

Stagflation Defined:

“Stagflation is an economic situation in which inflation and economic stagnation occur simultaneously and remain unchecked for a period of time. The expression "stagflation" is generally attributed to British politician Iain Macleod, who coined the term in a speech to Parliament in 1965. The concept is notable partly because, in postwar macroeconomic theory, inflation and recession were regarded as mutually exclusive, and also because stagflation has generally proven to be difficult and costly to eradicate once it gets started. Economists offer two principal explanations for why stagflation occurs.

- First, stagflation can result when an economy is slowed by an unfavorable supply shock, such as an increase in the price of oil in an oil importing country, which tends to raise prices at the same time that it slows the economy by making production less profitable. This type of stagflation presents a policy dilemma because most actions to assist with fighting inflation worsen economic stagnation and vice versa.
- Second, both stagnation and inflation can result from inappropriate macroeconomic policies. For example, central banks can cause inflation by permitting excessive growth of the money supply, and the government can cause stagnation by excessive regulation of goods markets and labor markets; together, these factors can cause stagflation.

Both types of explanations are offered in analyses of the global stagflation of the 1970s: it began with a huge rise in oil prices, but then continued as

central banks used excessively stimulative monetary policy to counteract the resulting recession, causing a runaway wage-price spiral.”

Source: Wikipedia

Wheat is Water:

Growing water scarcity in key wheat importing regions – China, Middle East, and North Africa - will create additional demand for wheat from key exporting countries like Canada and the US. It takes 1,000 tonnes of water to produce 1 tonne of wheat (Source: FAO). As water is too bulky and costly to transport to areas with shortages, food is and will to be imported in increasing quantities instead.

Freddie and Fannie – the continuing saga:

Freddie Mae and Fannie Mac together either own or have guaranteed \$5 trillion dollars of US mortgages - 70% of the market. Their solvency is in serious doubt due to accelerating mortgage defaults. A bail-out would require a huge injection of liquidity into the US financial system.

- **March 2001** – “Executives of Fannie Mae and Freddie Mac assured Congress yesterday that the companies, which dominate the U.S. mortgage finance business, are **run soundly and pose no risk to the global financial system.**” *Washington Post*
- **February 2004** – “The heads of mortgage giants Fannie Mae and Freddie Mac assured senators Wednesday that their **collapse was unlikely.**” *Washington Post*
- **November 2007** – “Freddie Mac, which **reported a record loss of \$2.03 billion in the third quarter this week,** may have underestimated when it projected that 0.11 percent of the debt it guarantees will go bad in the next two years.” *Washington Post*
- **July 2008** – “William Poole, former president of the St Louis Federal Reserve, believes **both are insolvent as a result of heavy losses,** pointing out that Freddie, the smaller of the

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two, owed \$5.2bn more than its assets were worth at the end of the first quarter. "Congress ought to recognise that these firms are insolvent, that it is allowing these firms to continue to exist as bastions of privilege, financed by the taxpayer," he said." *The Telegraph*

- **August 2008** – “Shares of mortgage financier Fannie Mae plunged Wednesday after its brother company Freddie Mac posted a larger-than-expected second-quarter loss due to higher delinquencies and foreclosures among creditworthy homeowners with exotic mortgages. Early Wednesday, **Freddie Mac said it lost \$821 million in the second quarter**, compared with a profit of \$729 million in the year-ago period. The loss was **more than three times larger than Wall Street expected.**” *Associated Press*. “During the past four quarters, **Fannie and Freddie have posted combined losses of about \$14 billion**, eating deeply into their relatively meager capital holdings.” *The Wall Street Journal*

On the Hunt for Farmland: A new category of investor is appearing on the farmland scene. One with a different motive than just profit – sovereign states seeking to secure food supplies for their countries. The following are just some of the countries (either in their own right or via private/public companies) that either have already invested in, or have expressed an interest in investing in, agricultural land away from "home."

| Country | Investing In |
|--------------|----------------------------------|
| Abu Dhabi | Sudan |
| Bahrain | Philippines |
| China | Africa and South America |
| India | Paraguay and Uruguay |
| Libya | Ukraine |
| Saudi Arabia | Thailand and South Africa |
| UAE | Pakistan, Sudan, Egypt and Yemen |

Inflation v. Stagflation Watch:

Though obviously a purely anecdotal indicator, the number of people searching for the word “stagflation” on Google has increased dramatically in 2008.

“The spectre of stagflation will likely keep the U.S. Federal Reserve, the European Central Bank, and the Bank of England from changing short term interest rates this week, and their hands may be tied for some time as economic growth slows but inflation remains high.” *Reuters*

