Business Record

2017 Economic Forecast

13 answers to the most pressing economic questions for 2017

BY BUSINESS RECORD STAFF

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In preparation for our economic forecast issue, our newsroom had our annual brainstorm to discuss and develop a list of the most pressing economic questions for 2017. Then, we went out to find experts to help enlighten us and of course the business community in an effort to shine light on a variety of the issues that are sure to have an impact on your business in the coming year. This year we identified 13 questions, and our experts answers are sure to provide you a few guideposts to navigate the waters in 2017.

Chris Conetzkey, editor of the Business Record

1.How will farmland and grain prices trend in 2017, and what will the impact be on Iowa businesses?

Agriculture in Iowa, the United States and around the globe is posting record consumption coming out of 2016. That said, U.S. farm income is down 32 percent from 2012 peak levels. The ag sector, globally, invested to take advantage of the record commodity prices posted in 2012, which were a result of two acts of Congress (Renewable Fuels Standard of 2005 and 2007) followed by acts of Mother Nature (poor weather in 2012 that culminated in the biggest drought since the 1930s Dust Bowl). These factors helped drive corn prices to $6.89 per bushel and soybeans to $14.40 per bushel. (For reference, corn prices averaged $2.25 per bushel from 1974 to 2006.)

Currently farmers have produced, with the help of the weather, four consecutive years of “above trend” yields, and 2016-2017 average corn prices are $3.30 per bushel, down from $3.60 last year. Assuming yields continue on the current trend, we anticipate corn prices will stay about at this level. In the end of the year, we could see that increase or decrease by around 50 cents per bushel, depending on what we experience in weather and yields in 2017.

The market for soybeans is worth watching in 2017, as South America seems to have big crops coming, and the market is currently trying to incent U.S. farmers to increase their soybean acres as well. If all this production comes together, soybeans could experience commodity price pressure unless China and other countries increase their consumption through imports.

Land prices did not increase as much as the commodity prices and also have been stickier on the way down. The relative returns to land are not falling as much as commodity prices, and farmers will need to maintain productivity (yield) increases to outcompete other investment options. Because of the Federal Reserve interest rate action in December 2016 and the outlook for a potential increase three times in 2017, this becomes more important to land prices, as the relative returns to land may not be as favorable relative to other investment options.

Investors outside of the traditional agriculture segment may look elsewhere for relative returns. If land prices were to drop another 5 percent to 10 percent, that would have ramifications on some farmers’ balance sheets, as well as impacting land valuations for taxes and support of local communities. This has effects that all of us, inside and outside of agriculture, need to watch and possibly take action on as 2017 unfolds before us.

Steven Elmore
chief economist and director of market intelligence, DuPont Pioneer

2. Do you expect the agriculture economy to pick up, slow down or stay about the same in 2017? What will the impact be?

With corn and soybean prices stagnant or even lower than a year ago and deteriorating livestock profit conditions, I expect the agricultural economy in the U.S. especially across the Corn Belt states to further slow down in 2017. No matter which commodity you examine in the U.S. agricultural sector — crops like corn or soybeans, or livestock like cattle or hogs — you will see expanding production and inventories. This is a result of overproduction on the global scale chasing the phenomenal profits in the late 2000s. This strong or sometimes record-level production has led to surpluses, which have depressed crop and livestock prices.

Unfortunately, current projections show a loss at these prices. Preliminary Iowa State University cost of production estimates for 2017 indicate a 50 cents per bushel loss for corn and possibly break-even for soybean production with average costs and yields. Additionally, the hog, cattle and dairy producers are embracing low to negative margins in the months ahead. A historical analysis of corn and soybean margins seems to suggest that it takes roughly six to eight years to move from the negative-margin eras to positive profits again for the industry.

These low crop and livestock prices have trickled down in the agricultural sector, leading to the lowest U.S. net farm income level since 2009, declining repayment rates for agricultural loans and vendor credit, and measurable declines in farmland values in major agricultural states. With the strong dollar, increasing interest rates and rising uncertainty in trade with key partners like China, the Federal Reserve Banks in both Chicago and Kansas City are reporting weakened expectations for repayment rates in each agricultural industry by bankers, signaling the heightened financial stress for producers and agricultural professionals.

