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# Agriculture in the Economic Recovery



The views expressed are those of the author and do not necessarily reflect the opinions of the Federal Reserve Bank of Kansas City or the Federal Reserve System.

# Today's Roadmap

- U.S. economic outlook
  - Sluggish growth with strong headwind or
  - Sluggish growth strengthening in 2011
- Inflation
  - Short-term deflation or
  - Long-term inflation
- Implications for agriculture
  - How long will the boom last?



# FOMC Statement

## (September 21, 2010)

- **Output:**
  - “The pace of recovery in output and employment has ***slowed*** in recent months.”
- **Inflation:**
  - “Measures of underlying inflation are currently at ***levels somewhat below*** those the Committee judges most consistent, over the long, run, with its mandate to promote maximum employment and price stability.”
- **Policy:**
  - “Economic conditions, including ***low rates of resource utilization, subdued inflation trends, and stable inflation expectations***, are likely to warrant exceptionally low levels for the federal funds rate for an extended period of time.”
  - “Maintain its existing policy of ***reinvesting principal payments*** from its securities holdings.”
- **Dissent:**
  - Thomas Hoenig, Federal Reserve Bank of Kansas City



# It's official, the recession is over!!!

**Sluggish, but stronger growth is the consensus forecast.**

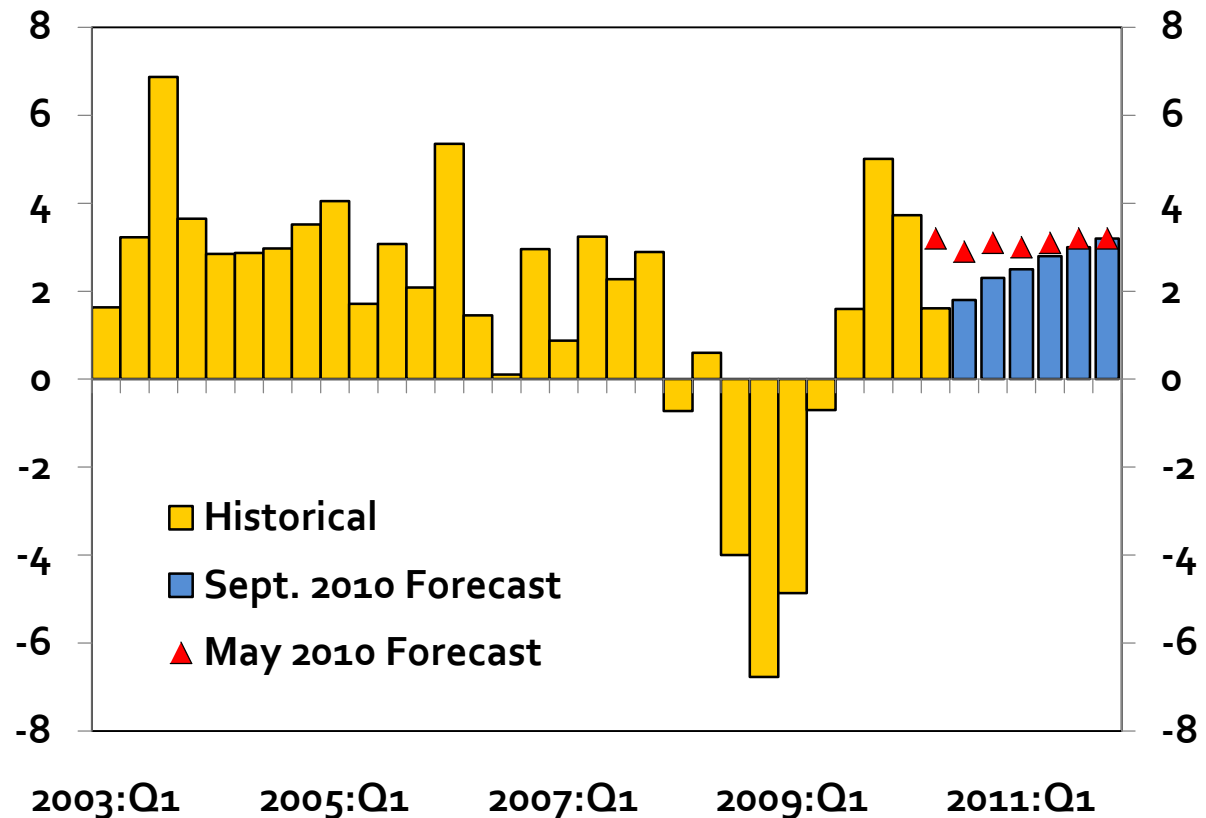
**Different comparisons affect the interpretation of GDP growth.**

*-In the near term, sluggish is key as strong headwinds cut economic forecasts in near term.*

*-In the long term, growth is key as forecasts point to positive and stronger growth near 3 percent.*

