

Federal Reserve Bank of Kansas City Meeting Summary
Kansas City, Missouri
June 8-9, 2010
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Overview

The Federal Reserve Bank of Kansas City held a regional symposium entitled “Farming, Finance, and the Global Marketplace” on June 8 and 9 in Kansas City, Missouri. The conference explored the profitability, structure and financing of agriculture in the 21st century by discussing the economic recovery, new opportunities for global agriculture and how the global structure of agricultural production will need to adapt to a growing population and shifting global demands. The symposium was broken down into four separate sessions and this summary is the highlights of all the speakers in those individual sessions. I have not attempted in this summary to credit anyone speaker but to highlight the comments of all speakers in a given session.

Session I: Agricultural Profitability in the 21st Century

This session explored the influence of market fundamental and policy on agricultural prosperity in the 21st century. Discussion centered on global supply and demand fundamental driving the revenues and costs of both crop and livestock producers and described how changes in the financial markets and government policies affect agricultural profits.

- Population growth in the “developing” countries, particularly Asia, Africa and China, will be big business drivers in agriculture and the demands for more food. Three billion more people by the year 2050 for a total population of 9.1 billion.
- Speakers projected a GDP growth of 4-5% each year to 2015 and noted that the 2009-10 world recession was a chance for everyone to catch their breath on demands from the rapid growth of the last few years.
- It was noted that 47% of the world’s population experience hunger of some type. Some due to production problems and some to political problems. As a side note here, a lot of this hunger disappears as per capita income per day exceeds \$2.50. Twenty percent of the world’s population makes less than \$1.25 per day and another twenty seven per cent make \$1.25 - \$2.50 per day.
- 7 billion tons of food was produced in 2005 and 3-4 billion more will be needed by 2025 and perhaps doubling the 2005 production by 2050.
- Food production and consumption areas are disparate which means trade will become even more important.
- Diets will change and affect all nations. Developed countries are looking to cut fats, calories, sweets, and increase fruits and vegetables while developing countries want to increase meat and protein in their diets and increase refrigeration to cut spoilage.
- There will be a need for global standardization in the supply chain and food system from storage, transportation, food inspection, food safety, etc.
- The threats to the food supply will be the failure to liberalize trade which will create imbalances in the production areas all the way to the consumers. Also a threat is insufficient capital investment both in developed and developing countries. For example, in the U.S., in roads, bridges, railroads, locks and dams and port capabilities and in

technology development and usage. In developing countries, it will be in the same thing, but also in research and development and greater emphasis on agriculture production.

- The other unknown and possible threat to expanded hunger and malnutrition is government changes / riots (food and other) / protectionism / stopping trades and trading.
- There will be growing resource constraints including land, labor and water shortages.
- 70% of the world's population will be urban by 2050.
- Huge challenge ahead will be to feed the growing population with less resources and less environmental impacts (footprints).

Session II: Reshaping Global Agricultural Production

This session discussed how the structure of global agricultural production could change with shifting market fundamentals, shifts in production locations and altering business practices and strategies to compete in the 21st century.

- Projected a rebound of global economic growth to an annual average of 3.3 percent, and a resumption of high growth rates in China and India.
- Projected real increases in crude oil prices, with refiner acquisition costs projected to be \$100 per barrel by the 2019 projection outlined.
- No change in biofuels policies, and continued growth in the ethanol industry.
- Corn, wheat, and soybean prices remain historically high, with farm-gate prices of \$3.65, \$4.75, and \$9.20 per bushel, respectively, at the 2019 projection.
- The U.S. dollar is projected to depreciate through the projection period, and thus will continue to positively impact U.S. exports.
- Demand from China and India for both crops and livestock products will continue to grow, particularly with dietary changes.
- USDA projection pointed clearly to two major changes in the geography of global agricultural production in the next decade: major expansions of domestic poultry production in developing countries and of soybean production in South America.
- Projections also pointed to sharp increases in U.S. production, exports, and imports of horticultural products (fruits, vegetables, and tree nuts). USDA projects a 10 percent increase in US acreage, with most of the increase in fruits and tree nuts, and a 30 percent increase in import volume.
- U.S. and European supermarket chains will continue organizing global procurement networks relying on a tight degree of vertical coordination. Vertical coordination in this session was not meant to be vertical integration where ownership starts at the production beginning and ends at a consumer sale.
- In the U.S., structural change at the farm level will encompass three closely interrelated features: larger farms; more complex farm business organizations; and more formal contracting in place of cash market relationships
- A major uncertainty to the USDA projections presented was noted as the macroeconomic policy in China, and in Asian countries generally. They are currently running large current account surpluses, offset at the global level by deficits in the US and, to a lesser extent, the UK. In China alone, it appears that savings (household and government) accounts for 60 percent of GDP. At the margin, investments from those savings, in US securities, appear to have very low returns. The concern expressed was the continued sustainability of the current pattern of global imbalances - policies that allow the US and UK to consume substantially more than they produce - while limiting consumption in

Asian countries. A modest relaxation of Chinese policy, leading to greater consumption by Chinese households out of national income, could lead to substantially greater dietary changes than were forecasted, with unknown consequences for global meat and feed grain production and prices.

