



Cornhusker Economics

Jerome Powell Is Not the Bad Guy

Market Report	Year Ago	4 Wks Ago	12-7-18
Livestock and Products,			
Weekly Average			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight.	116.00	114.00	118.00
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb.	178.98	169.61	171.59
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb.	165.87	154.36	149.34
Choice Boxed Beef, 600-750 lb. Carcass.	206.87	217.37	213.43
Western Corn Belt Base Hog Price Carcass, Negotiated	58.56	51.07	46.49
Pork Carcass Cutout, 185 lb. Carcass 51-52% Lean.	82.53	70.34	70.56
Slaughter Lambs, woolled and shorn, 135-165 lb. National.	132.18	135.43	133.49
National Carcass Lamb Cutout FOB.	386.01	380.23	384.06
Crops,			
Daily Spot Prices			
Wheat, No. 1, H.W.			
Imperial, bu.	3.09	4.43	4.60
Corn, No. 2, Yellow			
Columbus , bu.	3.14	3.40	3.50
Soybeans, No. 1, Yellow			
Columbus , bu.	8.97	7.79	8.12
Grain Sorghum, No.2, Yellow			
Dorchester, cwt.	5.61	5.48	5.61
Oats, No. 2, Heavy			
Minneapolis, Mn, bu.	2.68	3.18	3.29
Feed			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185			
Northeast Nebraska, ton.	165.00	*	*
Alfalfa, Large Rounds, Good			
Platte Valley, ton.	87.50	110.00	110.00
Grass Hay, Large Rounds, Good			
Nebraska, ton.	82.50	87.50	87.50
Dried Distillers Grains, 10% Moisture			
Nebraska Average.	147.50	137.50	157.50
Wet Distillers Grains, 65-70% Moisture			
Nebraska Average.	44.25	49.00	50.50
* No Market			

One of the maxims often heard in economics, agriculture, and politics is that those who do not learn from history are bound to repeat it. At first glance, this is a pessimistic view of human behavior. However, I believe that in some part it is a reflection of the positive spirit exhibited by many Americans. While it is true some have not bothered to learn from history, others have simply emphasized the positive times while simultaneously limiting the memory of more challenging experiences.

One example of our collective revisionist memory is the attitude farmers, ranchers, business people and consumers have regarding interest rates. Dissertations and research studies will be written for years to come pinpointing the causes of the Great Recession, and the conclusions will vary. I am, however, confident that nearly all of them will include the ease and amount of nearly free money available for real estate purchases, capital investments, and transportation.

Most of us have a personal experience (or know someone) who has been motivated to make such a purchase because of low interest rates. I am not implying these decisions were made with poor judgement; in fact, I often spurn the overly conservative advice of personal financial gurus. The purpose of low interest rates is to encourage business investment by lowering the hurdle rate. If money can be borrowed at 3 to 4 percent, or

taken out of an interest-bearing account with even lower yields, investments in buildings, technology, equipment, or more education are surely profitable as the investment only has to enhance profit by at least the explicit interest rate on borrowed funds, or the implied rate on self-financed investments.

So, in fact, it seems that many decision makers have learned a lesson from the Great Recession. An overreaction would be to spurn debt-financed investments altogether, something that has certainly not happened in Nebraska Agriculture. In my Farm and Ranch Management class, I challenge students to learn and apply a framework for making economic decisions based on liquidity AND profitability.

These new decision makers will soon graduate; upon their entry into the workforce, they may be faced with a slightly different interest rate environment. The current Federal Reserve Chairman, Jerome Powell, has made this clear in his announcements regarding interest rates. Many in Washington and the rest of the country were pleased when the Chairman recently announced the raising of interest rates would be *slowed down*. While rates will not rise as fast as once planned, they are certain to rise.

So who is this Jerome Powell, and why is he such a party pooper? Whether your political leanings push you to believe the current economic expansion (rising GDP and record low unemployment) is a leftover of the Obama era, or the result of President Trump's tax cuts and deregulation, low interest rates are the star of the party, and it seems as though Mr. Powell may be putting a premature end to the festivities.

While I was alive during our country's last era of high inflation (1974-1982), I was not making economic decisions, so I am only able to read and reflect on the implications of inflation. Although I have not personally felt the negative effects of inflation, I have taught the subject to college students for over ten years.