However, there are glimpses of hope for 2017: The corn and soybean prices are improving as costs and rents are working their way down. Average Iowa farmland values have shown a decline for the third year in a row — the first time this has happened since the 1980s farm crisis. For a pessimist, there are reasons to worry, especially for landowners and/or producers who are over-leveraged. For an optimist, this decline is still modest, and the probability of a replay of the 1980s farm crisis is low. The likelihood of another farm crisis is low due to steady farm income accumulation before the downturn, a stronger government safety net and an overall lower debt level in the agriculture sector.

Wendong Zhang
assistant professor in economics, Iowa State University

3. What effect would the easing of environmental controls under the Trump administration have on the Iowa economy?

The Federal Clean Air Act signed into law by President Nixon in 1970 passed the House and Senate with only a single "no" vote. Likewise, the Clean Water Act signed into law by President Kennedy enjoyed strong bipartisan support. Dangerous smog levels in major cities, acid rain that visually damaged buildings, rivers filled with raw sewage and literally burning with oil-soaked trash provided strong focal points that led to agreement that something needed to be done. After regulations took effect, major improvements in air and water quality followed, as did associated reductions in illnesses and deaths linked to pollutions. U.S. citizens may take these improvements for granted, but pictures from 50 years ago look eerily similar to pictures of smog and water pollution in current-day China.

It is important to note that these improvements did not come for free — they raised the cost of producing energy, processing raw materials and producing other industrial products. This in turn raised the cost to consumers and had employment effects in some industries. However, these regulations also spurred innovation that created jobs and lowered the costs of achieving these environmental improvements.

In Iowa, we enjoy clean air. Our waterways are no longer heavily impacted by industrial or municipal waste. Nutrients from agricultural sources remain a problem, but federal regulations do not apply to most cropland sources of pollution, so leadership from the state will be necessary to tackle this issue. While changes to environmental regulations from the federal level are unlikely to have much effect on Iowa business, proposals to support alternative energy (biofuels and wind) are important to Iowa businesses, and loss of federal support for these initiatives could negatively affect both our environment and economic activity within the state. Additionally, farm bill programs within the U.S. Department of Agriculture are an important source of money to address water quality; reduced funding for these efforts could hurt agriculture and water quality initiatives.

Catherine Kling
Charles F. Curtiss Distinguished Professor in Agriculture and Life Sciences, Iowa State University

4. The MPO sees Greater Des Moines reaching 750,000 or more residents by 2050. What factors would lead to the Greater Des Moines population expanding at a rate faster or slower than is currently projected?

The population of the Des Moines-West Des Moines Metropolitan Statistical Area (MSA) grew by nearly 60 percent from 1980 to 2015. The interplay of national, regional and local factors will determine whether or not the Greater Des Moines area maintains a similar growth rate through 2050.

Recent population projections from the U.S. Census Bureau indicate a slowing rate of growth across the nation. The U.S. population is expected to grow by 30 percent from 2015 to 2050, well below the 41 percent achieved during the prior 35 years. The national projections assume a continued decline in fertility rates and a modest decline in net international migration. Changes in U.S. immigration policy may further alter rates of national and local growth, and will be an important factor to watch.

Iowa and neighboring states in the Plains and Great Lakes regions have been capturing a declining share of U.S. population growth. These traditional manufacturing and farm-dependent regions have lagged states in the Southeastern, Mountain and Far West regions. Midwestern fortunes may improve with continued efforts to rebalance the regional industrial portfolio with higher-growth service industries.

Most growth occurring in the Midwest is accumulating to metropolitan areas, which compete with one another for residents and for jobs. The Des Moines-West Des Moines MSA ranked fourth among the 10 fastest-growing Midwestern MSAs since 2000, but faces strong competition from nearby Sioux Falls (which ranked second), Columbia, Mo. (fifth), Iowa City (seventh) and Lincoln, Neb. (10th). Prospects for Greater Des Moines may be tempered if growth in these or other nearby metropolitan regions picks up steam.

The rate of population growth in Greater Des Moines during the last several decades suggests that much is working well in the region. Continued success will hinge on the region's ability to provide not just jobs, but attractive career opportunities for young and midcareer workers.

Liesl Eathington
assistant scientist, Department of Economics, Iowa State University

5. What can we expect for the unemployment rate in 2017, and will there be any pressure on wage growth due to demand caused by a shortage of skilled workers?

U.S. job growth has been quite good since the financial crisis, with over 2 million new payroll jobs added in each of the last six years. Further, the unemployment rate has fallen from its high tick of 10 percent in 2009 to 4.7 percent last December. The latter rate suggests the United States is at or near full employment. However, the Federal Reserve is keeping monetary policy very accommodative because a key measure of underemployment, at 9.2 percent, is still unusually high for this stage of the business cycle. That last statistic includes, among others, discouraged workers, those who would like a job but aren't currently looking and those working part time but who want a full-time job.

