Executive Briefing
Farm Equipment Sector

Farm Equipment Demand Sips

Index Drops Again in February

Briefing Date: For Mar 2024

BLUF (Bottom Line Up Front): Farm equipment demand continued to drop as we head into April. The index came in at 62.2, down slightly from last month's adjusted 63.0. The transition out of a strong El Nino cycle into a neutral and then La Nina condition later this year is changing weather patterns, and generally will help farm production. The National Drought Monitor map shows improvements in most regions, although some upper Midwest pressure will remain for the interim, especially across parts of Kansas, Iowa, and Minnesota.

Favorable Economic Conditions:

- **Updated Economic Outlook Positive. –** For now, economic growth is exceeding expectations. If these trends continue, the US should see annual growth of nearly 2%, up nearly a full percentage point from estimates at the beginning of the year. Consumer spending is still trending ahead of expectations and corporate investment is generally remaining stable. There is no question that global geopolitics are weighing on expectations and have started to push some consumers to "bunker" (building cash reserves "just in case"), especially with uncertainties surrounding the election. But overall, the economy continues to be stable on the back of a solid jobs market. Without stable wage growth and employment, conditions would change quickly. And that's the data point to keep an eye on.

- **Farmer Expectations Mixed.** The Purdue CME Group Ag Economy Barometer for March showed that the current conditions index was lower month-over-month by 2 points, but the future conditions index improved by 5 points. That is the important distinction in this month's report, farmers are generally concerned about their drop in income over the past year and the squeeze on them from higher inflation and operating costs. But their outlook on the next 6 months is improving. They anticipate that it will be a better production year and that food prices will help with income. This is why we loaded this in the favorable economic conditions section, it appears as though sentiment is improving and optimism about the future will help with equipment purchases.

- **Interest Rate Questions Remain.** Just when it looked like the Federal Reserve would be poised to start cutting interest rates, the economy threw some curve balls at it. In the latest report from the Fed in March, expectations still hold for up to three, quarter-point cuts in 2024. The first quarter-point cut was projected to come as early as June, but those notions are starting to fade. Stronger than expected economic growth, sticky inflation, and a strong jobs market could keep the Fed in place longer. For now, most analysts still project that interest rates will move from a Fed Funds rate of 5.25% to 4.75% by the end of the year.

Risks Creating Headwinds for Sales:

- **Delayed Interest Rate Cuts.** Many farmers use various forms of debt to run their operations, and higher interest rates are a drag on spending and squeeze incomes. Farmers mentioned in the Purdue survey that they were optimistic about the Federal Reserve trimming interest rates later this year. But that may not be the case in the current environment. Inflation rates have flattened at roughly 3%, which is still well above the Fed's target rate of 2%. Until the Fed witnesses more progress toward its 2% target rate, it could hold rates unchanged for longer, which could impact spending.

- **Higher Input Costs Into Manufacturing.** Global manufacturing surveys in March indicated that most industrial firms were seeing higher input costs, largely stemming from global transportation costs increasing. Some increases in petroleum and chemical costs were also a factor pushing prices up in the near term. And lastly, this is additive on top of wage costs that continue to remain robust. Most private wage indicators show that wage costs are rising at nearly 5% annually. The manufacturing costs associated with absorbing these higher input costs are likely to push equipment prices higher, or margins will continue to get squeezed. Some manufacturers may start discounting selling prices if demand lags, but the process of recovering from the supply chain crisis of 2021/2022 is still a factor pushing parts sales as buyers work to get older equipment restored and running.

Conclusions:

1. Farm equipment demand continues to drop for the 11th month in a row, but it does remain higher on a historic basis against pre-pandemic measures despite falling below the long-term trend.

2. Farmer sentiment on capital spending in the near term also deteriorated in the latest data from March, but sentiment about spending over the next six months improved.

3. Weather patterns are changing, and a La Nina pattern could bring a long-lasting break in the US drought. The drought monitor map shows some improvement in key production areas in the west along with slight improvements throughout the Ohio Valley and parts of the Midwest.

Related Macro Items We are Watching:

1. **Petroleum Prices and Inflation.** At the time of writing, petroleum prices were rising and were up 19.6% year-to-date and were 15.9% higher vs. this time last year. JP Morgan is predicting that oil prices could move above $100 a barrel by July. And when it comes to many commodities, there may not be a more important item shaping global economics.