In the past twenty years, there have been only two years where inflation was at least 4 percent, and in those years (2006 and 2008) it was 4.0 percent and 4.3 percent respectively. Even those with a few gray hairs may not remember the complications inflation causes.

The good news about the inflationary pressure the Federal Reserve is currently forecasting, is that it is the *good* type of inflation. This *good* moniker is a bit mis-

leading; the impact of inflation is always the same; what differs is the underlying cause. The double-digit inflation of the 1970s was the *bad* kind, known as "cost-push" inflation. Soaring oil and fuel prices caused the supply of all goods to decrease, putting upward pressure on prices AND unemployment rates. The imminent *good* inflation is known as "demand pull," whereby the collective demand for goods and services is increasing faster than supply. While prices rise, unemployment remains low. This is why some inflation is deemed a good thing when an economy is coming out of a recession.

Right now we are long removed from the depths of the recession, and are enjoying historically low unemployment rates. Rates are so low, in fact, that most economists believe they are below the natural rate of unemployment. The "natural rate" is the rate whereby unemployment is only caused by job switchers and those unemployed by the natural machinations of a dynamic economy (known as frictional and structural unemployment).

The pressure of low unemployment will surely grow wages, consumer confidence, and spending. Combined with low interest rates, inflation will become a reality and not just a fear. Since 1982, expansions have always been tempered by The Federal Reserve and their "inflation fighting" standard. Over this time, they have been very successful in this regard.

The decision makers at the Federal Reserve (the Chairman, The Open Market Committee, and the Board of Governors) are appointed to terms in a specific way to shield them from political pressure. These leaders are the ones who have to put an end to the party by raising interest rates, an unpopular, but prudent decision. Raising interest rates will lower consumer expenditures (good-bye to zero percent auto rates!) as well as business investment and construction projects. In addition, unemployment may rise.

Clearly, these are all bad things. However, they are the side effects of the medicine that will ward off the disease that is inflation. Inflation rates as low as 6-8 percent seem harmless, but when compounded over a short period of time, the impact is large. Six

percent inflation over five years results in an overall increase in prices of 34 percent. Eight percent compounded over the same time results in prices

47 percent higher on average. This has two very important ramifications for ag producers in Nebraska. The first is related to the unequal impact inflation has on individual markets. If prices rise by 47 percent, it does not mean *all* prices rise by 47 percent, it simply means the average of all prices rises. Surely, some markets will be flat or even see price declines. Imagine a corn, soybean, or beef producer. The inputs necessary to produce these products are many and diverse. Over a time of rising prices, the cost of production is sure to increase in a way typified by the prevailing inflation rate. The output price of any of the big three may not. Commodity producers are already exposed to a large amount of market risk, inflation only adds to this concern.

The second reason inflation is a concern in agriculture is access to credit. We know that inflation can be curtailed by raising interest rates. However, persistent inflation will add to these rates. If lenders are not confident the Federal Reserve will fight inflation, they will include a larger buffer to warrant against unanticipated inflation. For example, imagine lending someone \$100 at 10 percent interest. Over the course of the year, there is 20 percent inflation. At the end of the year you are paid back \$110, which buys only 91.67 percent of what \$100 bought the year prior. Borrowers and lenders should be rewarded for making good decisions, not penalized because of unanticipated inflation. In this scenario, lenders will be reluctant to make long-term

loans in general, a serious concern for ag producers dependent on debt financing. So how high is too high? Inflation, whether anticipated or not, becomes a concern somewhere between 2

percent and 10 percent. I tell students there are two ways to tell if inflation is a concern. The first is whether it is noticeable or not. Even college students can think back far enough to remember lower prices, but it is likely they can barely remember. If, however, we notice prices persistently rising each week, month, or even year, inflation is probably too high. The second test follows the first. If inflation is high enough to notice, it is probably high enough to *beat*. That is, producers and consumers start to behave in a way to lessen the impact of inflation. We hold less cash, decline to enter long-term contracts, negotiate contracts more often, and seek out barter arrangements. All of these strategies lessen the negative impact of inflation, but waste a valuable resource, time.

In summary, rising interest rates are unpleasant. They lower business investment and consumer expenditure. They make buying land and expanding production more difficult and less profitable. The alternative, inflation, is worse. Persistently high inflation exposes ag producers to more market risk, lessens the availability of credit, and encourages people to waste time trying to defeat it. If the Federal Reserve continues to raise rates, think about this scary alternative posed instead of criticizing the very challenging decisions faced by our national economic leaders.

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