An Economic Report Card for the U.S. Economy and Agriculture
2016 Mid-Year Report
By
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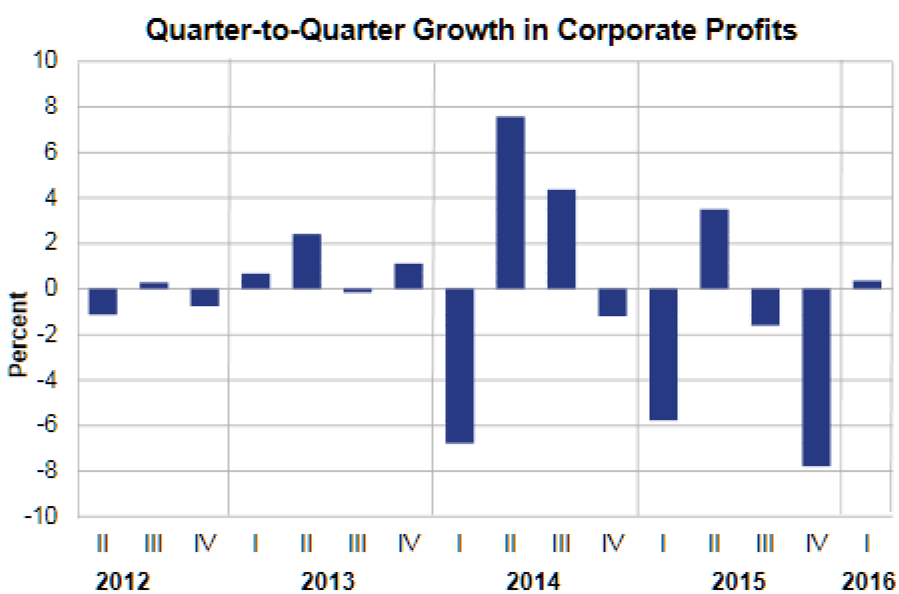
Joining forces once again, Dr. Ed Seifried and Dr. Dave Kohl provide insights on United States and global economies as well as that of general agriculture and rural America.

Grading the Macro Economy

The Economy and the Gross Domestic Product: Grade: "C"

The first quarter economic performance of 2016 was disappointing. GDP growth was 1.1 percent for the quarter. In the fourth quarter of 2015, real GDP increased 1.4 percent. The 2016(I) GDP represents a sharp drop from the results for calendar year 2015 when real GDP increased at a 2.4 percent annual rate. The Bureau of Economic Analysis (BEA) reported that the decline in GDP growth in the first quarter of 2016 primarily reflected positive contributions from personal consumption expenditures (PCE), residential fixed investment, and state and local government spending. The report was partially offset by negative contributions from non-residential fixed investment, exports, private inventory investment, and federal government spending. Imports, which are a subtraction in the calculation of GDP, decreased.

The graph below shows the most recent quarterly GDP results.