## Real U.S. GDP Growth

Annualized percent change



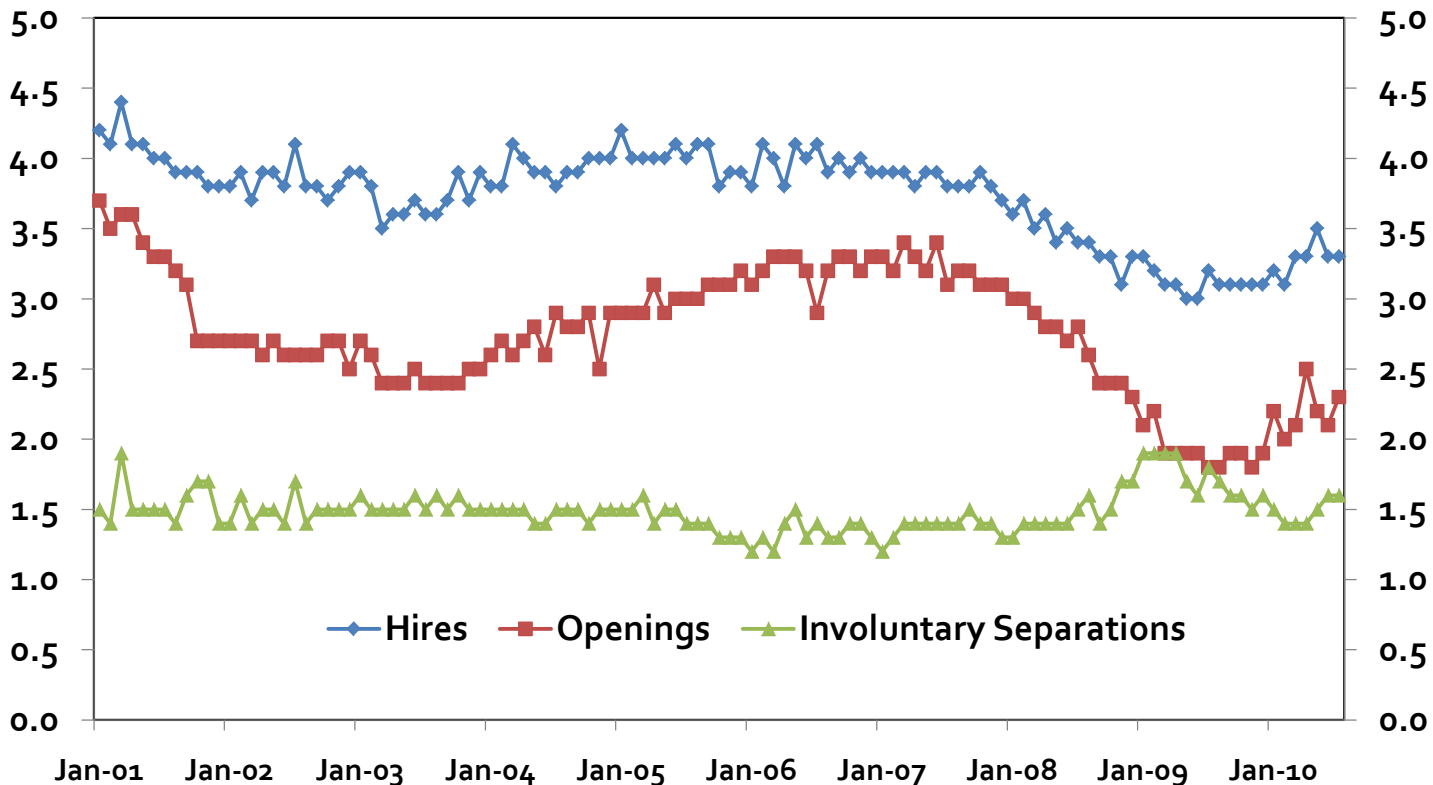
Calculations based on Bureau of Economic Analysis data



