

# The Economic Situation: Are We On the Road to Recovery?

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2009 Insurance Workshop

**“MANAGING THE RISKS OF THE VOLATILITY IN FARM PRICES AND THE GLOBAL RECESSION”**

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Salina, Kansas



# CARY SANDELL

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**Cary Sandell**, Vice President and Relationship Manager, joined the Wells Fargo Bank - Midwest Food and Agribusiness Commercial Lending Office in July of 2007. Based out of Lincoln, Nebraska, he is responsible for business development and relationship management for clients in the Midwest and Northern Plains. Cary joined Wells Fargo in 1994 as a credit analyst and became a relationship manager in 1996 with a focus on large scale animal agriculture and agribusiness lending. Prior to joining Wells Fargo, Cary was a licensed commodity broker with J.C. Bradford & Company specializing in domestic grain and livestock markets. Cary received a B.S. in Agribusiness and a M.S. in Agricultural Economics from the University of Nebraska – Lincoln. Cary also graduated with high honors from the Graduate School of Banking at Colorado. Cary resides in Malcolm, NE with his wife, Becki, and daughters, Courtney, Emily, and Jessica.



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## Degree of Belief

Cary L. Sandell

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November 2009

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Everything is connected.

We just can't see it.

Every new economic action comes from  
some other economic action's end

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## What you want to know

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- Is the recession done?
  - ◆ How can we tell?
  - ◆ What type of recovery? For who?
- What is holding the economy back
  - ◆ Fear of the unknown
  - ◆ De-leveraging (business and consumer)
- What is pulling the economy ahead
  - ◆ Productivity (technological and global)
  - ◆ Trade growth
- Implications for agriculture and credit

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## How much GDP makes us happy?

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C + I + G - (X-M)

GDP = 12,892 = 9,181 + 1,472 + 2,562 - 339 \*

72% + 11% + 20% - 3%

\* Net exports bottomed out at (\$757) or 5.7% in the 3<sup>rd</sup> quarter of 2006

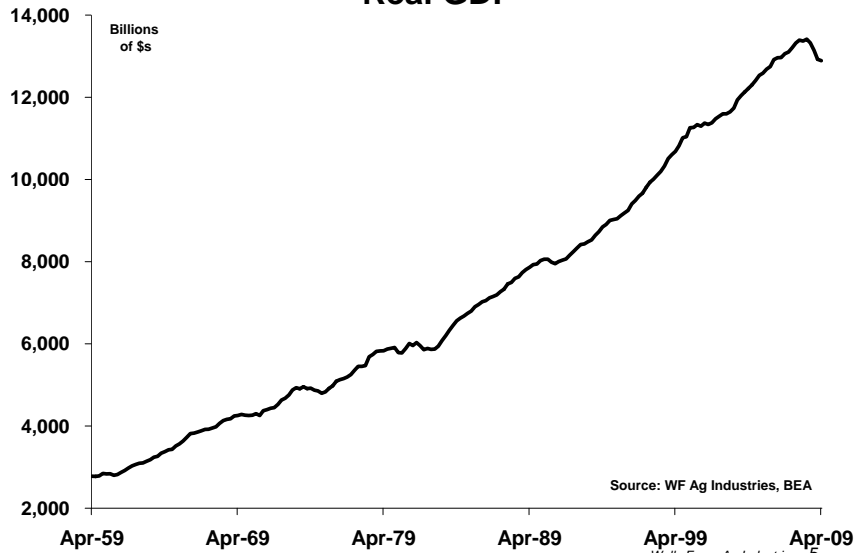
Source: BEA 2<sup>nd</sup> Qtr (billions inflation adjusted dollars – base 2005)

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# A very difficult # to get a handle on