   Geopolitical issues and recent drone strikes on Russian refinery infrastructure has elevated concerns about global supply. Prior to these events, the EIA had projected supply matching demand for most of 2024 and into 2025. With China's economy perhaps performing a bit better than expected, some strength in India and slight improvements in Europe, demand projections could be moved upward. And with hits to production raising concerns of global oil supply, it is pushing overall oil price expectations higher. As mentioned, for now.

   Lastly, there is some risk in trying to predict the weather, but the hurricane forecast for 2024 is ramping up to be one of the most active in recent history. With warm Gulf and Atlantic waters coupled with a shift to La Nina (which changes upper wind currents and reduces wind shear), the number of US landings has the potential to be higher. Gulf oil production has been unimpeded for several years, and that could change this year. This would also push oil prices higher. If a strong storm were to make landfall in the Gulf region, it would push refined fuels and petroleum prices higher. Oil prices surged 39% in the three months after Katrina in 2005.

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Index Slips Again in February

Spader Index Drops to 62.2 from 63.0

BLUF (Bottom Line Up Front): the **Spader Farm Equipment Demand Index came in lower again in February for the 11th month in a row (latest available) against adjusted data in January; and is further below the long-term trend.** This index uses multiple metrics to gauge demand for farm equipment in the six months ahead. Much like a leading economic index, the metrics were still pointing toward potential demand remaining historically elevated in the latest reading, but risks remain. Much better weather conditions should help increase output, but input costs are still high.

Demand Index:

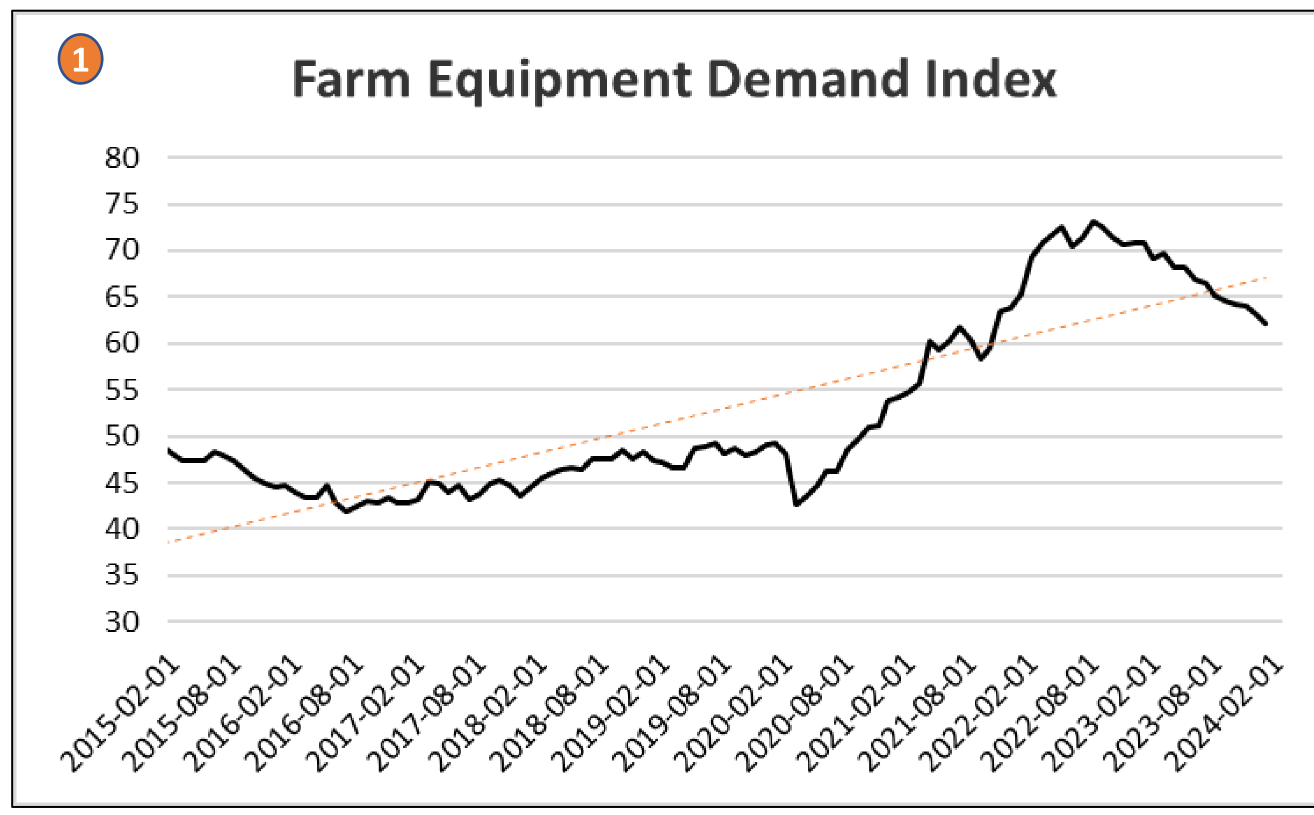
- February 62.2
- January 63.0
- December 63.9
- November 64.1
- October 64.6
- September 65.2
- August 66.4
- July 66.9