# Job openings and hiring will need to rebound before unemployment falls.

## Layoffs, Hiring, and Job Openings

Percent of employment

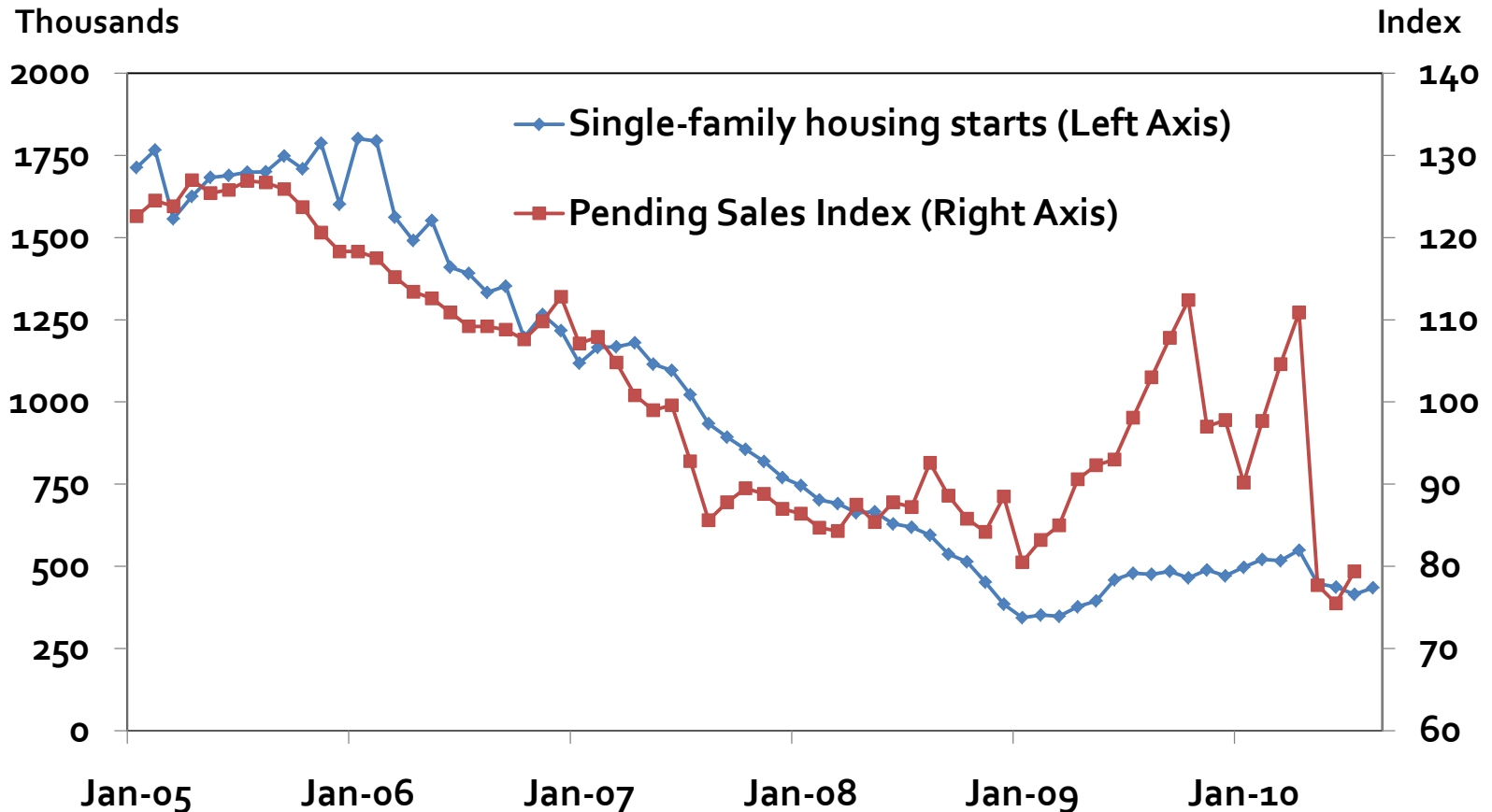


Source: Bureau of Labor Statistics



# The housing market slows after the end of the tax credits.

## U.S. Housing Markets

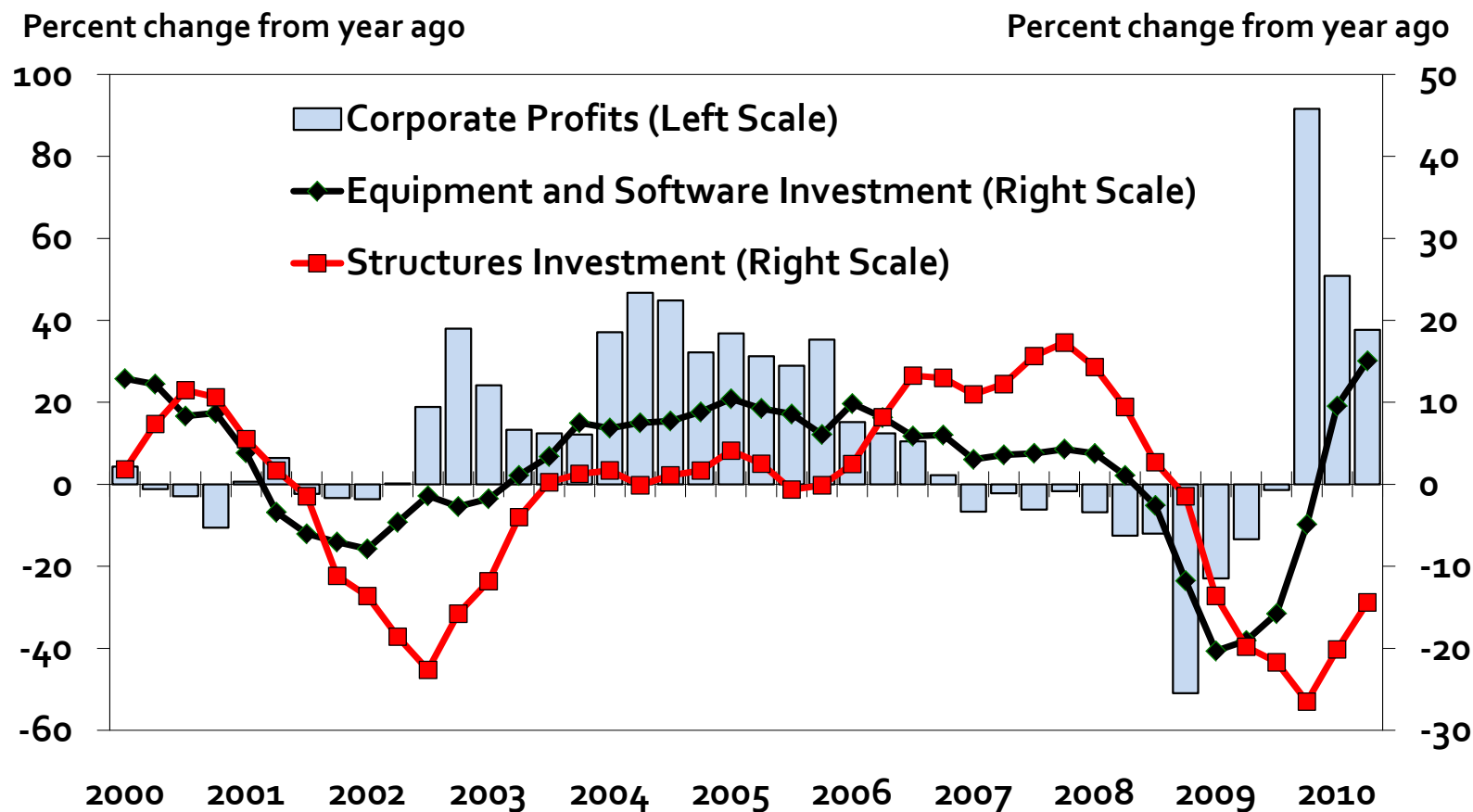


Source: U.S. Census Bureau



# Corporate profits and business investment are beginning to rebound.

## Corporate Profits and Nonresidential Fixed Investment



Source: Bureau of Economic Analysis



# Can we expect additional support from export activity?

Economic growth is stronger in emerging countries. However growth is expected to slow.

