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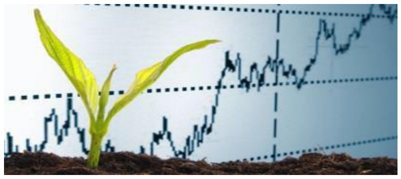
College of Agriculture, Food and Environment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FEATURED ARTICLES

LIQUIDITY CRISIS: TO TERM OR NOT TO TERM?

Most agricultural producers are still waiting for market conditions to allow greater profitability or at least move towards or above break-even. While that has yet to occur, many farmers have created an operating shortfall over the past couple of years. The impact of operating shortfalls can be in part quantified by the current ratio. The current ratio is simply your current assets divided by your current liabilities. A current ratio equal to one indicates that you have just enough current assets to meet your current liabilities. The goal for most farming operations is to have a current ratio of two or greater, indicating that you have two times the current assets at your disposal relative to your current liabilities. A current ratio of two allows for some built in "cushion." Considering that for many agricultural producers, current assets are largely made up of marketable commodities that can fluctuate in price between when the current asset valuation on the balance sheet is completed versus when those commodities are actually sold.

Let's assume that your current ratio is less than one. Further, let's assume that it was less than one last year and you project that it is less than one next year. What are your options for handling this operating shortfall? One option to consider is to refinance (term out) the operating shortfall over a longer period. Instead of having to pay that shortfall in the next 12 months, you may be able to stretch that repayment over the next several years. What are the impacts on your business? First, you must admit that some series of unfortunate events have occurred in order for you to find your business in that particular financial position. Identifying those events are important. Having an honest conversation with yourself is also important. You have to be willing to evaluate the situation thoroughly and carefully. Was it really just declining commodity prices or was it from management decisions during these low profitability times that only compounded those lower prices? Are you willing or able to make the necessary changes to help better ensure an operating shortfall will not occur again? The answer is very individualistic. Terming out debt without carefully addressing and formulating an action plan to prevent this scenario from repeating itself in the short-term is like putting a bandage on a wound that needs stitches. You will find yourself in the same scenario again, but with fewer options on how to handle it.

Typically, we think of terming out operating shortfalls. Sometimes, we also consider restructuring intermediate debts as well. One example of this would be restructuring grain bins or other equip-ment purchases and stretching them over a longer period. Interest rates have already started creeping upwards slowly and this trend is projected to continue. As interest rates continue to creep up, the interest that is paid on operating debt will also continue to increase. As a result, the financial costs of carrying operating shortfalls is going to increase. If the underlying fundamentals of your financial position do not change or are not projected to change, increasing interest rates will only impede your liquidity situation. With increasing interest rates on the horizon, terming out operating debt or restructuring intermediate term debt now will in theory ensure you are able to lock in a lower interest rate than if you wait to make these financial moves at some point in the future. The ability to term out this debt is highly dependent on your equity and your projected cash flows. You will have to have adequate equity to cover the debt but also show that your reasonable whole farm plan shows you will have the cash flows to service this debt as well. It does little good to restructure debt if profitability falls below your lender's threshold for repayment ability. Restructuring debt is not a decision that should be taken lightly but can be a very effective tool when coupled with a well-developed whole farm budget and plan. Be sure that you are having honest conversations with yourself and your lender about potential financing tools for your situation.

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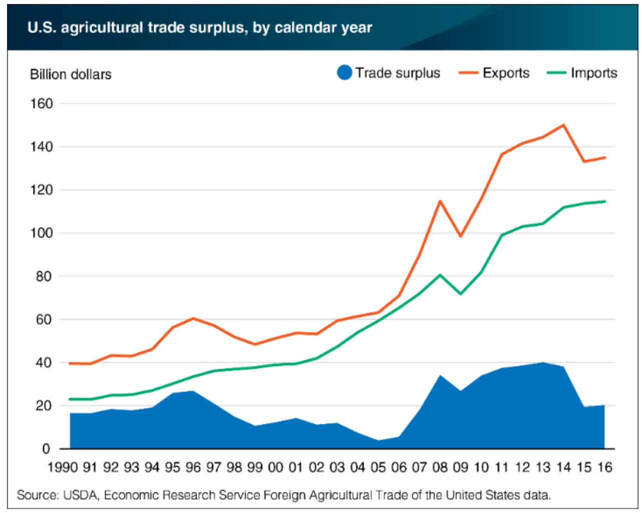
U.S. Ag/KY Trade Update and Outlook

