The State of the Agricultural Economy: Positioning for Future Success

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The State of the Agricultural Economy

Short-run:
The Farm Boom is Over

Long-run:
9+ Billion People
Burgeoning Middle Class

Real Net Farm Income
(Billions of 2009 constant dollars)
Minnesota Land Values are Sliding

Minnesota Non-irrigated Farmland Values

Percent change from previous year

Source: Federal Reserve Bank of Minneapolis
Positioning Ag for Future Success

Will world populations and income rise as expected?

Will global farm demand create its own supply?

What is the future path of interest rates?

Can Agriculture Feed and Fuel the World?

Are the necessary resources available?

How ag production costs adjust?
Does Agriculture Face Interest Rate Risk?

- Will the Federal Reserve raise rates today?
- In the long run, normalization would add 3 to 4 basis points to interest rates?
- How would a 3 to 4 percent increase in rates affect the financial health of your business?

Appropriate Pace of Policy Firming:
Fed Funds Rate

[Diagram showing appropriate pace of policy firming: Midpoint of target range or target level for the federal funds rate, with data points indicating changes over time.]
Today’s Challenge: Shrinking the Balance Sheet

Federal Reserve System Balance Sheet: Assets

Source: Federal Reserve Bank of Cleveland
What Drives Interest Rates Higher?

Too much money chasing too few goods
Inflation and GDP Growth will Shape Agriculture

- Potential GDP
  - Population
    How many people?
  - Labor Force Participation
    How many work?
  - Productivity
    How well do they work?

Source: Congressional Budget Office
What Forces Shape Inflation?

- **Demand-pull**
  - Stronger demand pulls up consumer prices

- **Cost-push**
  - Rising input costs drive up consumer prices

Technology

Demographics
Demographics

Of all external changes, demographics — defined as changes in population, its size, age structure, composition, employment, educational status, and income — are the clearest. They are unambiguous. They have the most predictable consequences. ...... They have a major impact on what will be bought, by whom, and in what quantities.”
Peter Drucker, *Innovation and Entrepreneurship*, 1985 (p 88 and p 89)
Demographics Drive the Future

U.S. Population Growth

Percent change per year

-1.00 0.00 1.00 2.00 3.00 4.00


25 to 44 year olds 45 to 64 year olds 65 years or over
Demographic Crosswinds

• What happens to consumer spending as millennials reach adulthood?
• How much money do baby boomers leave for their heirs?
• What happens to wages as boomers retire?

Calculations based on St. Louis Federal Reserve data
Technology has Always Affected Agriculture.

Minnesota Corn Production

Bushels per acre

Source: USDA
How will Technologies Shape Inflation?

U.S. Energy Prices

Source: Dept. of Energy
How does Agriculture Finance Itself for the Future?

• Low inflationary pressure through 2017
• Historically low interest rates through 2017

But ...

• Inflation and interest rates will begin to rise.
• How will agriculture respond to thinner profits?
The Stages of Farm Investment

- Land Investments
- Equipment Investments
- Lifestyle Investments
Farm equipment sales begin to fall, but remain historically high.

Through May 2015, combine sales are down 39% and tractor sales plummeted 47% below 2014 levels.

U.S. Tractor and Combine Sales

Thousands of Unit Sales

Source: Association of Equipment Manufacturers
* Estimated based on sales through May 2015
Family Living Expenses Have Increased Substantially

Source: Compiled from Kansas Farm Management Association Executive Summaries
What is the Future of Farm Finances?

Credit Conditions in Tenth Federal Reserve District

Source: Federal Reserve Bank of Kansas City
What is the Impact of Higher Interest Rates?

• Farmer impacts
  – Lower incomes
  – Eroding collateral
  – Higher debt service
  – Desire for fixed interest rates

• Agricultural Financing impacts
  – Will investors stick with agriculture?
  – How do commercial banks and vendor credits respond?
How Can Agriculture Respond?

1) Lock in low rates on existing debt
2) Build working capital (cash)
3) Evaluate commodity marketing plans
4) Drive efficiency in their operations
5) Focus on productivity when making investments
The State of the Agricultural Economy

Short-run:
The Farm Boom is Over
Low Interest Rates
Low Inflation

Long-run:
9+ Billion People
Higher Inflation
Higher Interest Rates

The Transition is Key:
How does agriculture respond if inflation moves faster than interest rates?
Conclusion

• The agricultural landscape is changing.
• *The next decade will be different than the previous decade*

• But ...

• The fundamental drivers do not really change: demographics, technology, interest rates, exchange rates, energy ...

• Its just that they are never constant and continuously evolve and agriculture’s success depends on evolving with them.