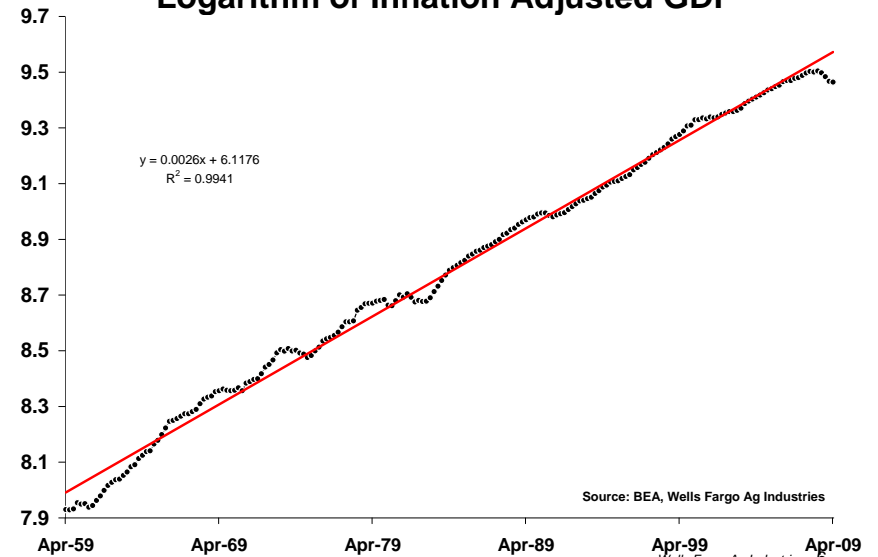
## Real GDP



# Another view



## Logarithm of Inflation Adjusted GDP

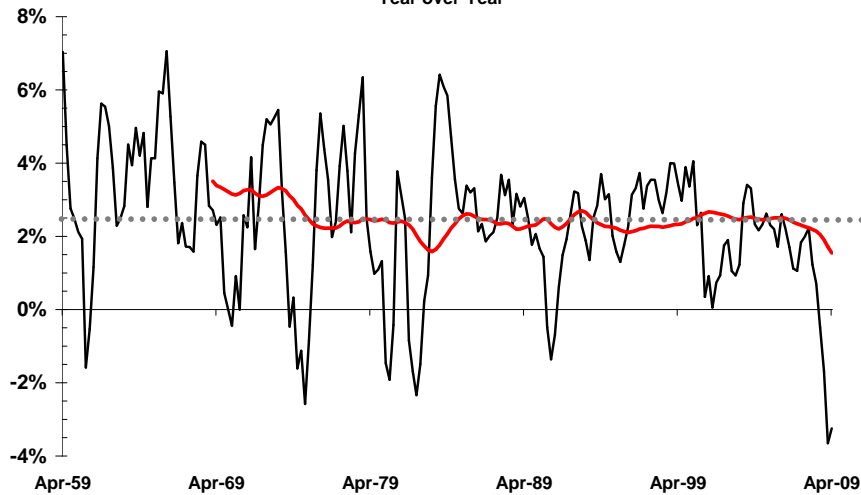


# "Blinded by the lately"



## GDP Change

Year over Year

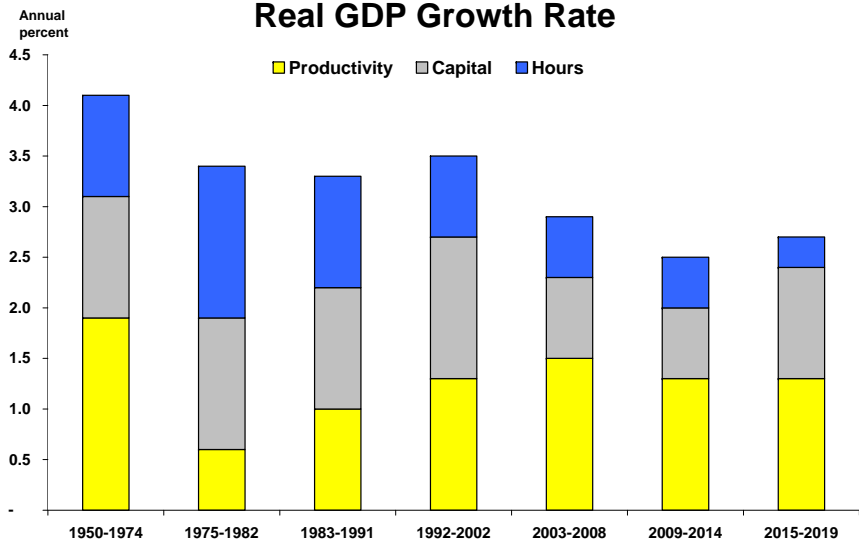


# How does the US economy grow?



- Long-term GDP growth is **2.7%**
- Output grows with inputs and productivity
  - ◆ Larger labor pool **0.4%**
  - ◆ More capital invested **0.9%**
  - ◆ Productivity gains **1.3%**
- A recession temporarily reduces demand not supply capacity

# If you don't have productivity ...



Source: CBO, Wells Fargo Ag Industries

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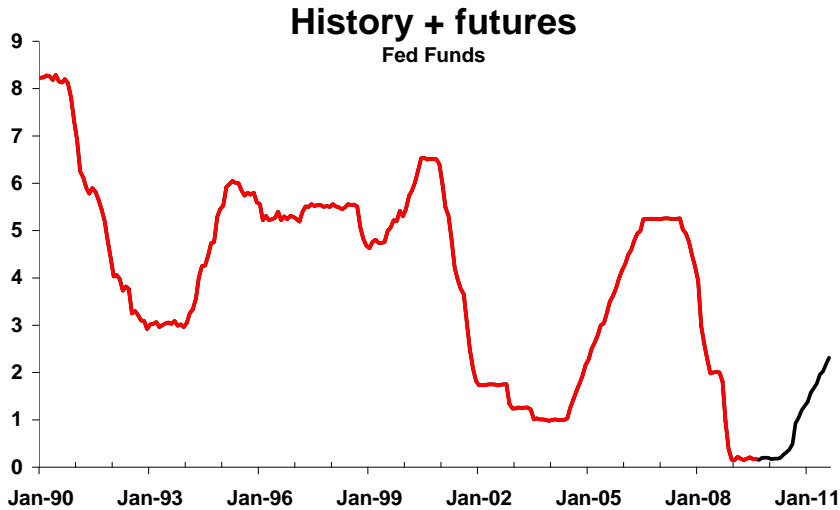


Can fiscal and monetary intervention really work?

And, at what cost?

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# Does it make sense?