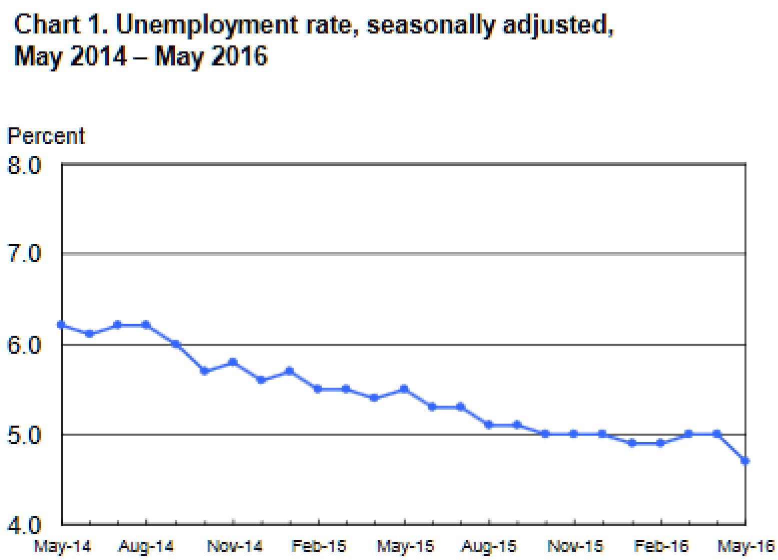


Source: Bureau of Economic Analysis

If it were not for relatively robust consumer spending the first quarter, GDP results would have been much worse. The BEA noted real personal consumption increased 1.29 percent in the first quarter. The BEA reported that the first quarter increase in real GDP was more than accounted for by an increase in consumer spending on services. Spending on household services increased; notably on housing, utilities and health care. Consumer spending on non-durable goods also increased; notably on food and beverage grocery items, gas and other energy goods. However, consumer spending on durables fell, especially on motor vehicles and parts. Residential investment and state and local government spending also rose in the first quarter.

The Labor Market - Unemployment Rate and Job Creation: Grade: C-

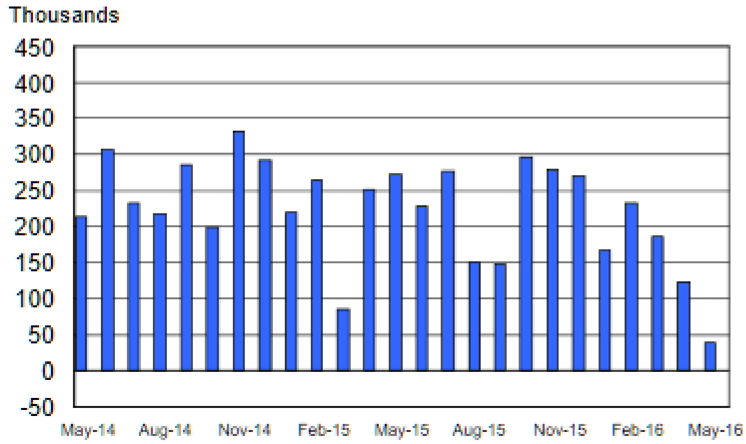
The unemployment rate has been relatively stable the first two quarters of 2016, with a relatively sharp drop in May. The unemployment rate increased from 4.9 percent to 5.0 percent in April, only to drop to 4.7 percent in May of 2016.



Source: Bureau of Labor Statistics

The record on job creation is disconcerting. Job creation for the first four months of 2016 has been relatively impressive. Yet, the markets were shocked when the figures were released for May of 2016. The economy created only 38,000 new jobs in May, one of the lowest months in years. The graph below provides the record of the economy's ability to generate job growth so far in 2016.

Chart 2. Nonfarm payroll employment over-the-month change, seasonally adjusted, May 2014 – May 2016