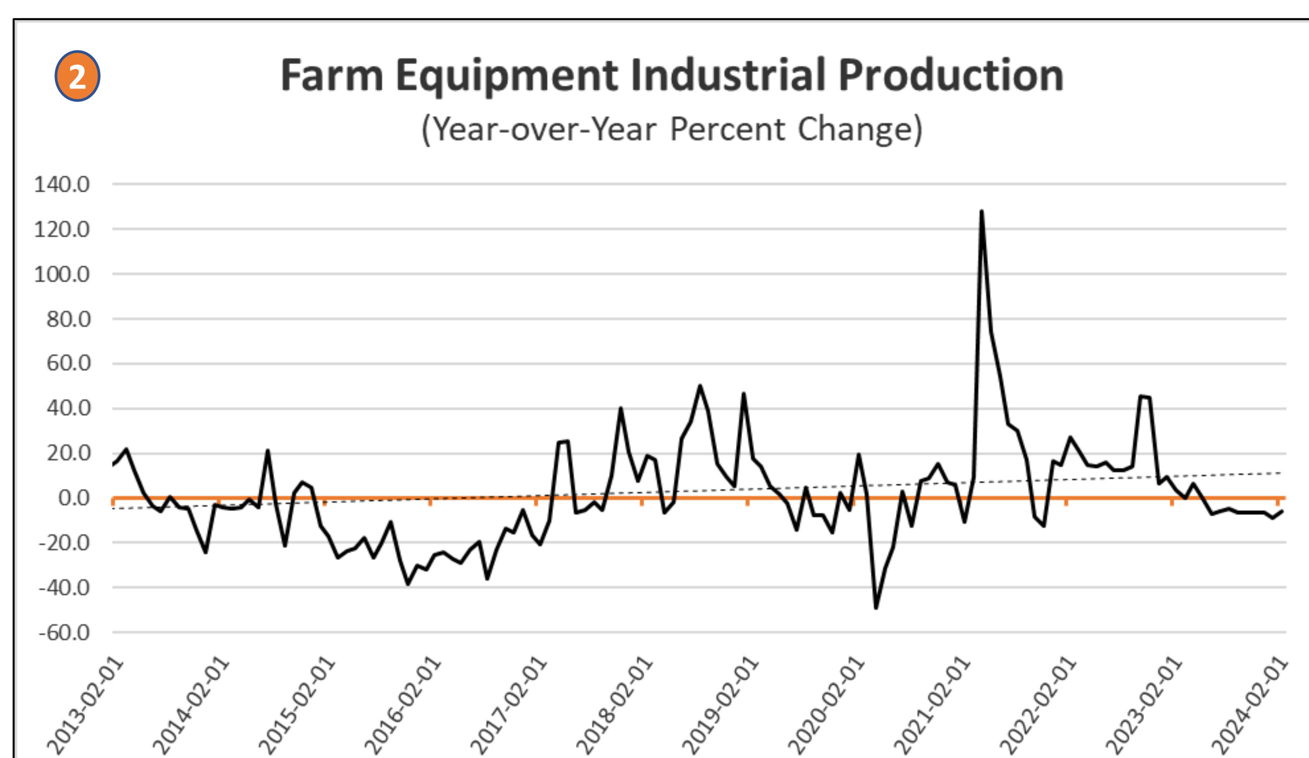
Farm Equipment Demand Index:

- **February Demand Index Comes in at 62.2.** The Farm Equipment Demand Index came in at 62.2 in February (latest available), down 1.3% M/M vs. the January level. It was 12.2% lower than it was in the same period last year (-11.0% lower in the last briefing). Data shows demand slowing but 1) it remains above the pre-pandemic levels and yet 2) it continues to remain under the long-term trendline.