Source: FRED, Wells Fargo Ag Industries

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# Water everywhere, but not a drop to drink



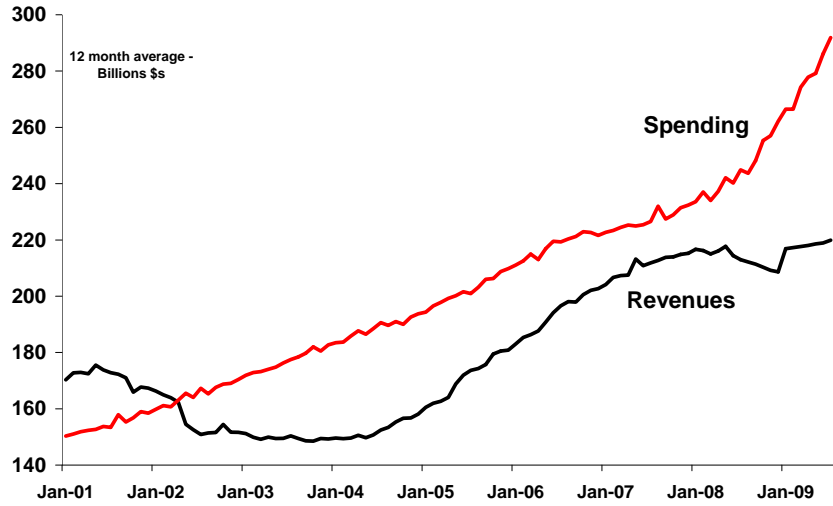
Source: FRED, Wells Fargo Ag Industries

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## This won't turn-out like they hope



### Government Fiscal Stimulus



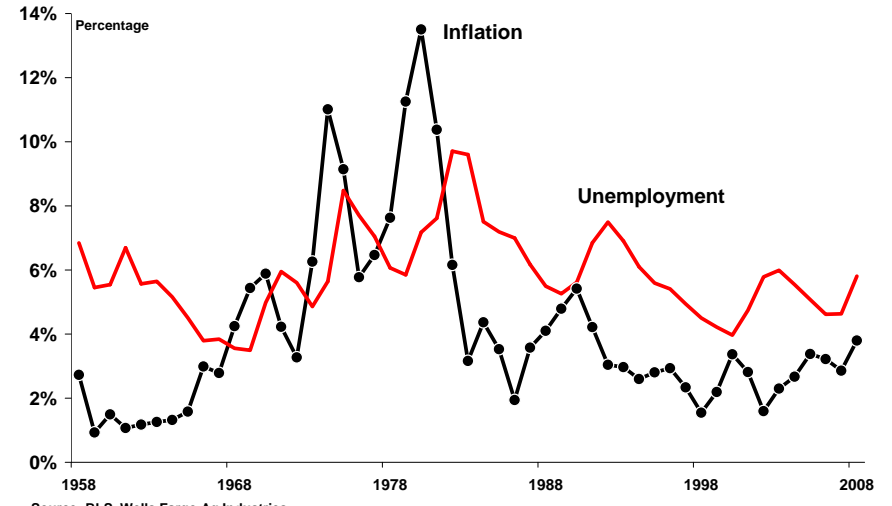
Source: WF, CBO

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## The Federal Reserve must have Alzheimer's



### Unemployment and Inflation



Source: BLS, Wells Fargo Ag Industries

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## What drives the value of the dollar?



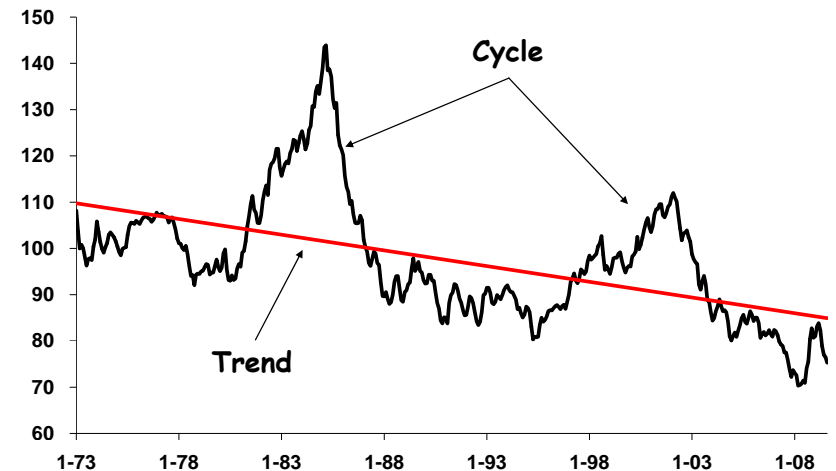
- Trade surplus or deficit
- Relative interest rates
  - ◆ Real interest (nominal less inflation)
  - ◆ Risk of investment
- Stability of government issuing the money
- Expectations of traders

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## This one they don't control