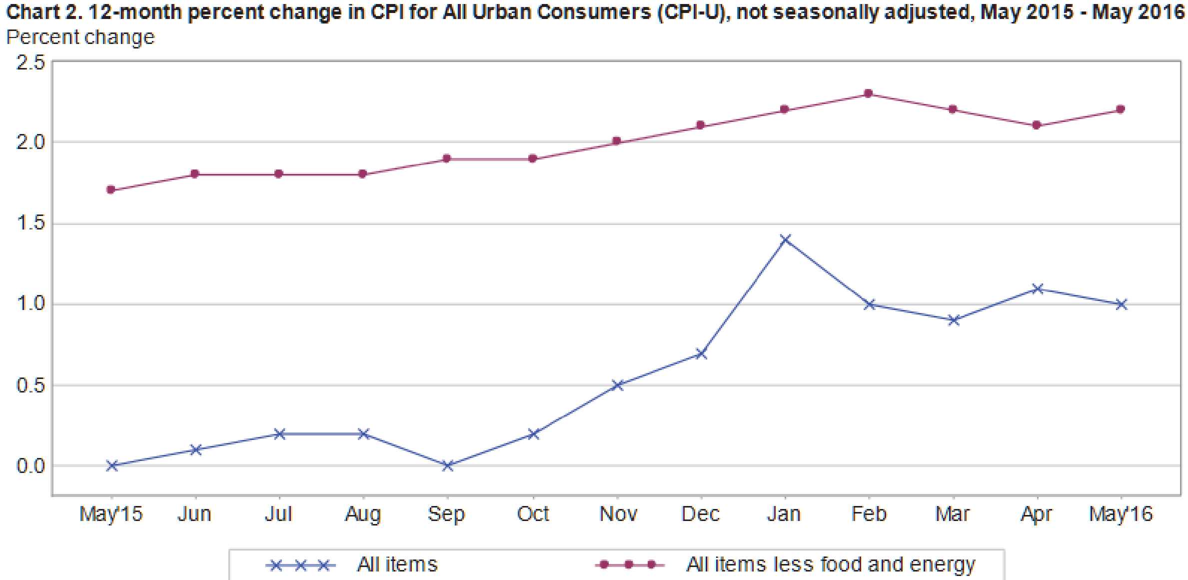


Source: Bureau of Labor Statistics

The Inflation Record: Grade: A+

The record on inflation is perhaps the best news in the first two quarters of 2016. Price increases in all items less food and energy (core inflation) have ranged from a low of 2.1 percent (LTM) in April 2016 to a high of 2.3 percent (LTM) in February 2016. The Consumer Price Index (CPI) for all products is lower than the core inflation estimate. The CPI index has ranged from a low of 0.9 percent (LTM) in March 2016 to a high of 1.4 percent (LTM) in January 2016. The chart below shows the stability of prices in 2015-2016.

Chart 2. 12-month percent change in CPI for All Urban Consumers (CPI-U), not seasonally adjusted, May 2015 - May 2016



Source: Bureau of Labor Statistics

<u>2016 Mid-Year Global Agricultural Economic Report Card</u>

The Halftime Report

It is almost hard to believe how rapidly the year 2016 is progressing! Connecting the dots between my discussion with producers, lenders and agribusinesses, it seems the majority of agriculture and rural areas are in a recession. As a backdrop to the mid-year analysis, there are several factors and observations to examine.

First, a majority of commodities are in an economic reset. The only current exceptions are vegetable and specialty crops, particularly almonds, due to their high global demand. Lenders report that the refinancing requests of operating debt to longer-term debt were extremely prevalent this renewal season. Often, land was used as collateral in refinancing requests. Some call this debt restructuring; however, it is perhaps better named as equity restructuring. Specifically, that is taking equity from the bottom half of the balance sheet to provide financial liquidity for the current assets section and short-term needs. Producers have already passed through one round of refinancing and restructuring for the economic reset. However, if commodity prices remain suppressed, the next three to four years may present more difficult financial conditions due to increased regulatory oversight.

Another factor impacting agriculture and rural areas is the cost of energy and oil. States invested in the growth of the oil shale industry are now experiencing major economic contraction in this sector. Of course, this impacts rural economic growth as well as liquidity due to losses in agriculture and rural areas.

Many producers with land equity demonstrate strong balance sheets. However, in some cases, this creates denial, complacency or even a sense of indestructible finances. As land values start to decline in many agricultural areas, an emphasis on profits and cash flow are imperative. If producers do not focus on strategies to improve both profits and cash flow, the result will be considerable equity drain.

The major factors that drove the economic super cycle are of course, waning. One of those driving factors was the increased demand from emerging nations. Today, that demand is tepid at best. In fact, indicators and data suggest a reversal in the demand trend is not expected anytime soon.

Today, ethanol is a maturing industry. There has been some consolidation but the well-managed businesses are still sustaining levels of profit. Oil prices will most likely settle in the $50 to $70 range per barrel unless a major, unusual event should occur, either domestically or abroad.

