More On Money And Grain

Nothing is more frustrating to an armchair quarterback than admitting the fellow on the field is not the root of all evil. I found myself in the unusual position earlier this month of noting the spike in wheat prices blamed in part for the political upheaval in Egypt (how's that dissolved parliament and suspended constitution under a military government working out for the protesting Cairenes?) could not be attributed to QE2 as it began well in advance of QE2 and you simply cannot cause the past.

Once we agree on two obvious things, that nearly all agricultural commodities are in strong rallies and the Federal Reserve is on a roll, we should pose a simple question regarding money and grain: Did previous large rallies in grains occur during periods of monetary tightening? If so, we would be placed in the logically uncomfortable position of concluding opposite credit conditions, previous tightenings and the current loosening, could produce the same result. If this is the case, we would have to conclude monetary policy is not a causal variable for higher agricultural commodity prices.

Test Cases

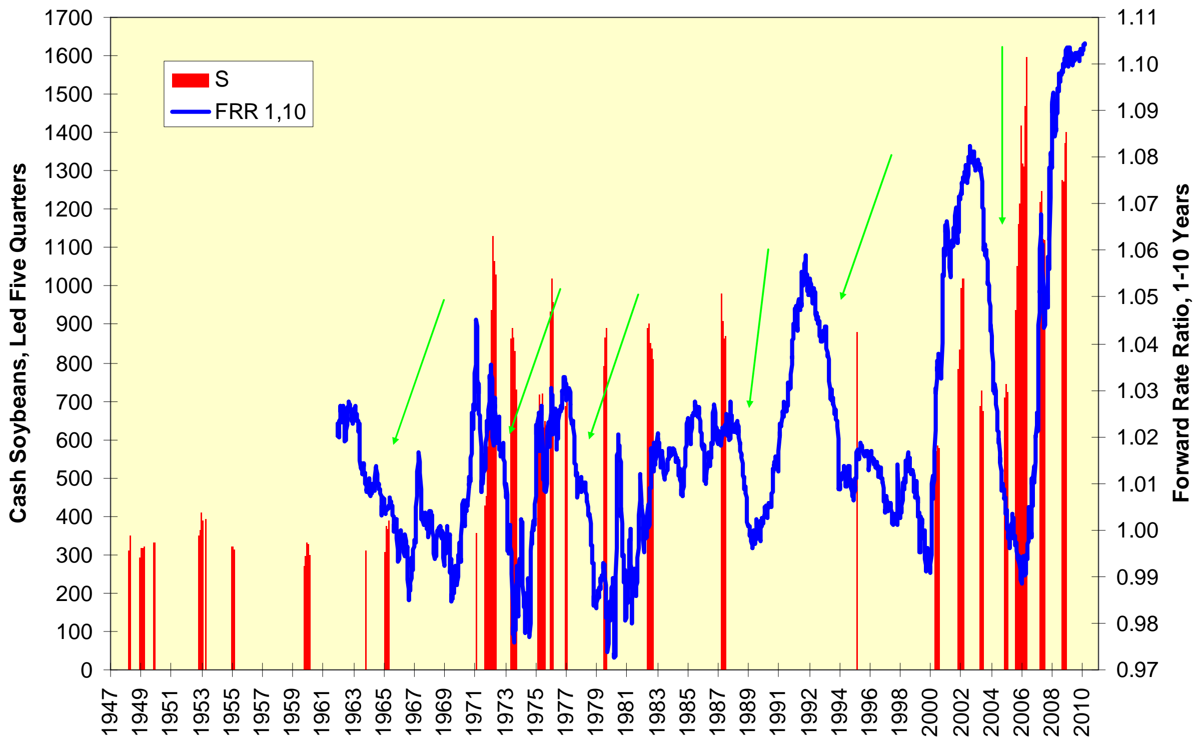
Some analyses are elegant; some involve nothing but brute force. This was a brute-force affair enabled by the long-term database from the CRB-Infotech CD-ROM. I created weekly average cash market prices for ten different markets, in some cases going back to the end of World War II, looked at their six-month percentage changes and then isolated the changes in excess of a 90% confidence interval using only data available at the time.

That *Jeopardy*-playing computer has a kindred spirit.

Next, I identified six long-term credit-tightening cycles based on the forward rate ratio between one- and ten-year Treasuries ($FRR_{1,10}$). This is the rate at which we can lock in borrowing for nine years starting one year from now, divided by the ten-year rate. A declining $FRR_{1,10}$ signals a tighter credit environment. The six periods, marked with arrows on the chart for soybeans below, were:

1. March 1963 – August 1969;
2. February 1971 – October 1974;
3. December 1976 – April 1980;
4. October 1987 – June 1989;
5. October 1992 – December 2000; and
6. October 2003 – March 2007

As crop-planting decisions involve a lead-time and as monetary policy works with the famous long-and-variable lags, I use a five-quarter lead-time to relate changes in the yield curve to the price spikes in the agricultural commodities.



Please note how often you see price spikes for soybeans during a credit-tightening cycle. This is true for the other commodities examined as well. While we can agree excess monetary creation creates an inflationary environment, we cannot blame it for the series of floods and droughts that have wreaked havoc on markets from wheat to cotton to sugar over the past year. I do not like loose money and I do not like food-price spikes, but just because I do not like two things does not mean I can lump them together.