USDA recently increased their agricultural export forecast for 2017 in response to stronger livestock, grain, feed, and cotton exports, with most of the growth occurring in Asian markets. See *Outlook for U.S. Agricultural Trade: May 2017*, https://www.ers.usda.gov/webdocs/publications/83665/aes-99.pdf?v=42880.

For FY 2017, USDA is now projecting U.S. ag exports to total $137.0 billion, one billion higher than their February 2017 estimate and nearly $7 billion higher than the their FY 2016 projection. However, export values remain far below the 2014 record high of $152 billion as a higher valued dollar, sluggish overseas economies, and ample global supplies have reduced U.S. trade volume and per unit values in recent years.



While the United States exports agricultural commodities and products to more than 100 nations worldwide, our top three markets, China, Canada, and Mexico (which of course has been in much of the political debate of late) comprise nearly one-half of our ag export market sales.

Given relatively stable import levels, the overall ag trade surplus remains around $22 billion. U.S. agriculture has experienced a trade surplus every year since 1959 and generally accounts for around 10% of total U.S. exports.

Certainly, many facets of the U.S. ag economy are very dependent on trade. Overall, USDA claims that around 20% of total U.S. agricultural production is purchased by foreign customers and every $1 billion dollars of ag exports supports an estimated 8,000 jobs and $1.27 billion in economic activity. Approximately one out of every 2 acres of U.S. soybeans and wheat production is exported, along with around 20% of pork, 15% of corn, dairy, and poultry, and 10% of U.S. beef production being shipped overseas. In addition to these commodities, foreign markets are critical to Kentucky's equine and tobacco industries, along with value-added items such as bourbon, timber, ethanol, and feed.

Undoubtedly expanding global markets played a significant role in the growth in the U.S. and Kentucky farm economies during the prosperous 2012-2014 period as both U.S and Kentucky ag exports swelled to record levels. Many are hoping that expanding exports are the answer in pulling out a severe economic downturn that has plagued U.S. agriculture since 2014.

However, intense international competition, along with anticipated macroeconomic trends (i.e., higher valued U.S. dollar) may limit short-term opportunities for trade growth. Plus, U.S. agriculture has received mixed messages on trade under the Trump administration given concerns of the perceived impact that certain trade agreements and trade programs have on American jobs.

In general, U.S. agriculture was very supportive of the Trans Pacific Partnership (TPP) as additional U.S. meat and grain for feed exports were likely to evolve from relaxing trade barriers in Pacific Rim markets demanding more protein in their diets. The Trump administration is also proposing a renegotiated North American Free Trade Agreement (NAFTA) – a regional market that has seen U.S. agricultural exports increase from less than $10 billion in 1993 when NAFTA was enacted to nearly $40 billion today. In addition, the Trump administration 2018 federal budget calls for eliminating funding for popular export market promotion programs for agriculture as part of the budget/farm bill debate.

In response to concerns raised by U.S. agriculture, ag secretary Sonny Purdue has publically recognized the extreme importance of trade to U.S. agriculture and recently announced his plans to reorganize USDA to include a new Undersecretary for Trade responsible for working with trade officials, policymakers and producers to expand U.S. agricultural trade. The current White House political strategy related to trade is to focus more on bilateral trade deals to open markets for U.S. agriculture and other export-dependent sectors. Recently, the Trump administration announced a trade deal with China that will allow U.S. beef exports to China for the first time since the outbreak of "mad cow disease" in 2003, with the potential of additional removal of trade barriers to this market for U.S. poultry. In addition, livestock officials are hopeful that recent bilateral trade discussions will lead to greater meat sales into Japan.