### US Trade Weighted Dollar



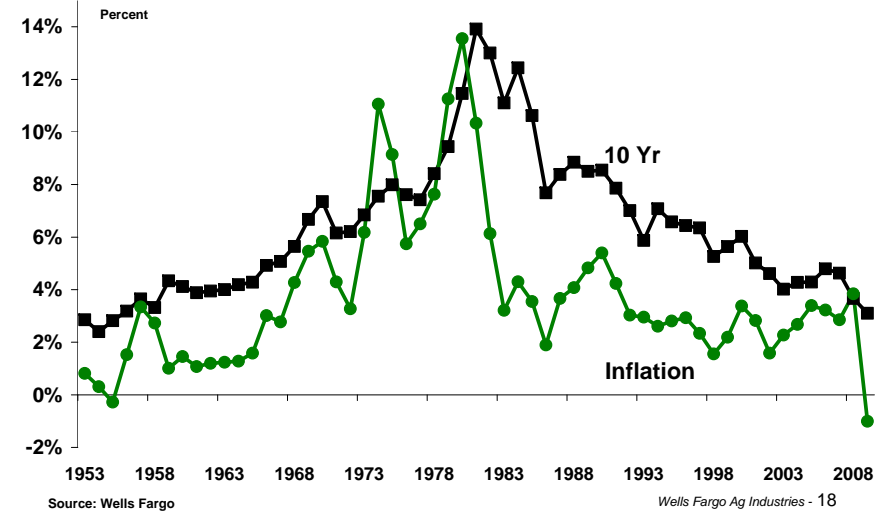
Source: Federal Reserve, Wells Fargo Economics

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For a quarter century this model worked. **Now what?**

## DCF: Discounted Cash Flow Model

### 10 Year Treasury v. CPI



## Three scenarios – three challenges

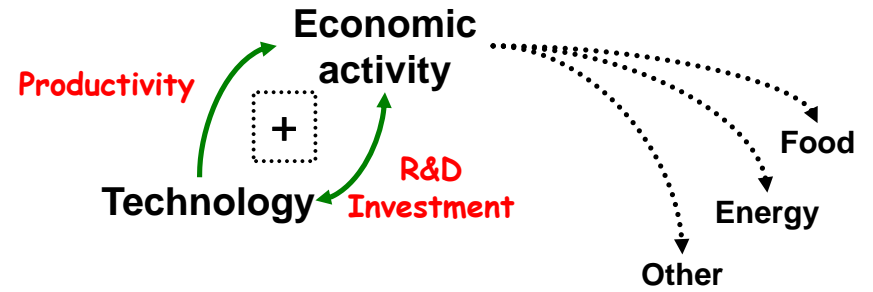
- **Falling real interest rates**
  - ◆ Buy most assets now
  - ◆ Use as much debt as possible
- **Stable real interest rates**
  - ◆ Buy only competitive assets now
  - ◆ Use as much debt as possible
- **Rising real interest rates**
  - ◆ Sell least competitive assets now
  - ◆ Avoid as much debt as possible

**So why a recovery?**

**And for who?**

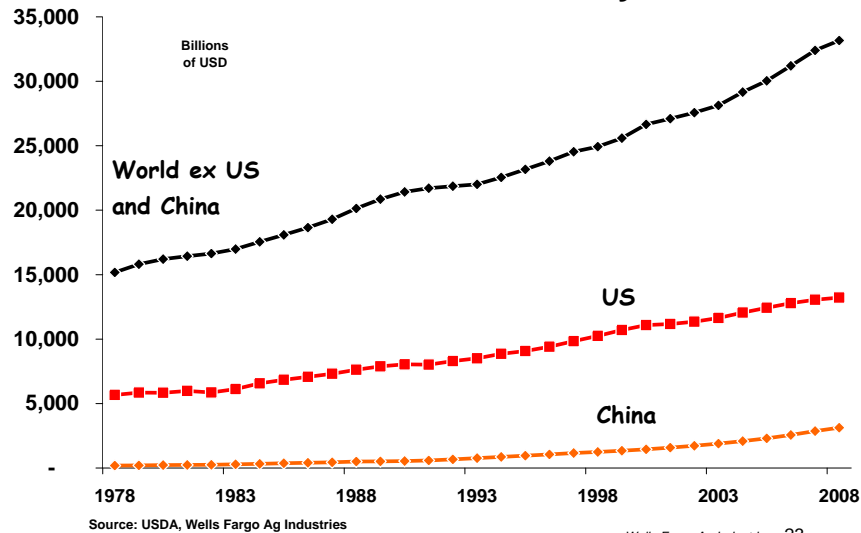
All models are **wrong**.  
Some are **useful**.

