close attention must be given to land value dynamics.

Some of the reactive or indifferent managers are now on their third refinance or debt restructure. This means that short-term losses have been converted to long-term debt. This strategy increases debt service requirements and can hinder cash flow and profits in the long run if no adjustments have been made to management. How many more times can these reactive managers go to the equity well without destroying wealth on the balance sheet? In the upcoming loan renewal season, expect lenders and regulators to be much more judicious regarding refinances.

To compound variables, watch for interest rate increases and the subsequent impact on cash flows. This will be a major focus for those with debt on variable interest rates. I posed the following question to a Federal Reserve official sitting on the Federal Open Market Committee, "How does the agriculture industry impact your negotiations when setting interest rates?" The blunt, very simple answer was, "Not much." Agriculture is only one to two percent of the population and interest rates are mostly determined by the urban, suburban, and coastal populations.

If unemployment remains in the high three to low four percent range and inflation increases to three percent or greater, higher interest rates are imminent. The growth of the gross domestic product (GDP) and the level of consumer sentiment will both be secondary factors to consider regarding future interest rate hikes. Farm management instructors, lenders, and producers reading this column can use this data to predict how many interest rate hikes we might have in the future. It looks like three interest rate hikes at 25 basis points each could be a high probability in 2019.

Amongst all the uncertainty, risk management will be critical for both lenders and producers. On the producer side of the equation, strategic marketing will be a focus. For a lender, an increasing source of risk is third-party credit. Agribusiness people will need to keep a close eye on accounts receivable. Vendor and agribusiness financing, which has had the luxury of refinances when accounts go in arrears, may not be so fortunate in the future. Many lenders will put more focus on who is financing the operating costs of the farm and whether those funds will continue to be available in the long run.

Producers and lenders will need to monitor finances at least quarterly instead of only once per year. With more zeros and commas on the balance sheets and income statements, bigger numbers mean that a business can go upside down very quickly.

The silver lining is that the best managers adjust in difficult times. Producers, lenders, and farm management instructors must maintain open lines of communication. The business plan will have to be adjusted as “game” conditions change.

Unfortunately, sometimes the sound advice may be to preserve equity. Perhaps this may require a partial or total liquidation. If this is the case, remember that your self-worth and your net worth are not related. There are many facets of life that are very important, and you have talents and skills that will allow you to make valuable contributions regardless of the status of your business.

Yes, it is what is. The reigning profits from 2004 to 2012 have only occurred three other times in 100 years; those times are unlikely to come back. Today’s agricultural producers with a high business IQ and a proactive management mindset are in position not only to sustain but prosper through any economic cycle.