While the uncertainties over future trade agreements, along with global dialogue of "nationalism" and "protectionism," has dampened some of the optimism of future movement of U.S. agriculture overseas, growing world population and incomes promises future opportunities for additional growth in global agricultural trade. A recent Brookings study (*www.brookings.edu/wp-content/uploads/2017/02/global_20170228_global-middle-class.pdf)* indicated that an additional two billion consumers will enter the middle class by 2030, with most of this growth occurring in Asia. The approximately 140-150 million annual increase in the global middle class is nearly ½ of the size of the current U.S. population. Increasing income results in increasing purchasing power to expand and improve diets, which of course begs the question, will that increased demand for food be met by local production, U.S. ag competitors, or the United States?

If the latter occurs, where does Kentucky fit into the equation? In reality, Kentucky is nearly twice as dependent on agricultural trade as U.S. agriculture as a whole with around 35 to 40% of our production being exported. While other states such as North Carolina and Virginia currently have more resources devoted to ag export market promotion, Kentucky agriculture has several unique advantages in the trade arena including:

- Established international reputation for quality ag-related products such as bourbon, horses, and tobacco
- Significant number of international businesses, political connections, and visitors
- Diversity of ag and forest products
- Increasing entrepreneurial spirit among Kentucky farmers and businesses
- Transportation resources and infrastructure

These advantages will likely provide future opportunities for Kentucky ag commodity exports, with greater opportunities for differentiated/value-added products. Currently the Kentucky Department of Agriculture and other agricultural leaders in the state are working on developing a trade development plan. Stay tuned!

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Our Land-Grant Values

The University of Kentucky College of Agriculture, Food and Environment was founded as, and remains a land-grant institution, committed to improving the quality of life for Kentuckians. Our research, teaching, and extension programs are part of a national system that maintains a statewide presence and links local, state, and global issues. Agriculture, food, and environmental systems are key components of Kentucky's economic future, and the college is playing a prominent role in those areas with its programs.

USDA Provides First Projections for the 2017-18 Marketing Year

As planting for the spring row crops is well underway, USDA's monthly *World Agricultural Supply and Demand Estimates* (WASDE) shifts its focus away from projecting supply and use for the crops harvested in 2016 to crops harvested this fall. Market analysts have been discussing the potential 2017 supply and demand estimates since last fall when soybean futures markets began bidding for additional acres and fewer acres of corn and wheat. The March 31st *Prospective Plantings* confirmed what analysts already guessed that farmers planned to increase soybean area by 5.9 million acres while reducing corn and wheat area by 4.0 and 4.1 million acres, respectively.

A survey of market analysts before the May 10 WASDE had analysts projecting a significant increase in 2017-18 soybean stocks with expected reduction in stocks for corn and wheat.

Table 1. Consolidated 2017-18 Supply and Demand Estimates for Corn, Soybeans, and Wheat with the Change from the Previous Marketing-Year.

	Corn		Soybeans		Wheat	
	2017-18	Change from 2016-17	2017-18	Change from 2016-17	2017-18	Change from 2016-17
Planted Area (million)	90.0	-4.0	89.5	+6.1	46.1	-4.1
Harvested Area (million)	82.4	-4.3	88.6	+5.9	38.5	-5.4
Yield (bushels/acre)	170.7	-3.9	48.0	-4.1	47.2	-5.4
			Million Bushels			
Beginning Stocks	2,295	+558	435	+238	1,159	+183
Production	14,065	-1,083	4,255	-52	1,820	-490
Imports	50	-5	25	+0	125	+10
Total Supply	16,410	-530	4,715	+187	3,105	-295
Exports	1,875	-350	2,150	+100	1,000	-35
Domestic Use	12,425	+5	2,085	+42	1,191	-15
Total Use	14,300	-345	4,235	+142	2,191	-50
Ending Stocks	**2,110**	**-185**	**480**	**+45**	**914**	**-245**
Days of Stocks	54	-3	41	3	152	-37
U.S. Marketing-Year Average Price ($/bu)	**$3.40**	**+$0.00**	**$9.30**	**-$0.25**	**$4.25**	**+$0.35**

Source:May 2017 WASDE - USDA: WAOB.