## Accelerating global demand



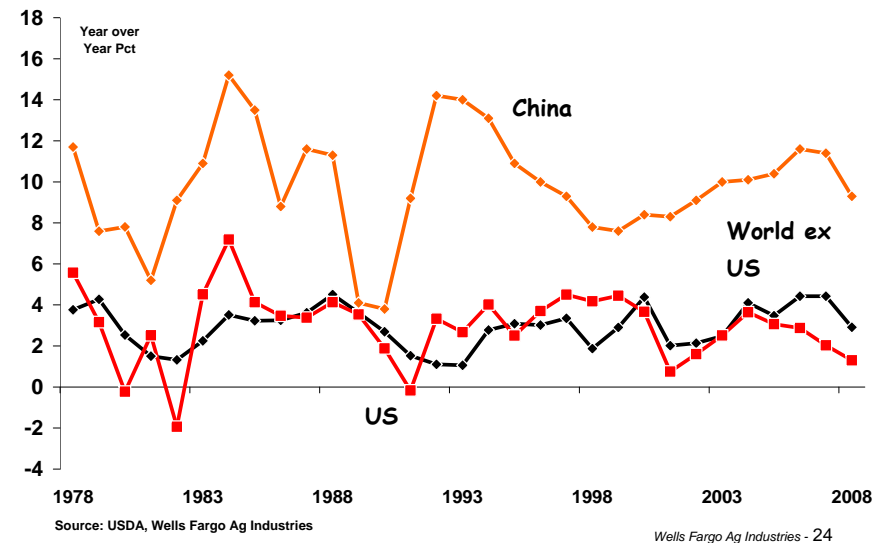
## Climbing up Maslow's hierarchy

### Global Economic Activity



## Will you bet against it?

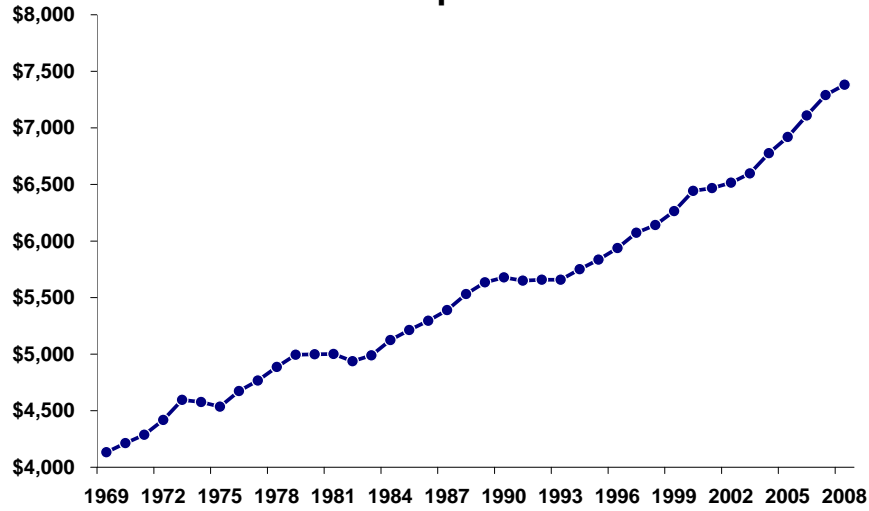
### Global Economic Growth



# The net/net is very positive



## Global Per Capita Real GDP



Source: USDA, Wells Fargo Ag Industries

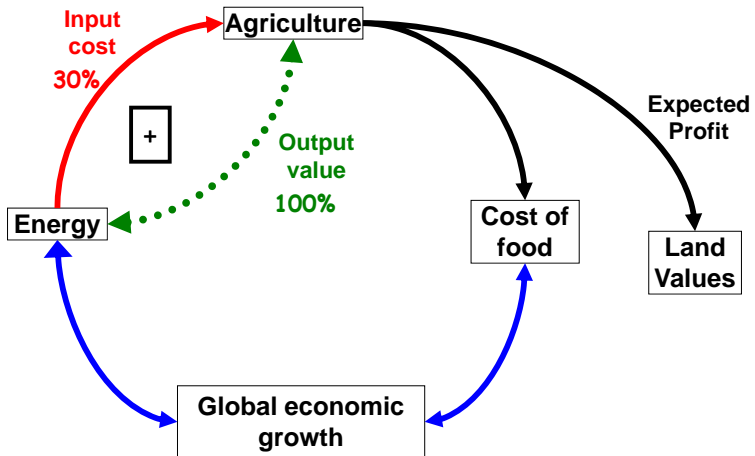
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# How will it hit agriculture and credit?

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# (Un?)intended Consequence

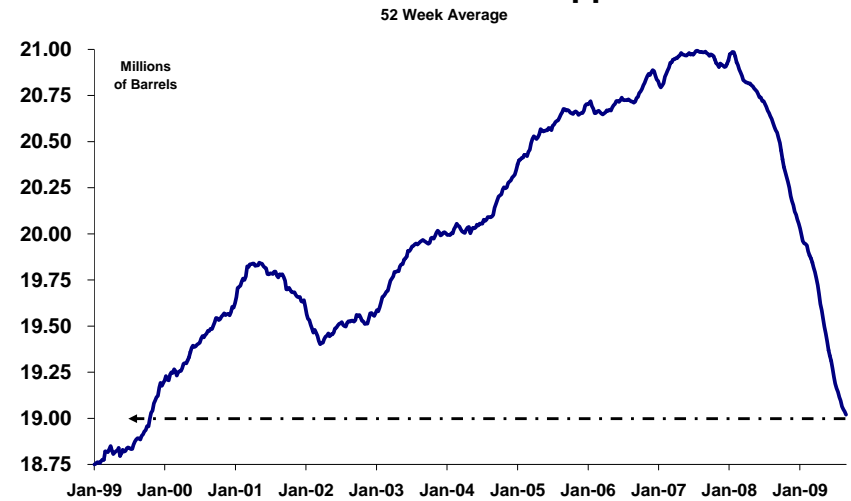


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# Guess what? Feedback, delay and noise