- **Production Continues to Slow.** Farm equipment manufacturing activity in the United States fell at a 5.9% rate year-over-year through January (latest available and 8.9% lower last month). But it was higher month-over-month by 2.8%. Industrial Production in the farm equipment complex can be volatile as the chart in area #2 shows.

- **What is Pushing the Demand Index?** The index uses a variety of variables to gauge demand and several factors started to pull it lower. Farm incomes were struggling under the weight of inflation and higher interest rates were slowing purchases of new equipment on a macro basis across the country. Inventories have largely recovered. But note that spending continues, and at a faster rate than the period prior to the pandemic on a national basis.



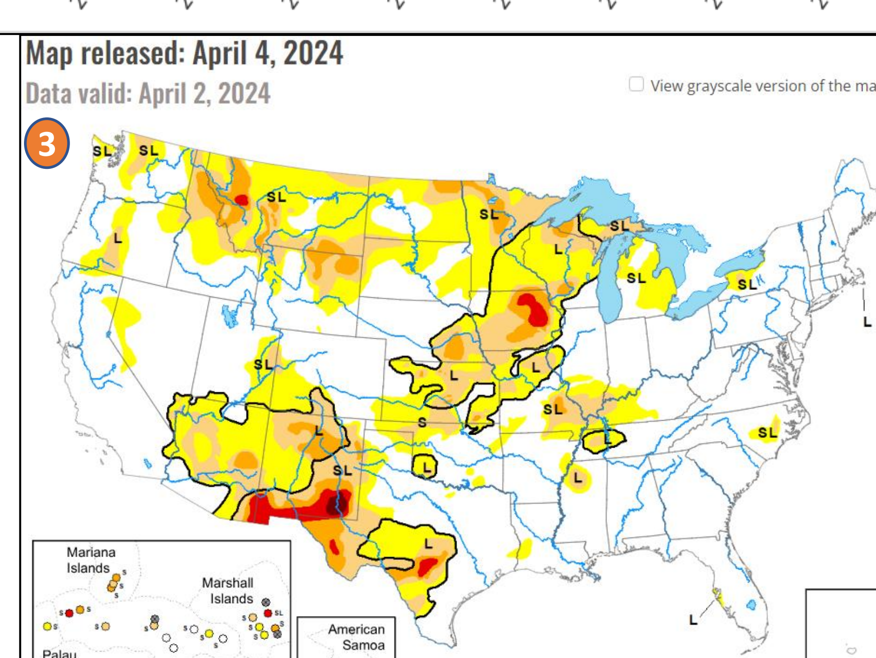


Looking Forward:

- **National Drought Monitor Map Improving.** The US Drought Monitor map (lower right) shows that national drought conditions are generally much better than in the past 5 years. Areas of drought continue to be problematic, but most of those regions are short term (with some mild long-term impacts). The most concerning region stretches from Kansas through the Great Lakes region and conditions here have taken on a longer-term impact. Spring rains could ease conditions and winter and spring wheat crops can be resilient with a small amount of precipitation. Production in the West could be the strongest in a decade or more, given substantial water resources and improving irrigation conditions.

- **US Beef Herd Lowest Since 1951.** USDA estimates suggest that the US cattle herd will drop 2% year-over-year to 28.2 million head, the lowest level in 73 years. Texas herds (15% of the national total) are the smallest since 2014 and those figures were pulled prior the disastrous wildfire situation which may have killed more than 10,000 (out of 4.1 million).

  Officials are also watching Avian Influenza (H5N1) in which some crossover cases have reached the cattle herd. Although the virus doesn't necessarily kill cattle, it can significantly impair growth and could impact or slow reproduction.



Source: UN FAO World Food Price Index