As is typical with this type of report, USDA provided a surprise for the grain markets. The May report surprised analysts with stronger than expected demand for the soybean market (Table 1). Previous columns have remarked how the corn and soybean market benefited from last year's drought and floods in Brazil and Argentina, respectively, which reduced their production and increased U.S. exports for both the 2015 and 2016 marketing-years. Analysts expected U.S. exports to decline for the 2017 marketing-year as South America reentered the export markets with large corn and soybean crops. The May report pegged 2017-18 corn exports 350 million bushels less than last year which conformed to expectations Soybean exports, on the other hand, are projected to be 100 million bushels larger than 2016 (Table 1).

The increase in soybean exports from last year, if realized, would keep 2017-18 ending stocks below 500 million bushels and keep large stocks from pressuring soybean prices. USDA is projecting that the smaller than expected increase in stocks will lower the U.S. marketing-year average farm price by $0.25 per bushel for the upcoming marketing-year (Table 1).

If farmers reduce corn harvested area by 4.3 million acres and harvest "normal" yields, then there is potential for ending stocks to decline slightly from 2016. Corn exports may be the deciding factor for the fate of the market as USDA projects domestic corn demand at about the same as last year. If Mother Nature blesses the corn market with above trend yields, then another large crop may limit any reduction in stocks and push farm prices lower for the 2017 marketing-year. The corn market needs lower stocks to support higher prices.

The wheat market has been begging for reduced supply for a couple of years, and the combination of reduced area and inclement weather may provide the supply reduction needed to boost the wheat marketing-year average price. USDA projects the 2017 wheat crop at 490 million bushels less than 2016. USDA estimates the 2017-18 wheat supply to be 295 million bushels less than last year even with a larger carry-in (Table 1).

The wheat story remains that of sluggish use primarily in exports. Regardless, there is potential for ending stocks to decline to 914 million bushels mostly through supply reductions. The decrease in stocks could boost the U.S. farm price to $4.25/bushel (Table 3).

Until production is better known, analysts will continue to scrutinize the demand projections. Exports face headwinds with the strength of the U.S. dollar relative to the Brazilian Real and Argentine Peso. Another headwind is policy uncertainty with major trading partners that could limit 2017 export potential.

For more information, readers are encouraged to look at the latest *Crops Marketing and Management Update* (http://www.uky.edu/Ag/AgEcon/extcmmu.php) for more details about Western Kentucky price potential and risk management opportunities.

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Move over Millennials, Gen Z is on the Way

In the "more art than science" world of generational differences, there's a new group on the horizon. Demographers have begun to describe Generation Z as those born between 1996 and 2010. The Baby Boomers (1945-65) are now late career and retiring in droves. The WWII Generation are already gone from the work force, but their legacy remains. Gen Xers (1965-80) are at the prime of their careers, the Millennials (1981-1995) are early career wave-makers, and now get ready for Generation Z.

While it is impossible to define an entire group by a set of observed characteristics, mangers have long known that there are some general differences in age groups that may well be the result of the times in which they were raised. An old proverb wisely indicates, *"People resemble their times more than they do their parents."*

Employers and managers would be well advised to consider that while generational differences exist, they do not have to be destructive and may even be beneficial. Too many articles and anecdotes focus on the differences as deficiencies to overcome – those entitled Millennials, those self-absorbed Gen Xers, the anti-establishment Baby Boomers. And now, the always connected, social media Gen Zers.

Even Socrates (although the evidence is sketchy) has been quoted as saying "*Children now love luxury; they have bad manners, contempt for authority, and disrespect for elders…"* So, while disparaging youth has a long history, it is their future and they will shape it. Employers, managers, and educators will find that Gen Z will approach problems differently – they've always had smart phones with answers close at hand. They will be multi-cultural – Rodriguez has replaced Smith as the most common last name in America. Millennials have been attributed with liking teamwork. Time will tell with Gen Z, but it will almost certainly involve electronics and an ease and expectation that may baffle their bosses. In my classes I do not ban phones but try to use them for information delivery and fact checking (with the caveat that a few things on the internet might not be true).

A final observation – a young Gen Zer asked me what the title of a Serbian ag publication was about. I didn't know and said so. He changed his smart phone keypad to Serbian Cyrillic, typed the title into Google translator, and told me. Now I know.

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