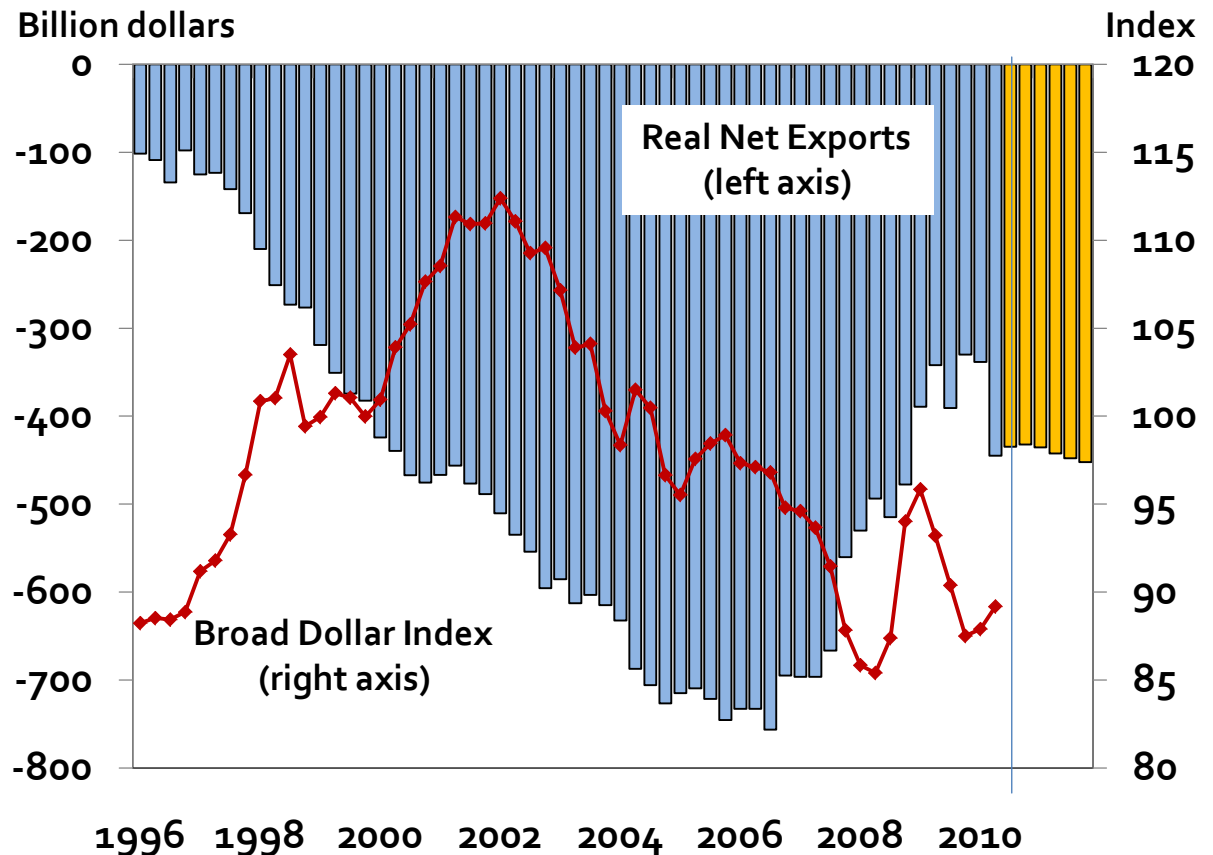
## Annual GDP Growth

	2010	2011
Brazil	7.3%	4.8%
Russia	4.8%	4.4%
India	8.4%	8.1%
China	10.0%	9.0%
Hong Kong	5.6%	4.5%
Korea	6.1%	4.1%
Taiwan	7.1%	4.2%
Canada	3.3%	2.8%
Mexico	4.5%	3.7%
Eurozone	1.4%	1.4%



Source: Blue Chip Forecast

## U.S. Real Net Exports and Value of the Dollar



Source: Bureau of Economic Analysis, Federal Reserve Board of Governors, and Blue Chip forecast

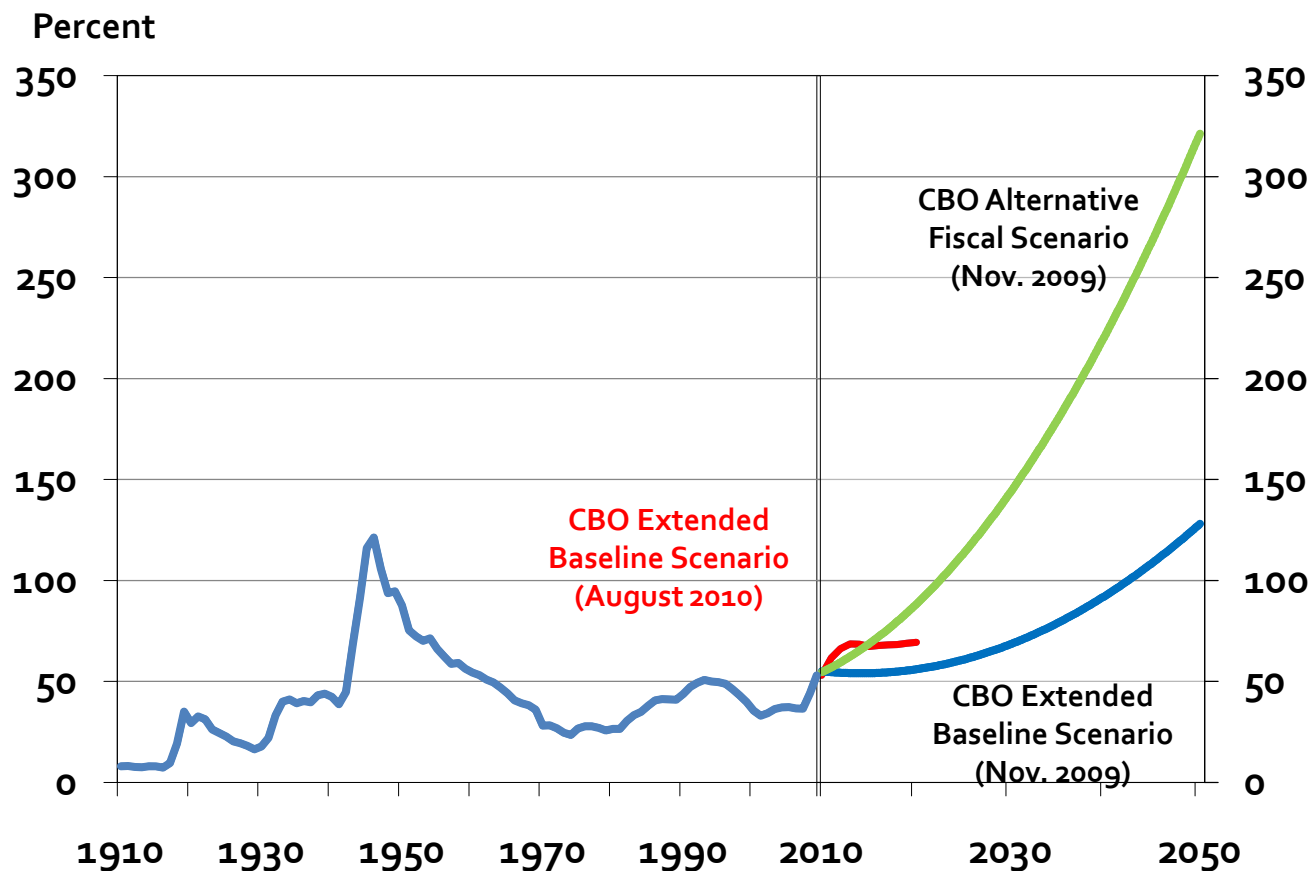
Federal Reserve Bank of Kansas City – Omaha Branch  
Regional, Public and Community Affairs Division





