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“New normal”: that term has been thrown around quite a bit in recent months. The predominant question within economic and financial disciplines is now, "What is (or will be) the new normal?" Indeed, that's an important question and has some important implications for all of us - as consumers, investors and traders. Moreover, it also leaves no industry untouched including agriculture. That theme that indirectly established last month's Agsight title, “Ag’s Trade Dependency, Price Volatility Dictate Need For Risk Management.”

For example, Art Kleiner (Editor-in-Chief) leads off the most recent issue of Strategy + Business (Summer '09) with the following question, “How Real is the New Normal?” Kleiner explains the outcome is really about the degree to which transformation occurs from the recent past. The financial crisis may ultimately possess both tangible and non-tangible effects that are difficult to discern. But the only thing that really matters is the outcome in terms of what the new business environment will look like in years to come. And clearly at this juncture there are no definitive answers.

Along those lines I like how Mohammed El-Arian (CEO, Pimco) states the case for risk management. He noted in March (Allianz Global Investors briefing, London) that, “We are in a crisis that will continue to move, we are going towards a new normal. While no one can tell you what it is going to look like, the balance between government and private sector is shifting in terms of owner control. You can no longer predict asset values without putting in the role of the government. It is no longer a referee but a referee and a player.” Perhaps most pertinent to agriculture is El-Arian’s observations about going forward: “...we are on a bumpy journey to the next situation...It is not enough to ask how to capture the upside but how to capture the upside while protecting the downside. There is recognition that to protect the downside you have to give up some of the upside.”

Agsight has previously emphasized the importance of understanding the role of price volatility, risk management and functioning of futures markets. The continued outlook for global economic uncertainty, currency fluctuations and politics coupled with agriculture’s heavy dependence upon international trade make attentiveness to the current transition phase more important than ever. That’s especially true when considering the capital-intensive nature of agriculture coupled with the inherent inability to control many factors out of our control – namely, weather.

Late-May was especially indicative of underlying volatility with a number of commodity prices working sharply higher. That surge represented an important reversal for commodity prices (see graph below). For instance, oil prices were beat back to \$30/bbl just this past January – the market has since passed the \$70 boundary. Meanwhile, the December corn contract fell below \$4.⁰⁰/bu in late-April; May’s closing value encroached \$4.60 and the contract is seemingly poised to work higher. Opinions vary widely about the fundamental drivers of the recent surge in commodities including improving economic prospects and shrinking global supply. Regardless, the outcome is the same.

Concomitant with last summer’s decline in commodity prices was a sharp rise in the U.S. dollar. The tables have turned...initially considered a global safe-haven in recent months, there’s now increasing worry among investors about the U.S. Treasury’s monetary policy. The upshot is new qualms about inflation and government’s ability to serve its mounting debt obligations. Those concerns have burdened the position of the U.S. dollar among currency traders. Inflationary concerns drive down the dollar while also spurring investment in commodities as a hedge against potential inflation. Global markets and heavy dependency upon trade make those developments especially important to agriculture.

This represents somewhat of a double-edged sword for producers. On one hand, improved prices means improved revenue opportunities. On the other hand, it also means uncertainty around input costs. Bottom-line, amidst change and turbulence, producers can find themselves getting squeezed - that is paying for inputs at the peak while being forced to sell at the bottom. Therefore, amidst the transition to some type of “new normal” (whatever that might be) producers must invest the time and effort to remain up-to-date, practice disciplined decision-making (on both the input and the marketing side) while utilizing all available risk management tools; it’s never been more important!!! So while producers might have proven themselves successful they cannot be impervious to shifting sands – competitive advantage is relatively short-lived in this environment.

One last observation that’s pertinent to the “new normal” within the U.S. economy. Edmund Andrews (economics/business correspondent with the NY Times) appeared on Bloomberg on the Economy (May 27) discussing his new book entitled, Busted. Andrews outlines his personal experience; his knowledge and expertise allowed him to understand the dysfunctional nature of the financial industry – there was no practicality of providing mortgages at ridiculously low rates with no money down. But he participated anyway because of his own personal reasons (admittedly on his part, mostly unreasoned and emotive) which ultimately caught up with him.

Radio host Tom Keene asked Andrews about his experiences and observations relative to individual savings. Will there be a real, enduring shift towards savings or is the recent trend simply a panicky response that will fade once vision of the crisis is over? Andrews answered this way: “...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.” As such, Andrews envisions an enduring and important shift in spending behavior. Those anecdotal observations are backed up by last week’s U.S. savings rate data: April resulted in a 14-year high-water mark with personal savings climbing to 5.7% (up from 4.5% in March).

Wealth perception predicated on housing values which move to higher levels in perpetuity is coming to an end. Now throw in job concerns on the home front and therein becomes lasting motivation to change. The home no longer serves as the sole source of savings...it’s being replaced by real savings. That possesses a dramatic impact on consumer spending going forward and in-of-itself establishes “new normal” (for more on consumers please see AgSight: April, 2009).

Tying it all together: several months ago I noted that, “...if 2008 taught us anything (financial crisis or not) is that the trading puzzle has become increasingly complex. All markets are inexorably linked and increasingly dynamic. Neither simple nor safe havens no longer exist. Therefore, there’ll be no reprieve from needing to be hyper-vigilant in terms of decision making, marketing and/or risk management in the future.” Economic uncertainty will continue until some type of “new normal” is established.