In many places, Central Banks continue to utilize currency valuation as a means to spur economic activity. The strength of the U.S. dollar is definitely a headwind for many commodities, manufacturing businesses and rural areas. The dollar's continued strength suppresses demand internationally, but also increases imports, which creates more competition for American companies.

Overall, agriculture has two particular stress points: young and beginning producers, and larger, aggressively growth-oriented producers. Those producers that entered agriculture in recent years must focus on ways to stay sustainable. The other group will face serious issues of financial liquidity. In both cases, producers must be proactive in order to successfully navigate the economic reset.

A silver lining is the reduction of some input costs such as cash rents, equipment, fuel and fertilizer. Realistically, unless there is a major weather aberration that significantly increases commodity prices, cost efficiencies must be the top priority over the next three years.

For proactive producers, the midterm grade is B+.
For the businesses lacking a revised strategy and practicing denial, the grade is D-.
Focus and discipline are the tools to earn a passing grade for the rest of the year!

Special Report on "Brexit" Vote

Since the time this midterm review was originally written, Great Britain voted to exit the European Union which necessitates mention here.

First, was this a surprise? Two days before the vote, I was in Spearfish, South Dakota at a banking school where I told a banker the "Brexit" was unlikely. Then, on a red-eye flight to Denver, the news of the British vote was reported at 3:00 a.m. EST. I was surprised; and I believe this may be the beginning of major political discontent worldwide. There is such extensive unrest in many population segments against large government and institutions. The emotional explosion through social media can certainly accelerate the situation. Politically, as well as economically, this could be very volatile summer and fall throughout the world.

Next, does the British exit from the European Union matter? Well, first it weakens the euro and positions the dollar to be a safe-haven currency. Of course, a strong dollar continues to be a headwind to U.S. exports. Massive inventories of agricultural commodities, a strong dollar and weakened global demand are negative indicators for U.S. agriculture, energy and manufacturing industries.

Collectively, the economies of Europe are actually larger than the U.S. economy. This area of the world is important to international trade such as, China to Europe and the U.S. to Europe. The shockwaves of the "Brexit" will most likely place Great Britain in recession sometime in 2017. It is also likely to lower the GDP by up to 1 percent in the European region, where economies are already struggling,. This decline could in turn, shave one-half percent off the global economic growth.

Next, the "Brexit" vote could become quite a process or something like a soap opera. One decision will lead to more discussion with drama and emotions running high. It will take considerable time to re-write regulations, policy and trade agreements. No doubt, the world will watch each turn with interest. Maintain a close eye on Scotland and nations in the European Union as talks continue. A total breakup of the European Union would be a major shock to a fragile world economy. Additionally, it will be interesting to watch how this situation impacts the immigration strategy in this area of the world and globally.

In the U.S., it is likely that policies will trend more conservatively regarding international trade and immigration reform. The Trans-Pacific Partnership (TPP) will be a forefront issue in debates. This outcome of this agreement will have major implications for U.S. agriculture, particularly the West Coast states.

Another variable to watch is the world equity markets. If markets continue to decline, this would create a wealth effect in reverse. Specifically, that is when the value of stocks, equities and other assets decline, causing investments and spending to decline as well. With much of the wealth held by the senior demographic, this could potentially be devastating; changing the spending and investment patterns of seniors and others who then become more financially conservative.

Finally, this political tsunami is quite out of the Central Banks' control. Stimulus policies of the past have limited available options. As a result, the world is starting to see the true impact of political dysfunction in rich nations across the globe. This is a classic 50 to 75 year cycle where economics and technology change the political arena. Consequently, this cycle creates uncertainty, challenges and a re-shaping of economic and political landscapes.

In summary, welcome to the wild world of global economics and politics complete with advanced technologies and constant information! This environment will create havoc and mayhem; but more importantly, opportunities for those who plan, execute and monitor.