Fed Chair Janet Yellen believes that many of those potential jobholders could be enticed back into the workforce as the labor market tightens. That has not happened much to date, and the labor force participation rate remains near a several-decade low of 62.7 percent.

Wage growth, though, has been very sluggish most of this business cycle and has only started to accelerate over the last 15 months, with average hourly earnings now up 2.7 percent on a smoothed basis from the prior year. Meager wage gains may be part of the reason the underemployment data stayed so high and few people have rejoined the workforce. That could be changing.

We look for wage gains to accelerate and expect average hourly earnings growth to exceed 3 percent and perhaps even 3.5 percent this year as the demand for skilled workers in a tightening labor market keeps rising. Wage growth of 4 percent or more has not been atypical in the later stages of past business cycles. Those better wage gains could draw in more workers and expand the labor force. That combination could keep the unemployment rate in the low to mid-4 percent range this year and allow the Federal Reserve to stay gradual with its rate hikes.

Bob Baur
chief global economist, Principal Global Investors

6. With one big exception, the development of spec office buildings seems to be going nowhere in Greater Des Moines. Why?

We should be grateful that market discipline has helped Des Moines avoid overbuilding.

Fourth quarter 2016 office vacancy in downtown is 16 to 17 percent and in the suburbs is 9 to 12 percent. Downtown hit nearly 30 percent vacancy several years ago.

While there has been some absorption, repurposing the downtown office space to housing was the major factor in bringing the vacancy rate down. Both downtown and the western suburbs are impacted by construction of corporate headquarters development.

Not overbuilding spec office space has kept supply and demand in balance and the vacancy rate relatively stable, especially in the western suburbs.

Major markets boom and bust in the office space on a pretty predictable cycle, while Des Moines has enjoyed the benefit of smart, controlled growth in this sector.

Jennifer Cooper
vice president and manager, commercial real estate, Bankers Trust Co.

7. What can we expect for the stock market in 2017?

Based on our analysis, the S&P 500 is currently trading at or near what we consider “fair value” for this point in time. We believe the modest growth/modest inflation environment we have been living with for the last six years will likely continue in 2017. Although economic growth is below the longer-term trend, investors around the globe have largely viewed the U.S. economy as dependable and our domestic stock market as somewhat of a relative safe haven in an uncertain world.

Our projection calls for 2017 S&P 500 earnings to grow 6 to 7 percent as the energy sector becomes much less of a drag on overall results and the economy slightly improves. Our 2017 year-end target range for the S&P 500 Index is 2,230 to 2,330.

We continue to have a positive view of the stock market into the middle portion of 2017. We look for the growing economy to push revenues ahead modestly in the coming year. In the second half of 2017, we believe investors will start to be concerned about wage inflation and slightly higher overall inflation in 2018. They will likely also worry that the Fed might be “behind the curve” and may need to “catch up” by moving rates higher at a quicker pace than most anticipate. That will be a headwind for stocks in the second half of 2017, in our opinion.

Given our outlook for continued growth, for now, we are still focusing mostly on those cyclical sectors which are more sensitive to the ebb and flow of the economy. We recommend overweights in the consumer discretionary, industrials, financials, information technology. We are also recommending an overweight in the health care sector (normally defensive but a value call here). Net-net, from Jan. 1 through Dec. 31, 2017, we look for a rather flat performance in the S&P 500. We are not calling for an end to the cycle — more like a “stall” year for stocks.

Scott Wren
senior global equity strategist, Wells Fargo Investment Institute

8. How do foreign economies affect the commercial real estate market in Central Iowa?

Foreign investment increases competition in the secondary and tertiary markets, pushing down cap rates, and ultimately can increase property prices.

U.S. real estate is generally considered a more safe investment when compared to real estate in other global markets.

Understandably, foreign investors are interested in putting their money to work in U.S. real estate assets in this low interest rate environment.

The majority of the real estate investments considered are coastal population centers and large noncoastal markets like Dallas, Denver, Chicago, for example.

As the sellers of the U.S. properties look to reinvest proceeds, they also want an acceptable return and look to a value-add play. They can either acquire a property in a lower quality asset class to increase yield or buy an asset in a secondary or tertiary market where yields are higher.