- The session also talked about the future of biotechnology and the need for intellectual property rights on a global scale. Future biotechnology development will be for drought tolerance crops, better nitrogen utilization and more very specific traits for manufacturers and food processors to utilize.
- This session also emphasized that there is a globalization of food processors who want globally consistent ingredients, government regulations (food safety) and transportation.

Session III: Evolving Agricultural Supply Chains

Discussion in this session centered on the evolution of agricultural supply chains due to changes in the profitability and structure of agriculture. The session addressed implications for farm input suppliers, wholesalers, distributors and retailers.

- From a business standpoint there is twice the price risk and volatility today than there was in the 80's. Everyone used to use the USDA supply and demand reports, delivery reports and or usage reports as their base for decision making, now businesses must also consider index fund prices, crude oil prices, exchange rates, trade barriers and tariffs, and crops moving from production areas to other areas or even other countries. The examples given were how soybeans are now grown in North Dakota and displaced small grains and how soybean oil price is now tied to diesel oil prices not vegetable oils.
- With project yield increases (double by 2030 for corn, wheat and soybeans), the logistics of handling this large size will take considerable infrastructure improvements and capital for elevators, railroads, barges, farm storage and equipment.
- Biotech is the game changer. It will drive the location of crops, infrastructure needs, and create more need for supply chain management with the highly differential GMO traits coming.
- Expect interest rates to go up and if GDP stays as projected globally, inflation will have to be controlled by the interest rates and or removing government dollars from the money system, globally.
- Large chain stores (WalMart for example) have changed smaller grocery stores, their margins and customer expectations. Deliveries and package sizes have also been influenced by these large store demands on suppliers.
- Restaurants have been influenced and will continue to be going forward with dietary changes, food safety concerns, quality demands and a belief that more vertical integration and or coordination is needed between suppliers, distributors and transportation mechanisms.
- Consumers will drive the supply chains to provide their needs; period.

Session IV: Meeting the Financial Needs of Global Agriculture

This session discussed how the agricultural finance system will evolve to meet the financial needs of global agriculture.

- Banks will continue to offer both transactional and structural financing for agribusinesses. Transactional means through letters of credit with approval and costs depending on the size of the firm involved, whether they are specialty crops and or the

logistics of the transaction(s). Structural financing will be based on asset valuation (collateral), foreign currency risks and management capacity of the entity requesting the financing.

- There is a belief that foreign firms will continue to buy U.S. assets, including banks given the future of agriculture. Foreign banks also bring with them some additional costs of capital, environmental standards and even governmental goals from the home country.
- The banks represented in this session were optimistic on agriculture in the future. However, some concerns were expressed about the age of the farming population and the lack of a younger generation in farming, both, due to start up costs and or the lack of opportunity to farm.
- Banks also expressed their concerns about additional regulations and how they must now allocate some of the capital as reserves. This, according to them, was a waste of valuable resources that could be used to finance agricultural needs in the future.
- Future capital market challenges include: higher capital costs; possibility of slower growth, less leverage or a decline in asset values; commodity/financial market linkages via globalization of fund flows, resource and land ownership and financial institution competition; and the resurgence of risk.

Summary

These were seven take-away points that I got from the meeting.

- Very positive outlook for agriculture in the long-term. GDP growth along with increased volatility will drive the sector forward.
- We are going to see increased consolidation and collaboration in the future in all sectors of agriculture. The old 80/20 rule may become 90/10 in the future.
- The U.S. and world economy is recovering which will raise interest rates sooner than later with a risk of inflation.
- There is definitely more risk and volatility in the agricultural sector at all levels of input and retailing. This may drive consolidations and integrations along the value/supply chain.
- The U.S. infrastructure will need major improvements if we are to be the leading provider of food and commodities. This includes the transportation sector (road, rail, water, ports) as well as on-farm storage, elevator storage and in food processing systems.
- Globalization will cause foreign direct investment in the U.S. to happen. We will continue to export like in the past but the new ownership may be foreign to start with.
- Innovation and technology will drive a lot of the future growth and development in agriculture. Starting with biotech, new information systems that automatically capture data along the supply chain and process controls like GPS systems.