

**An Economic Report Card for the U.S. Economy and Agriculture
2016 Mid-Year Report**

By

Dr. Edmond J. Seifried and Dr. David M. Kohl

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.

The US Economy: Final Grade Report for 2016

By

Dr. Edmond J Seifried

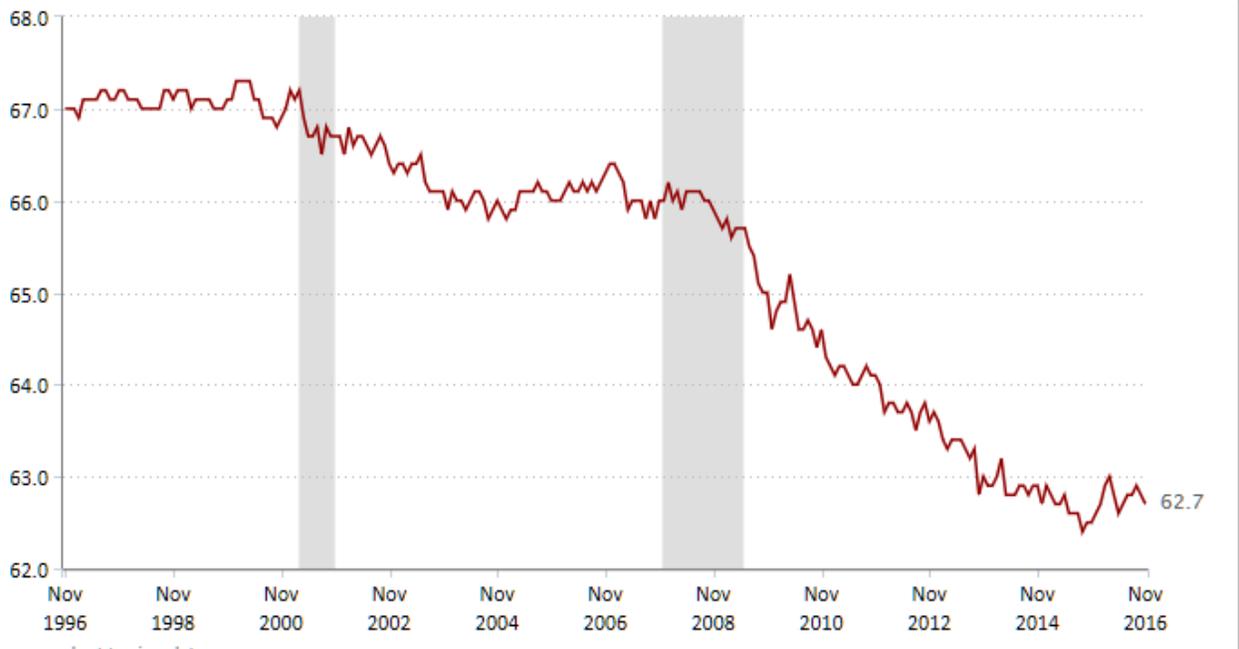
The academic year of 2016 has revealed an economic performance that in certain instances has been steady and strong; in other sectors, uncertain and volatile. This final report card for 2016 will concentrate on two areas of measurable performance. We will review the performance of the labor market using various measures including the Gross Domestic Product (GDP) or economic output.

Unemployment, Labor Force Participation, and Job Growth

Grade B

The unemployment rate in January of 2016 stood at 4.9 percent, and the latest data release for November 2016 reports the rate to be 4.6 percent. Most experts would argue that the unemployment rate is very close to what is frequently called the full-employment rate or natural rate. The policy making body of the Federal Reserve, the FOMC, does not announce an unemployment rate goal for full employment or the natural rate. However, the FOMC does provide a quarterly forecast for the longer-run normal levels of unemployment, or the natural rate. The latest FOMC forecast from December 2016 indicates that the natural rate is 4.8 percent. This is very close to the current unemployment rate of 4.6 percent. It doesn't look like we can expect this rate to fall very much in 2017. In 2016, job growth was 180,000 per month, which is good, but not as strong as 2015. New job growth in 2015 averaged approximately 229,000 per month. Labor Force Participation Rate continued its steady decline in 2016. The chart below captures the bad news.