# How will surging federal debt levels affect economic conditions long-term?

## U.S. Debt as a Percent of GDP

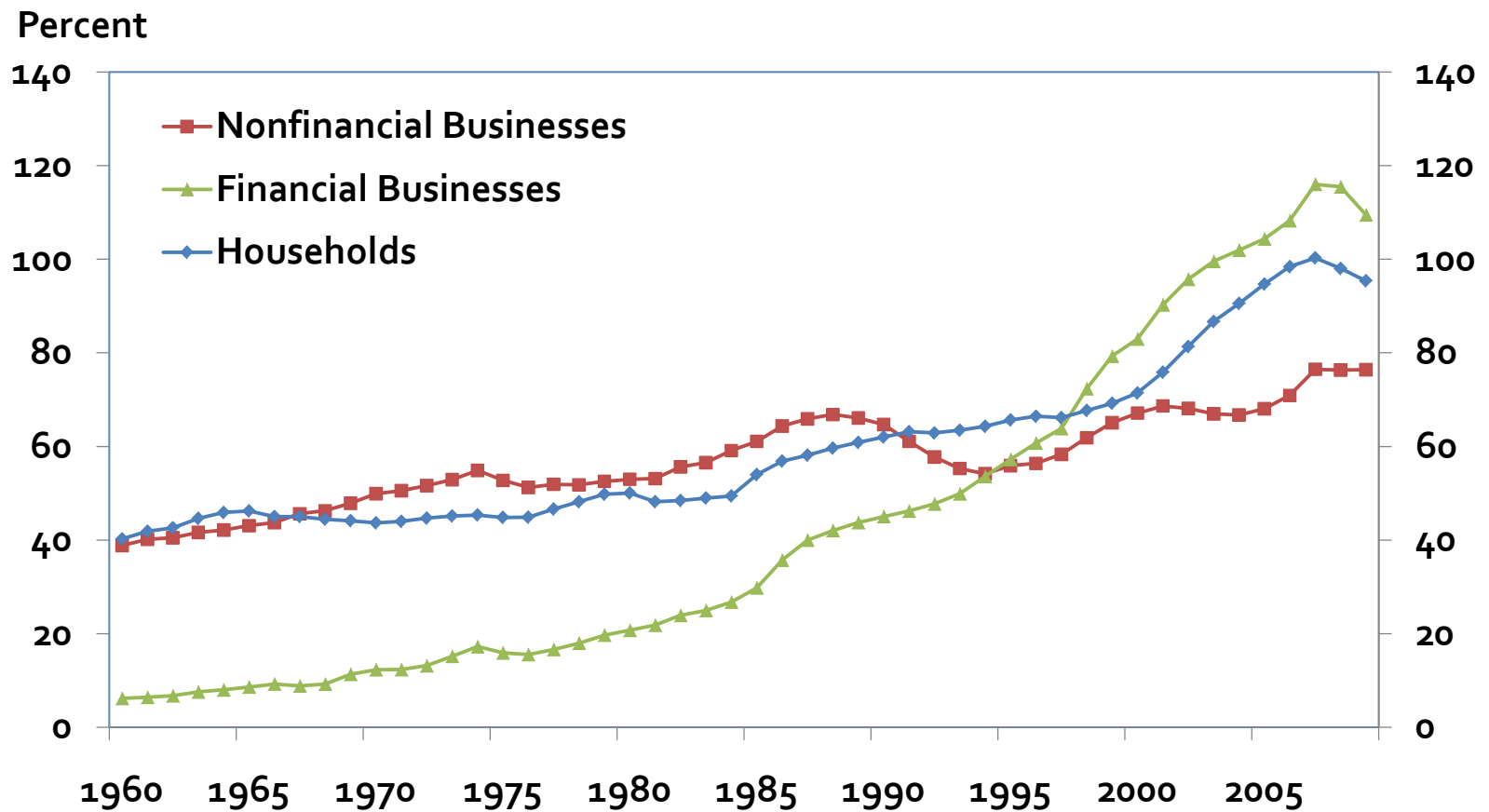


Source: Congressional Budget Office



# How much de-leveraging will take place?

## U.S. Debt as a Percent of GDP



Source: Calculations based on Federal Reserve and BEA data



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*Inflation is based on money and velocity.*

## Quantity Theory of Money

$$\text{Price} = \frac{\text{Money} * \text{Velocity}}{\text{Quantity}}$$

### Definition of Inflation:

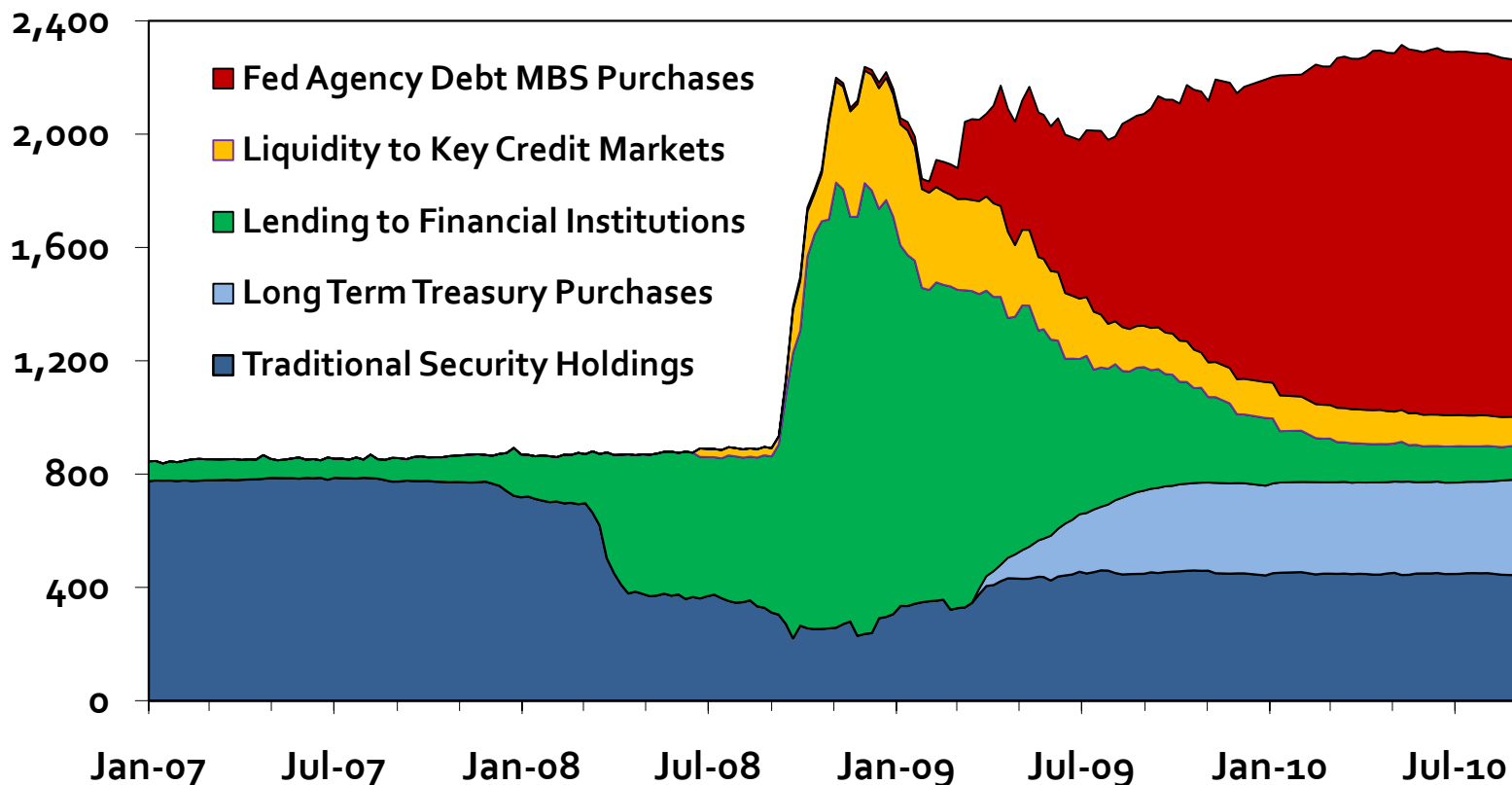
Too much money  $M \uparrow$   
chasing  $V \uparrow$   
too few goods  $Q \downarrow$



