Economic Conditions: Cautiously Optimistic for a Soft Recovery
Today’s Roadmap

- The Economic Recovery is Underway
- Concerns Shift from Growth to Inflation
- Implications for Agriculture
The U.S. economy is projected to rebound in 2010.

Real GDP Growth

Annual percent change

Source: Bureau of Economic Analysis Federal Reserve Board of Governors
Midwest economies are in better shape.

Unemployment Rate
2007 Monthly Average

Source: Bureau of Labor Statistics
Midwest economies are in better shape.

Unemployment Rate
January 2010
(12 month average)

Source: Bureau of Labor Statistics
U.S. consumers are starting to spend money.

U.S. Monthly Retail and Food Sales

Billion dollars

2007
2008
2009
2010

Source: U.S. Census Bureau
Have U.S. housing markets hit bottom?

U.S. Housing Markets

Source: U.S. Census Bureau
Business activity is expanding.

U.S. Manufacturing Activity Indices

Index


Source: Institute of Supply Management
Corporate profits and business investment are beginning to rebound.

Corporate Profits and Nonresidential Fixed Investment

Percent change from year ago

Source: Bureau of Economic Analysis
After dramatic improvements since 2007, U.S. net exports have stabilized.

U.S. Real Net Exports of Goods and Services and Value of the Dollar

Source: Bureau of Economic Analysis and Federal Reserve Board of Governors
In the short run, deficit spending is an economic stimulus.

U.S. Government Outlays

Source: Congressional Budget Office, March 2010
Today’s Roadmap

- The Economic Recovery is Underway
- Concerns Shift from Growth to Inflation
Inflation is based on money and velocity.

**Quantity Theory of Money**

\[
\text{Price} = \frac{\text{Money} \times \text{Velocity}}{\text{Quantity}}
\]

**Definition of Inflation:**

Too much money \( M \uparrow \)

chasing \( V \uparrow \)

too few goods \( Q \downarrow \)
The Fed has increased the monetary base. But, the bulk of it is in excess reserves.

Federal Reserve Balance Sheet: Assets

Billion Dollars

- Fed Agency Debt MBS Purchases
- Liquidity to Key Credit Markets
- Lending to Financial Institutions
- Long Term Treasury Purchases
- Traditional Security Holdings

Source: Federal Reserve Bank of Cleveland
How will the Federal Reserve shrink its balance sheet with Agency and MBS debt?

- Hold to maturity
- Sell assets
- Keep reserves on deposit at the Fed.
  - Interest on excess reserves
  - Reverse repurchase agreements
  - Term deposits
- All strategies lead to higher interest rates.
  - When?
  - How fast?
Labor markets are key to “chasing” and inflation.

Nonfarm Employment Change and Unemployment Rate

Net Change in Employment (Left Scale)
Unemployment Rate (Right Scale)

Source: Bureau of Labor Statistics
Implications for Agriculture

• U.S. consumer demand
How strong will U.S. food spending rebound?

U.S. Food Expenditures

Percent change from previous year

Source: USDA
Implications for Agriculture

- U.S. consumer demand
- Export activity
Stronger economic growth is expected through 2011.

GDP Growth

Source: IMF, January 2010
Can agricultural exports rebound to 2008 record highs?

U.S. Agricultural Exports

Billion dollars

Source: USDA
How will the types of food exports change?

Households Owning a Refrigerator

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Source: USDA, Euromonitor

Households Owning a Microwave Oven

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Source: USDA, Euromonitor
Implications for Agriculture

- U.S. consumer demand
- Export activity
- Energy markets
What will happen to crude oil prices if consumption outpaces production?

World Crude Oil Supply Balance

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<thead>
<tr>
<th>Year</th>
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</table>

Source: Energy Information Administration

Forecast: May 2010
Energy markets: A boon or bane for agriculture?

Crude Oil and Natural Gas Prices

Source: Energy Information Administration
Implications for Agriculture

- U.S. consumer demand
- Export activity
- Energy markets
- Farmland values
Is a farmland bubble brewing?

Farmland Values to Rent Ratio

- Iowa Farmland Value to Rent
- East NE Irrigated Cropland Value to Rent
- S&P PE Ratio (Average since 1945)

Calculations based on Iowa State University and University of Nebraska data
To identify a bubble, follow the debt.

U.S. Debt Repayment Capacity Utilization

Source: USDA
Implications for Agriculture

- U.S. consumer demand
- Export activity
- Energy markets
- Farmland values
- Government policy
How will surging federal debt levels affect farm policy?

U.S. Debt as a Percent of GDP

Source: Congressional Budget Office, November 2009
Conclusions

- The economic recovery is underway.
  - Stronger consumer demand is boosting business activity.
  - But, deleveraging will limit the recovery.
- Questions will switch from growth to inflation.
  - Will high unemployment limit inflation?
  - What will start the “chasing”?
- The recovery brings opportunities and risks to the farm sector.