Civilian labor force participation rate, seasonally adjusted

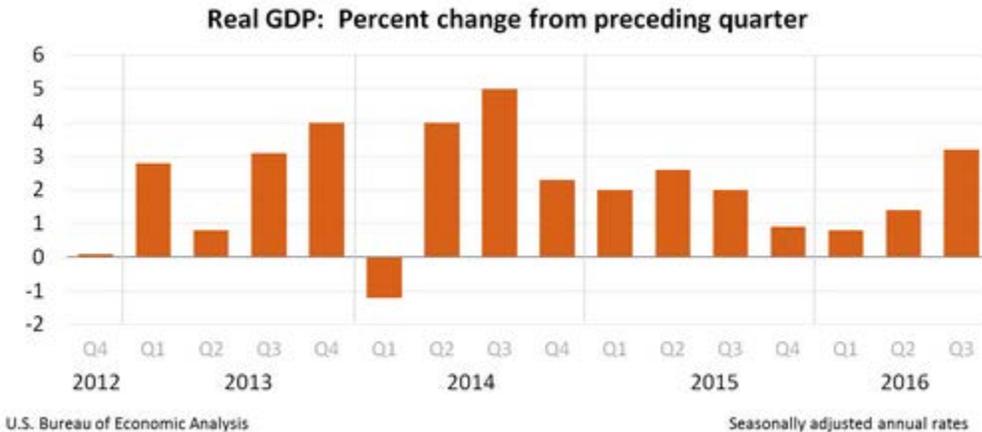


Source: Bureau of Labor Statistics

GDP Grade: B-

The Bureau of Economic Analysis (BEA) defines Real Gross Domestic Product (GDP) as the value of the goods and services produced by the nation’s economy less the value of the goods and services used up in production, adjusted for inflation. GDP is also equal to the sum of personal consumption expenditures, gross private domestic investment, net exports of goods and services, and government consumption expenditures and gross investment.

The GDP performance for the first two quarters of 2016 was poor. The economy grew at a rate of only 0.4 percent in the first quarter, and an improved, but still very weak 1.4 percent, in the second quarter. At this writing, the third quarter GDP growth rate is 3.2 percent. Please note the quarterly GDP growth rates are released in three estimates: an advanced estimate, or the first estimate, followed by a revised second estimate, and then the final or third estimate. The current rate of 3.2 percent is the second of three estimates and may be revised in the final estimate. Clearly if the current growth rate of 3.2 percent holds up, the third quarter results would be very impressive and represent a sharp improvement over the first six months of 2016. The table below shows the recent record of GDP growth.



Final Grade
By
Dr. David M. Kohl

The agricultural classroom has completed another year. Today's world of agricultural economics is defined by a surplus of most commodities, strong dollar and weakened exports, cooperative worldwide weather and production, and economic stress. Through my travel, networking, presentations and participation in numerous events, I witnessed the dynamics and shifts in different sectors of the industry. Let's examine the individual components and variables that left their mark on the financial statements of agricultural businesses.

Most commodities are in the third year of an economic reset. Analogous to a baseball game, innings one through three of the reset impacted cash flows and profits. Now, many producers are in the fourth through seventh innings burning through working capital or core equity. Of course, for some, liquid assets are not available and the only remaining equity is in land.

The grain industry had an advance of two years in the economic downturn. Now, the livestock industry also faces suppressed prices ranging from livestock to dairy. In fact, it appears that the beef industry may be in for another two years of lower prices. The financial fortunes of the dairy industry are still uncertain at best. In addition to production, the agricultural suppliers, and machinery dealerships are also impacted by the economic reset. As an example, new equipment sales are down 20 to 30 percent. Consolidations are increasing in many sectors, which of course, bare weight on interconnected rural businesses and towns.

Interestingly, analysis of University of Minnesota's FINBIN data shows that the top half of producers are still squeezing out a profit. Strong yields and production, selective cost controls, disciplined marketing and risk management practices, and in some cases, government payments have preserved a level of profit for many of these farms and ranches.

Some farm businesses with negative margins are not covering total costs (fixed and variable), but are covering only the variable costs. A well-tested economic guideline is when short-term variable costs are no longer manageable, it is time for drastic action. Basically, the options are to either discontinue production, or take extreme measures to stop the financial bleed of the business.