# The Fed will now take principal payments from securities to purchase long term treasuries.

## Federal Reserve Balance Sheet: Assets

Billion Dollars



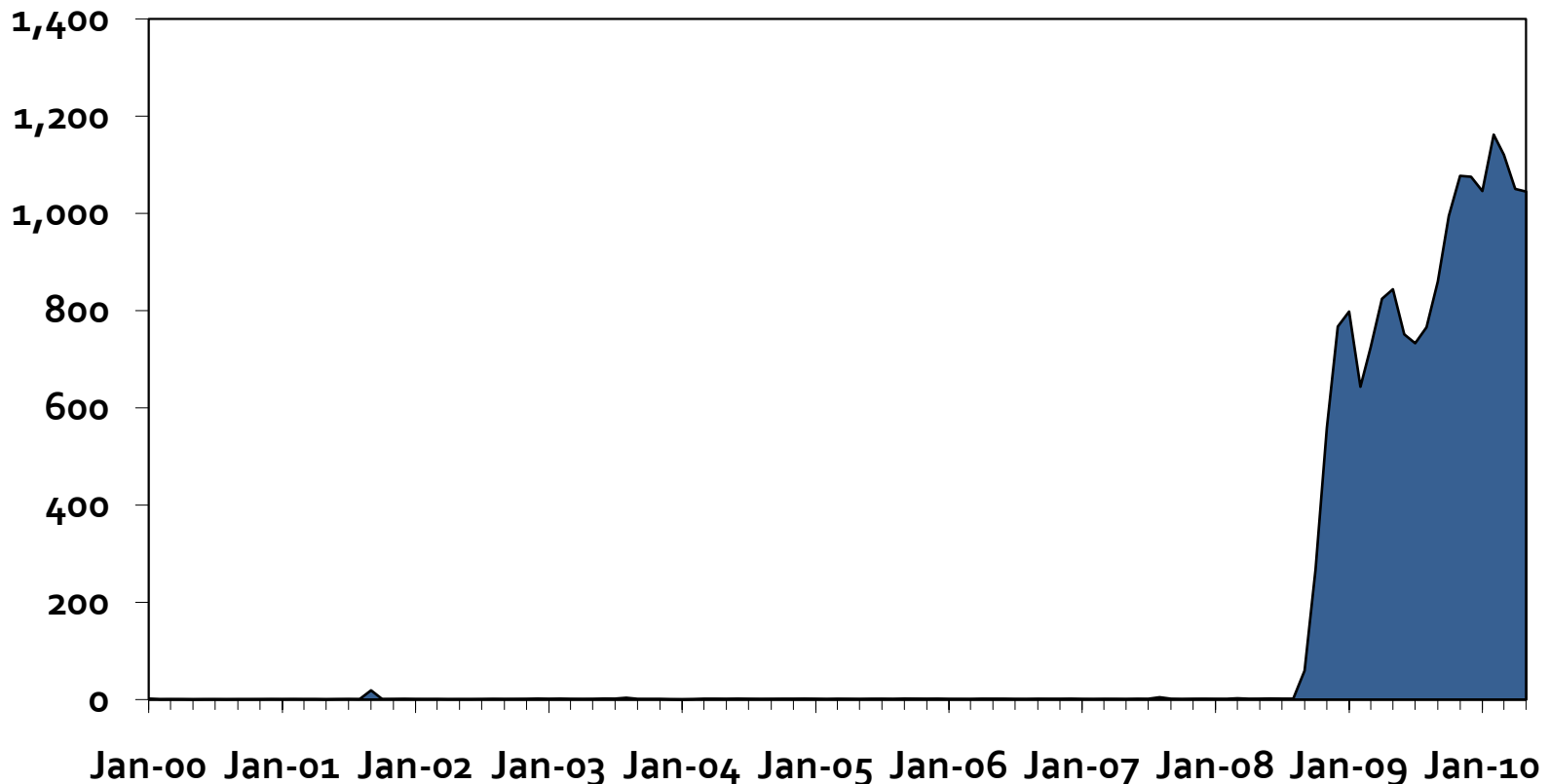
Source: Federal Reserve Bank of Cleveland