## Petroleum Product Supplied



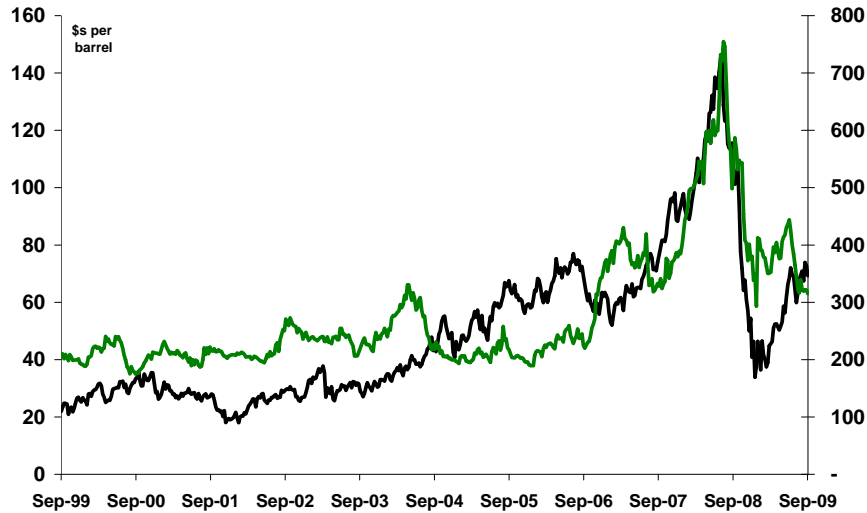
Source: EIA, Wells Fargo Ag Economics

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# Convergence: Temporary or permanent?



## Nearby Crude Oil v Corn



Source: NYMEX, Wells Fargo Economics

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What do correlations *really* represent?

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# One of these things is not like the others



## US Supply and Demand Estimates

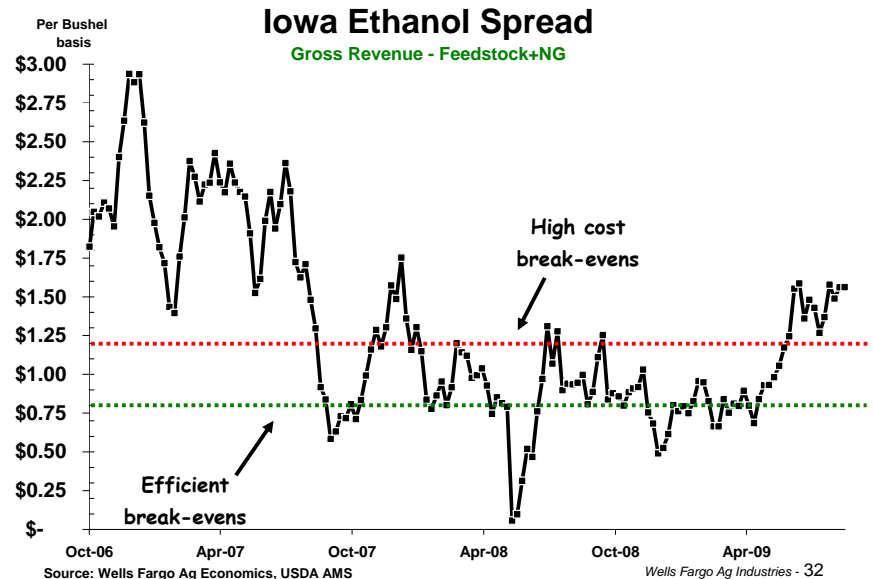
Corn	05/06	06/07	07/08	08/09	09/10	Change
Beginning stocks:	2.1	2.0	1.3	1.6	2.6	0.9
Production	11.1	10.5	13.0	12.1	13.0	0.9
Co-products	0.4	0.6	0.8	1.0	1.1	0.1
Imports	0.0	0.0	0.0	0.0	0.0	-
<b>Total supply</b>	<b>13.2</b>	<b>12.5</b>	<b>14.4</b>	<b>14.7</b>	<b>16.6</b>	<b>1.9</b>
Feed	6.2	5.6	5.9	5.4	5.4	-
Ethanol	1.6	2.1	3.0	3.8	4.2	0.5
Other	1.4	1.4	1.3	1.3	1.3	(0.0)
Exports	2.1	2.1	2.4	1.8	2.2	0.5
<b>Total use</b>	<b>11.3</b>	<b>11.2</b>	<b>12.7</b>	<b>12.1</b>	<b>13.0</b>	<b>0.9</b>
Ending stocks	2.0	1.3	1.6	2.6	3.6	1.0

Crop Year Billions of Bushels

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# They don't run – just for fun



