

AGSIGHT: JULY, 2009
NEVIL C. SPEER, PHD, MBA (nevil.speer@wku.edu)
WESTERN KENTUCKY UNIVERSITY

Mid-year always serves as an opportune time to take inventory of the previous six months; that's especially true in 2009 amidst current economic uncertainty. I noted in January's Monthly Market Profile that, "The coming year will likely prove to be...marked by variations on [last year's] themes. Namely, it will be year defined by revenue, volatility and policy." Clearly, those themes have proven enduring and played out in an important way during the past six months. It's unmanageable to tackle all those issues in a thousand words or less so I'm opting to focus on an all-encompassing theme: uncertainty.

Per that theme the financial crisis remains the primary issue to reckon with and possesses some important implications upon agriculture. On one hand, it seems we're making progress. For example, compare survey results in the table below from several prominent sources – note the improved outlook in recent months). On the other hand, it's a long, complicated journey as witnessed by July's job report. Economic slowdown continues to erode the job market – job losses actually accelerated in June, despite promises of government stimulus and well ahead of expectations; the culmination being unemployment is now pegged at 9.5%.

Regardless of how deep the trough or how delayed reversal might be this recession differs from previous slowdowns in several key ways. As discussed last month, the outcome will be some type of "new normal" going forward. Most important among the aftershock, though, is the enduring effect of changing consumer behavior; at the very core we're witnessing deleveraging at the consumer level. I included this anecdotal observation by Edmund Andrews in last month's AgSight; Andrews was responding to the question about the recent savings trend and whether it would prove enduring: "...any inconvenience from not spending money is minor, is trivial, compared to the agony and the anxiety of constantly being in debt that you do not know how you're going to repay. Once you've been through that, believe me, you don't want to go back." Therefore, the economy won't be able to depend upon the consumer, responsible for 70% of economic activity, to drive recovery – the consumer is busy shoring up his personal balance sheet.

Along those lines, Eric Janszen (iTulip.com) makes this observation about consumers and their subsequent use of credit ([Harvard Business Review](#), July/August, 2009):

To win over newly tightfisted, debt-averse consumers, companies will need to follow the path of firms that succeeded in previous downturns by promoting value and utility over luxury and brand...The Federal Reserve wants to reinflate the credit bubble and engineer a return to the old days. But that isn't possible. When a nation's businesses and households take on too much debt and the economy stumbles, the cash flow needed for financing dries up, defaults rise, and a vicious cycle of falling incomes, asset prices, and collateral values begins. That cycle ends only when asset prices, debt levels, and incomes get back into balance. Misuse of consumer credit is gone for good.

Along those lines, I noted in April's AgSight that consumer spending is often based upon how we "feel" – it's not always a rational decision (for even more on this issue read the newly-published [Animal Spirits](#) by Akerlof and Shiller, c. 2009).

What's really important here is the application. The outcome of all this discussion is a potentially important legacy effect upon consumer spending and secondarily upon investment strategies. First, shifting consumer spending habits will impact the food industry. Rabobank addresses those issues in a new report (June 17):

Moving forward, consumers are starting to replace some of that lost wealth by increasing their savings, and some of this increase in savings is often cited in one of the causes in the dip in consumer spending...Even an improvement in the economy may bring back consumer confidence, but I [Rabobank's Food & Agribusiness Research and Advisory

(FAR) Executive Director Stephen Rannekleiv] don't think ... a strong level of consumer confidence (will) bring back some of those spending patterns prior to this recession... consumers have changed...Food and beverage companies need to be prepared for more frugality from consumers.

Second, alteration in credit availability and risk evaluation may potentially impact asset valuation. That has consequences for all types of capital assets including equipment, facilities and most importantly, farm real estate. (Not to mention the challenges of valuation given increasing difficulty in forecasting realistic cash flow streams with recent volatility of inputs and grain prices.) Bill Gross, PIMCO Managing Director, explains it like this in his July Investment Outlook newsletter:

Investors who stuffed themselves on a constant diet of asset appreciation for the past quarter-century will now be enclosed in a cage featuring government-mandated, consumer-oriented fasting...Because this is so, short-term policy rates will be kept low for longer than cyclical norms, and the outlook for risk assets – stocks, high yield bonds, and commercial and residential real estate will involve just that – risk.

Admittedly, all of this discussion can seem abstract and theoretical – it’s tough to get a handle on all of the various facets at play. So what’s the take-home message? It goes without saying...we’re in the middle of significant change with even more transformation pending on the horizon. Comparatively, agriculture is in a favorable position but uncertainty still encompasses every sector with no faction being completely buffered from its influence. The most real-time impact has been seen within the credit market: lending requirements are becoming increasingly more stringent and the chasm is widening between entities able to secure credit versus those which cannot.

Most importantly, it all speaks to the importance of thinking differently; success will be dictated by the ability to constantly analyze, assess and strategize. What are the opportunities today? Where will they be tomorrow? Regardless of your position within agriculture the mandate to constantly monitor and interpret news and market developments has never been more important. There’s very little stability in the foreseeable future and every possible contingency needs to be accounted for. That can be a daunting message. There’s good news, though, on the other side: turbulence and shifting conditions also establishes new opportunities for those who remain forward-thinking and versatile and position themselves accordingly.

	American Securitization Forum, Deutsche Bank (February 2009): <i>When will the economy return to ‘normal’ mortgage and consumer asset securitization?</i>	Harvard Business Review Reader Survey (July/August, 2009): <i>When will the U.S. emerge from the current economic downturn?</i>
2009	0.2%	10%
2010	26.5%	71%
2011 or later	57.4%	19%
Beyond 2012 or never	15.9%	