*Banks are holding money in excess reserve,  
which limits velocity.*

## Excess Reserves of Depository Institutions

Billion Dollars



Source: Federal Reserve Board of Governors

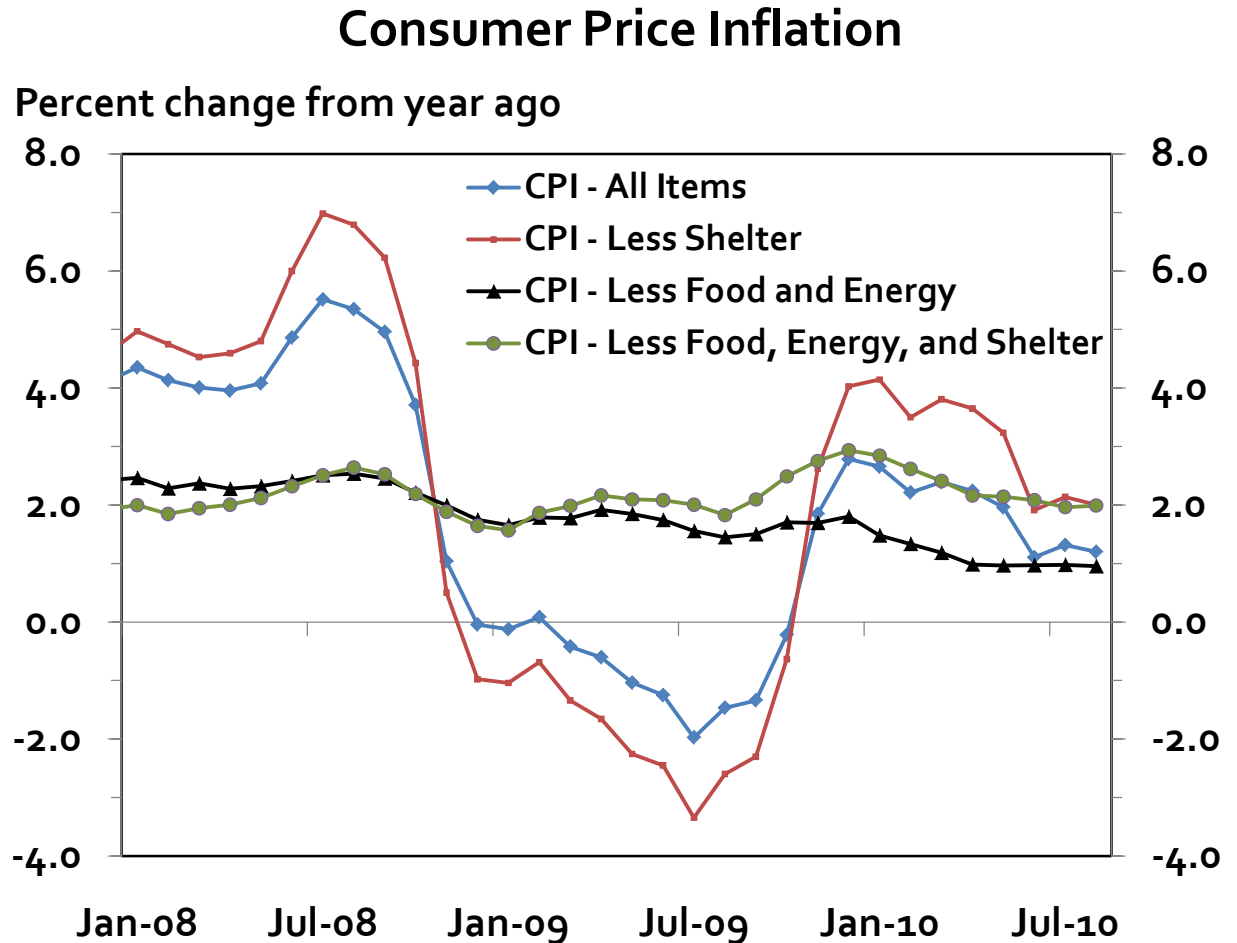


# Different inflation measures point to different levels of inflation.

-Inflation is running 1% above year ago levels according to both core (less food and energy) and headline inflation.

-However, consumer prices are 2% above year ago levels if you remove the costs of shelter.

-The storyline: lower home values are pulling down the inflation indexes.



Source: Bureau of Labor Statistics



# Two Perspectives on Monetary Policy and Resource Allocation

- The Issue: long periods of low interest rates lead to financial imbalances.
- Two Perspectives:
  - "... My preference at this time is to use prudential regulation and supervision to strengthen the financial system and lean against developing financial imbalances."  
Donald Kohn, Vice Chairman, Federal Reserve Board of Governors, May 13, 2010.
  - "It was after a period of too-low interest rates, too much credit, too much leverage that the collapse of the housing bubble, the rapid deleveraging and the ensuing financial crisis occurred." ...

"Monetary policy is a powerful tool. Certainly lowering interest rates is the appropriate monetary policy response to the onset of an economic recession and rising unemployment. But it is also a blunt instrument that has a wide set of unintended consequences that can and have worsened economic outcomes including misallocation of precious resources, inflation and long-term unemployment."