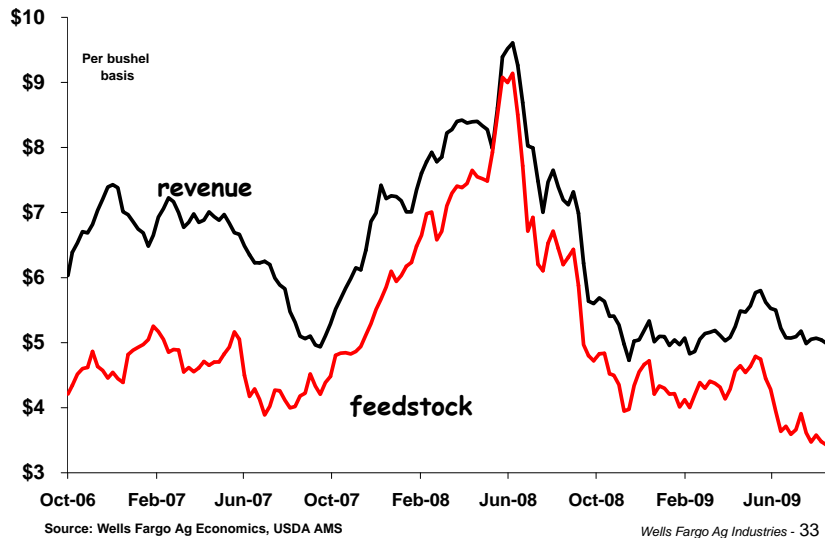
Source: Wells Fargo Ag Economics, USDA AMS

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## The worm always turns



Iowa Ethanol Revenue v. Feedstock



Commodities prices will “trend higher” but “cycle violently” with the global economy

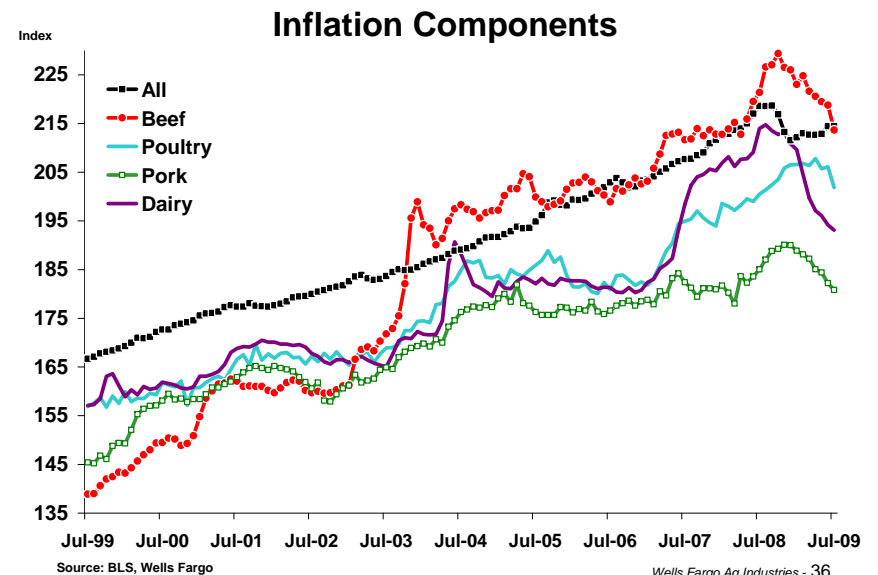
Prices don't confuse the “effect” for the “cause”

## Implication for Livestock



- Huge future growth
  - ◆ Global population
  - ◆ Global economic activity
- Proprietary intellectual property
  - ◆ Animal biology is complex relative to crops
    - ☒ Genetics
    - ☒ Practices
- Barriers to entry grow
- Most value-added occurs off-farm
- Battle for the “hearts and minds”
  - ◆ Animal welfare and restrictions
  - ◆ Carbon taxes