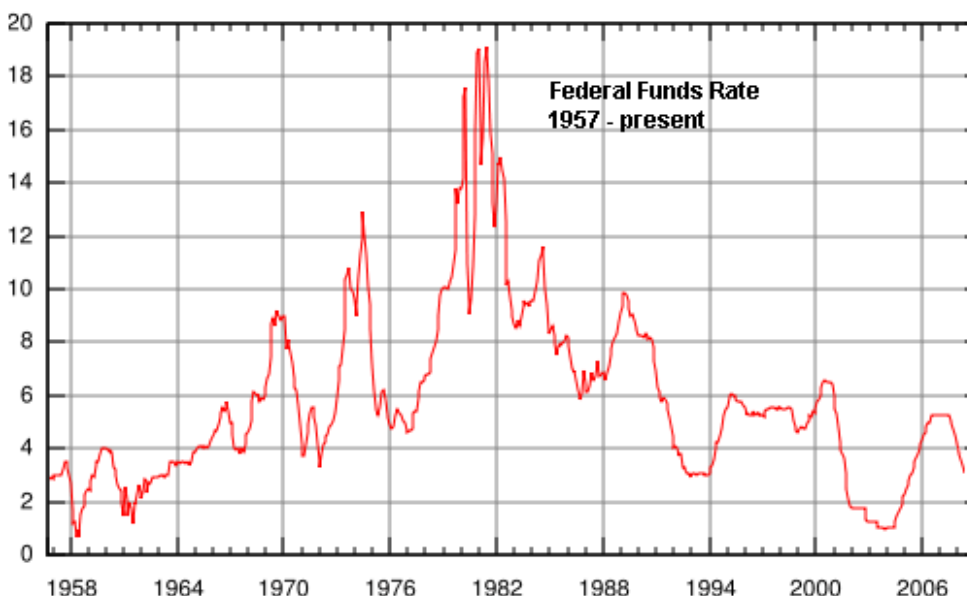


“Stagflation is, of course, a combination of excessive inflation and high unemployment, a particularly testing mix. Should policymakers raise interest rates to squeeze inflation out of the system, all the while accepting an even higher rate of unemployment? Or should they, instead, cut rates in the hope of generating higher demand, thereby reducing unemployment but threatening a persistent rise in inflation and inflationary expectations? Inflation is about to make an unwelcome return. Inflation will pick up either because money supply grows too quickly or because, for a given money supply, the available bundle of goods and services shrinks.” *The Independent*

“Thirty years after the last stagflation, the world may again relive a period of low growth coupled with high inflation. Thanks to the euro's appreciation, which mitigates the oil-price hike, Europe is generally in a slightly better position than the U.S” *The Wall Street Journal*

Is the Fed Concerned with Inflation?

To provide a perspective on the Fed's publically stated concern with inflation a little historical



perspective is useful. The chart below shows the Fed Funds rate since 1958. We see from the above chart that the key overnight lending rate is at its lowest point since the years immediately after 9/11. Prior to that you have to go back to 1962 to find a similar level.

Quotable Quotes:

Farmland Best Recession Hedge

Reza Vishkai, head of alternatives at fund manager Insight (one of the UK's largest with over \$200 billion in assets under management), says: "From an investor's standpoint, equities are the long-term asset – that's where you get the higher rates of return. But you can hit periods like now that wipe out the returns". He adds: "Diversification makes a huge amount of sense.

The single best recession hedge of the next 10 or 15 years is an investment in farmland. he says. "Demand is going up very strongly on a global basis." *Independent*

Food Nationalism Growing?

“Russia plans to form a state grain trading company to control up to half of the country's cereal exports, intensifying fears that Moscow

wants to use food exports as a diplomatic weapon in the same way as Gazprom has manipulated natural gas sales. The move by Moscow, the world's fifth-biggest exporter of cereals, has been sharply criticised by US agriculture diplomats as a “giant step back” to the Soviet era. The decision to control food exports is the latest sign of how soaring food prices are reshaping the agriculture industry. The recreation of Soviet-style state trading will aggravate anxieties of food-importing countries about their dependence on the

international market, which has been severely disrupted this year after exporters, including Russia, imposed prohibitive foreign sales duties or export bans. Western diplomats and agriculture industry officials said Russia intended to transform its Agency for the Regulation of Food Markets into a state trader, controlling between 40 and 50 per cent of Russia's cereal exports within the next three years. The company would take over government interests in 28 important storage depots and export terminals. "Essentially, [it will be] the latest in a series of industry renationalisations, and a reversal of what till now has been one of Russia's privatisation success stories," the report said." *FT*

Commodity Price Changes (as of August 11th)

| | Today | 1 Year Ago | Change |
|--------------------|---------|------------|--------|
| Barley | 7.15 | 4.25 | 68% |
| WTI Crude | 114.45 | 71.62 | 60% |
| Corn | 4.51 | 3.06 | 47% |
| Soybean Oil | 0.48 | 0.35 | 37% |
| Cocoa | 2985.00 | 2230.00 | 34% |
| Sugar | 15.26 | 11.47 | 33% |
| Lard | 0.47 | 0.36 | 29% |
| Gold | 863.75 | 669.85 | 29% |
| Wheat (KC) | 8.25 | 6.60 | 25% |
| Platinum | 1543.00 | 1276.00 | 21% |
| Silver | 15.34 | 12.87 | 19% |
| Coffee | 1.33 | 1.13 | 17% |
| Aluminum | 1.29 | 1.10 | 17% |
| Natural gas | 8.20 | 7.12 | 15% |
| Cotton | 0.62 | 0.54 | 14% |
| Beef | 150.99 | 135.18 | 12% |
| Chicken | 0.88 | 0.81 | 9% |
| Eggs | 0.91 | 0.90 | 1% |
| Copper | 3.36 | 3.48 | -4% |
| Cheese | 177.75 | 194.00 | -8% |
| Milk | 143.00 | 193.00 | -26% |



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