Next, I continue to observe that those managers and businesses committed to the execution of a marketing and risk management plan are making money. According to University of Minnesota's Center for Farm Financial Management, larger operations able to market corn for an additional \$0.15 per bushel, and soybeans for an additional \$0.77 per bushel, were able to add approximately \$85,000 in net income for the operation. This is a great demonstration of planned, incremental profit that really paid off. In short, those managers that plan and strategize, but then, execute and monitor are more likely to retain profitable and sustainable businesses.

Yes, in my travels I talk with some business owners that are losing significant amounts of money. The reasons for loss are various, but in most cases, growth or high-priced rented land play a large part. With tight cash flows and reduced balance sheet equity, these operations will face careful scrutiny in the coming loan renewal season. The key for these operations is preparation. A lender that receives accurate and complete financial information as well as a plan of action will be much more useful for the producer.

At least for the time, farmland values appear to be holding. In some sectors of the Midwest region of the country, land values are down 10 to 20 percent. Land values in the Coastal regions and in the Southern region are generally maintaining their strength. Crop insurance, interest by hedge funds, and high equity positions of farmers and ranchers have combined to provide resistance for further drops. The upcoming loan renewal season and the refinancing ability of farm businesses will be critical to the direction of farmland values.

Another issue in agriculture and rural America is the increase in land taxation. This impacts both landlords and renters in states that used additional income from the great commodity super cycle to build schools and infrastructure. Now, with suppressed commodity prices, this taxation has become a major burden to already squeezed margins.

In my conversations and financial analysis, the cost of healthcare continues to emerge. For many in agriculture and rural areas, premiums have skyrocketed. Some producers shared printouts of changes in their healthcare plans. Shared plans ranged annually in cost from \$20,000 to \$36,000 for a family of four. Other producers with high-deductible plans have seen some relief with premiums, but not much. One producer had a healthcare plan for his family of four and farmed approximately 3000 acres of row crops. He shared that it cost him \$0.14 cents per bushel of corn, or \$0.27 per bushel of soybeans and \$0.24 per bushel of wheat just to pay the premiums. When commodity prices were at their zenith, these types of costs were palatable. Today, however, these

medical insurance costs can amount up to 5 to 7 percent of the price per bushel for a given commodity. In addition, those with high-deductible plans must maintain excess financial liquidity for emergencies.

As the New Year begins, many accountants have advised producers to pre-pay expenses in order to defer taxes; citing lower future tax rates as a possibility. While this was a heated campaign issue for the new Administration, be cautious. If one does not take physical delivery of these goods, the pre-paid expense can become an unsecured line of credit. This could be extremely problematic if the agribusiness firm should unexpectedly file bankruptcy. In today's environment of economic stress, take care to assess the financial condition of agribusinesses from which you purchase pre-paid products.

As I encounter young people and managers in the expansion mode, it is clear that now is a good time to acquire assets. One young farmer told me that he purchased a good-condition forage harvester that is normally priced in the range of \$125,000, for \$28,000. Also capitalizing on the timing of the economic cycle, others are purchasing livestock and assets at discounted prices. In an industry driving toward economic efficiency, perhaps, now rather than five years ago, is the right time to start up, grow or expand your business. There's an old adage, "timing is everything in business" which seems to hold true.

As we move into 2017, proposals of the new Administration and Congress must be monitored closely. Policies on international trade and agreements, interest rates, immigration, taxation, and regulation, particularly, environmental and banking, will provide either a headwind or tailwind to certain agricultural sectors as well as those interrelated businesses. Opportunities and challenges in areas such as, organic, local, natural, GMO, food safety, and animal welfare will create a transitory time for the agriculture industry.

Regardless of national policies or other outside forces, an increased focus on financial and risk management will be required for a successful business. This type of efficiency and proactive management is the product of continual learning, use of advisory teams, and the ability to plan, strategize, execute and monitor your business. As the landscape of agriculture continues to change and evolve, the various outcomes of business will be interesting to watch.

The 2016 year-end grades for the agricultural sector are as follows:

For the below average manager, specifically, in management and finance, the grade would be a D or perhaps, F.

For the above average managers as measured by business performance, their grade is B+ with an A for effort!

The bottom line is a solid measure of performance. If a manager improved even 5 percent in areas like production, finance, or marketing and risk management, they should be placed on the honor roll.