Consequently, cities like Des Moines are seeing investors from the East and West coasts purchasing properties here. In certain cases, foreign investors are also starting to acquire assets in these secondary and tertiary markets.

Michael Helak
market president, community banking, Des Moines, U.S. Bank

9. What effect would a unified statewide minimum wage increase have in Iowa, both in the short term and the long term?

As a part-time office clerk while a college student in 1977, I made $2.30 an hour, the minimum wage then. Adjusted for inflation using the personal consumption expenditure index from the U.S. Bureau of Economic Analysis, it would take $7.53 an hour today for me to have the same purchasing power. In 1979, that same minimum wage job, then $2.90 an hour, was worth $8.15 an hour in today’s dollars. The current $7.25 minimum wage does not look all that much out of whack with these examples, but it is. It is perpetually out of whack because the minimum wage is too often a political construct, not an economic construct.

By not adjusting the minimum wage in a timely manner, which is the political norm, workers eventually lose purchasing power and must work more hours to compensate for the losses. For example, a full-time, full-year worker making just the minimum wage since 2009, the last time it was boosted nationally, will have lost, cumulatively, $6,280 in purchasing power due to price inflation through 2016.

Labor markets have already responded, political inertia notwithstanding: Most entry-level retail and service jobs in Iowa in 2015 paid $8.15 an hour or so, according to Department of Workforce Development tables. Further, some states and cities have passed their own adjustments, to include a handful of Iowa’s communities. Gov.

Branstad recently announced he is in favor of setting a statewide minimum wage, though likely to be coupled with legislation to eliminate city-set and county-set minimum wage initiatives.

But the minimum wage should not be a point of political negotiation at the local, state or federal levels. Fundamental fairness to workers dictates that it should be adjusted annually for inflation, with a new federal minimum set by rule at the beginning of each year. Federal legislation would be required to do this, and it is long overdue. An initial baseline minimum needs to be established, and then the system can be put on autopilot.

Lacking federal leadership, which is likely, Iowa should adopt this strategy — that's what South Dakota did and what more states should do, absent federal attention. Businesses and workers will benefit from wage certainty from year to year, and Iowa will not have a fragmented wage system that engenders derision and dissent or requires piecemeal workarounds.

Dave Swenson
economist, Iowa State University

10. What's the outlook for merger and acquisition activity for Iowa companies?

There was much discussion over the state of the M&A markets in 2016. After a record-breaking 2015, we saw a sizable dip in global deal volumes in 2016 (although still a healthy $3.6 trillion). This has been attributed to a variety of factors; however, difficulties surrounding regulatory approval of large, cross-border mergers and uncertainty over the future administration in the U.S. were two of the biggest headwinds.

We believe 2017 will be another strong year for business transactions despite the uncertainties. Iowa business owners who are looking to transition ownership will still find a host of willing and able buyers with plenty of capital to deploy. Many strategic buyers are still experiencing sluggish organic growth and are looking to supplement that through purchases. An added benefit that could come to fruition from the new administration is a decrease in taxes. Based on our discussions with business owners, the potential tax savings are a very important consideration when deciding to sell.

On the flip side, many Iowa businesses can be expected to make acquisitions of their own. We have many companies in the state that have strong management teams and are growing tremendously. These companies can use their resources to make strategic acquisitions of competitors, suppliers or complementary product lines that might not be getting the proper attention and investment to grow under current ownership. Although interest rates increased in 2016, and expectations are for further increases this year, they remain low by historical standards and should not have a significant effect on the attractiveness of financing options.

Overall, Iowa businesses are somewhat insulated from the major M&A headwinds we witnessed in 2016. Most are not of the size to garner regulatory scrutiny and deal primarily on a domestic basis. Although international economic policies and turmoil can have a trickle-down effect in the U.S., we feel that the domestic business and regulatory climates will remain the drivers of activity for companies in the Heartland.

Steve Jacobs
president, BCC Advisers

11. The luxury housing market is starting to wane nationally at the same time Des Moines is attempting to bring three luxury projects out of the ground. A challenge in Des Moines is finding financing for these projects. Why?

This question boils down to supply and demand.

There are a significant number of new high-end apartments under construction in the market, with more on the drawing board. Rents have continued to rise and are at an all-time high for the product and market.

Construction for high-rise apartments has a longer timeline and requires larger loans usually necessitating a number of banks in a participation pool and equity requirements. The ability of projects to cash-flow with interest rate and rent sensitivity analysis, and a lack of existing product type to use for comparison, makes it a challenge to finance such projects.