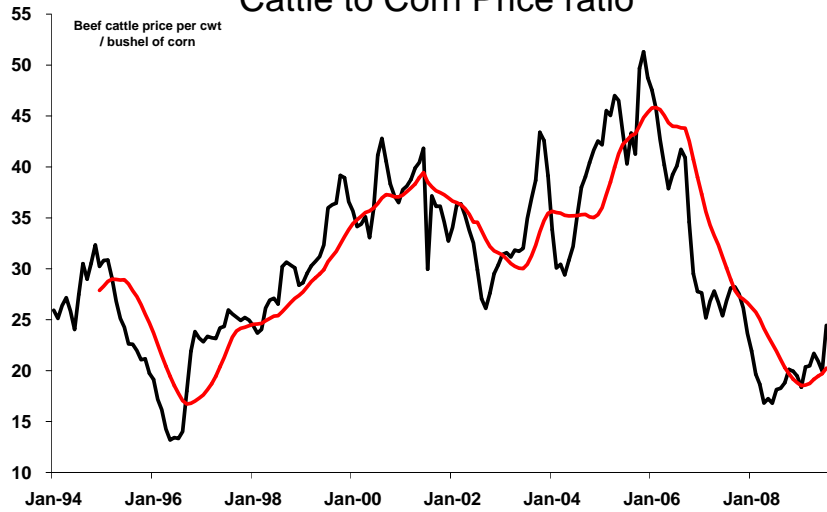
## The consumer has come through



## Not sustainable – expect a hysteresis development



### Cattle to Corn Price ratio



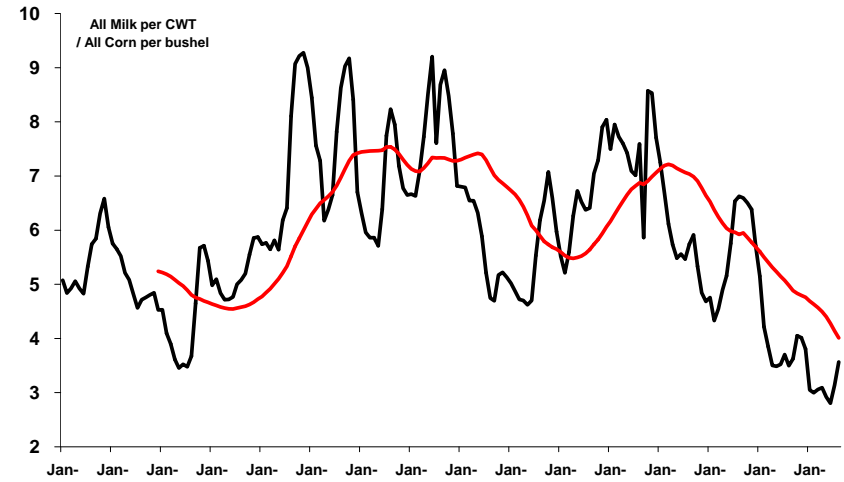
Source: Wells Fargo Ag Industries

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## A long way from working



### Milk to Corn Price Ratio



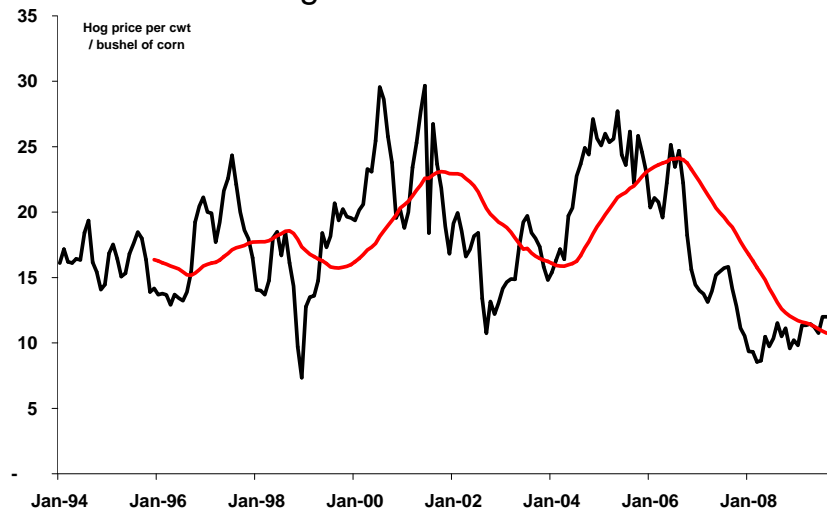
Source: WF Ag Industries

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## Remember fixed cost barriers



### Hog to Corn Price ratio



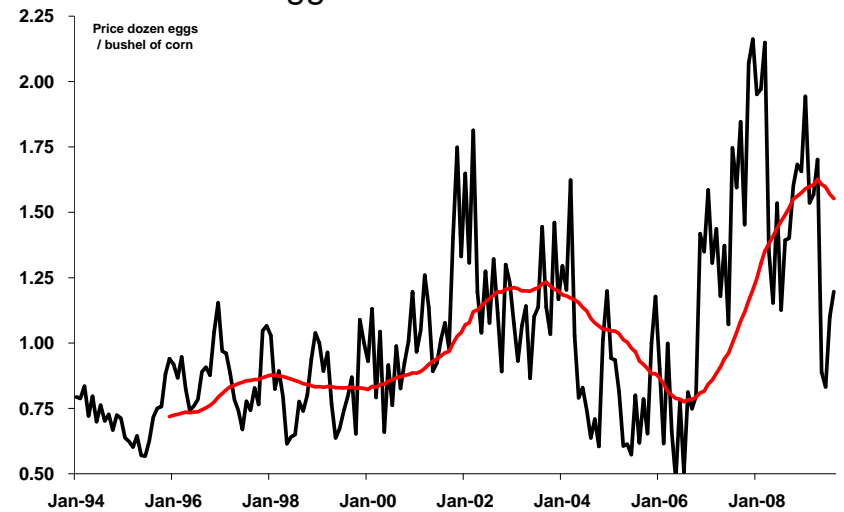
Source: Wells Fargo Ag Industries

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## Their row has yet to be hoed



### Egg to Corn Price ratio



Source: Wells Fargo Ag Industries

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## Row crop implications



- Food, fuel and fiber
  - ◆ Great demand but who supplies it?
  - ◆ Comparative versus competitive advantage
- Fuel is the wildcard
  - ◆ Carbon tax collateral damage
  - ◆ Technological change
  - ◆ Can we export biofuels?

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## Increasing volatility has consequences



- All commodities will have greater price volatility
- Margin management v. "guessing"
  - ◆ Risk management is never free
  - ◆ Deleveraging has a financial cost
- The "knowing doing gap"
- Averages mean nothing
  - ◆ Timing
  - ◆ Inter-industry competitiveness

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