I am at a loss to find a new construction high-rise in the Des Moines MSA, as all of the existing stock or construction is rehab of former high-rise office properties. The Plaza would probably be the last new high-rise residential property constructed as such.

All of these factors make financing such a venture more challenging, albeit not impossible, than a smaller, low-rise or rehab multifamily project.

Michele Stevens
vice president for commercial lending, Central Bank

12. What effect would a rollback of the Affordable Care Act have on the Iowa economy?

A rollback of the Affordable Care Act will have a negative impact on many Iowans but paradoxically little effect on the state's $175 billion economy. Further, it is unlikely the bill would be completely eliminated, at least not immediately. Allowing people under the age of 26 to stay on their parents' health insurance and the requirement that health insurers cannot refuse coverage to those with pre-existing conditions are extremely popular.

What might be eliminated would be the employer mandate that requires larger employers to provide affordable care to their employees. Also, the individual mandate, which requires everyone to have health insurance or pay a tax penalty might be gone, and the subsidy making insurance available to lower income people could be eliminated. Medicare recipients will pay more and Medicaid benefits will be decreased.

This would cause a medical hardship for many people, even those with insurance. Further, some estimates put the number of Iowans who might completely lose insurance at about 150,000. That could put a strain on government and health care providers who could provide limited free care, but not a huge impact on the state economy. We would return to the pre-ACA time when people relied on charitable health care, government, or went without.

Dropping ACA will negatively affect a lot of people, but it is unclear who will benefit. For larger employers, part of health care cost is included in the calculation of overall compensation packages. As insurance costs rise, wages tend to be adjusted accordingly. Salary increases may not be as great, and other benefits may be reduced or even eliminated. So, after all adjustments, dropping ACA could result in higher health care costs for workers but also slightly higher wages. This will probably not help the low income or unemployed, and we could see a redistribution of income from them to higher income groups. A change in individual spending might result, but little modification in overall state spending.

While the gainers from repealing ACA are not clearly identified, the losers are. Health care for many will become more expensive or limited, and fewer people will have insurance. The bottom line is even though many thought ACA was a disaster for business, it was not. Repealing it will hurt many people, with almost no impact on the state's economy. The repeal of ACA will cause financial hardship for many to benefit an unknown few.

Fred Abraham
UNI economics professor

13. What sectors of the economy would rising interest rates most benefit or most negatively affect?

Sectors of the economy that rely heavily on borrowing for purchases would seem likely to experience a negative impact from rising long-term rates. Housing, due to increased mortgage rates, along with farmland and agriculture due to borrowing costs for land and inputs, are two that will be most concerning to Iowans. But before people get too worried, they should remember that even with the year-end increases, the benchmark 30-year fixed-rate mortgage averaged 3.65 percent throughout 2016, the lowest since Freddie Mac began keeping records in 1971. Housing and agriculture did just fine in times of relatively higher rates prior to the financial crisis of 2007-2009. In the near term, housing looks to be a growth sector of the economy as lower unemployment and wage growth more than make up for the small increases in mortgage rates. Additionally, prospective homebuyers, or buyers considering "moving up," may accelerate that purchase decision now that rates have started to rise. If growth outpaces increased borrowing costs, all parties could be winners.

Financial companies (e.g., banks) that generate their income from lending will see some positives due to rising rates as their gross revenue should increase. For lenders, managing the interest rate spread between what they pay depositors to create lending capacity and the rates they can charge borrowers for loans will still be a key metric for profitability. Banks also can still borrow at historically low rates from the Fed and, coupled with deposit growth, should have ample lending capacity, creating the opportunity for growing both revenue and profitability. New regulations passed following the financial crisis and a long memory hopefully will restrain banks from repeating the lending mistakes that helped fuel the housing boom and bust of the 2000s.

Fed rate increases indicate there is an expectation of sustainable economic growth and potential "healthy" inflation on the horizon. Economic growth is a welcome sign across all sectors of the economy. Inflation has been historically low. One of the historical drivers of so-called "healthy" inflation is rising wages commanded by workers as unemployment rates fall and the supply of available workers shrinks. This combination could accelerate "real" wage growth (earnings rising faster than inflation). This result would be a welcome sign of health in the economy and a relief to households who have had to pick up a greater share of their increasing health care costs and cope with rising costs of higher education.

Kent Kramer
chief investment officer, Foster Group