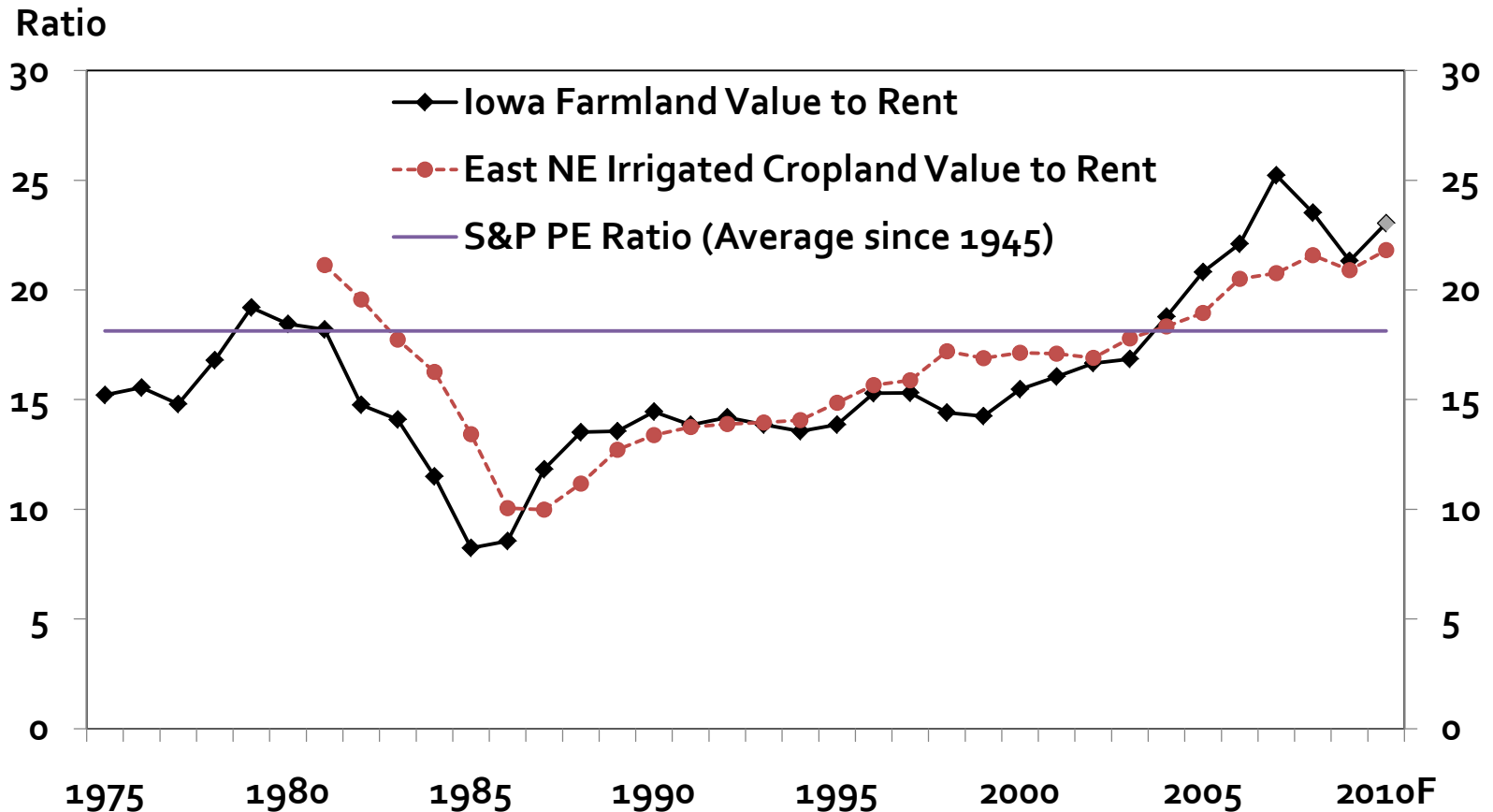
Thomas Hoenig, President and CEO, Federal Reserve Bank of Kansas City, June 3, 2010





# Is a farmland bubble brewing?

## Farmland Values to Rent Ratio



Calculations based on Iowa State University and University of Nebraska data



# Today's Roadmap

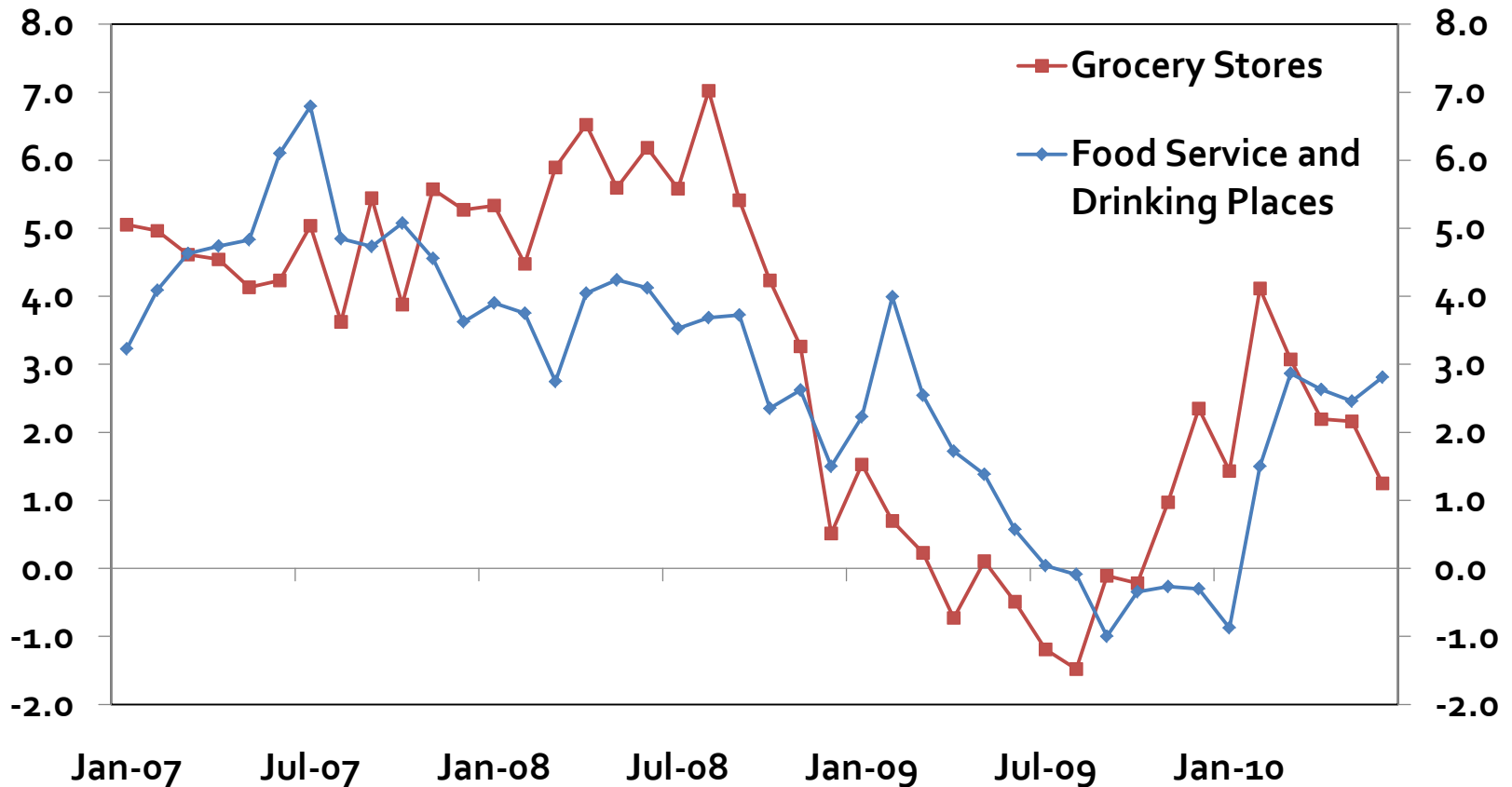
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# U.S. food expenditures have rebounded.

## U.S. Retail Sales at Grocery Stores and Restaurants

Percent change from year ago



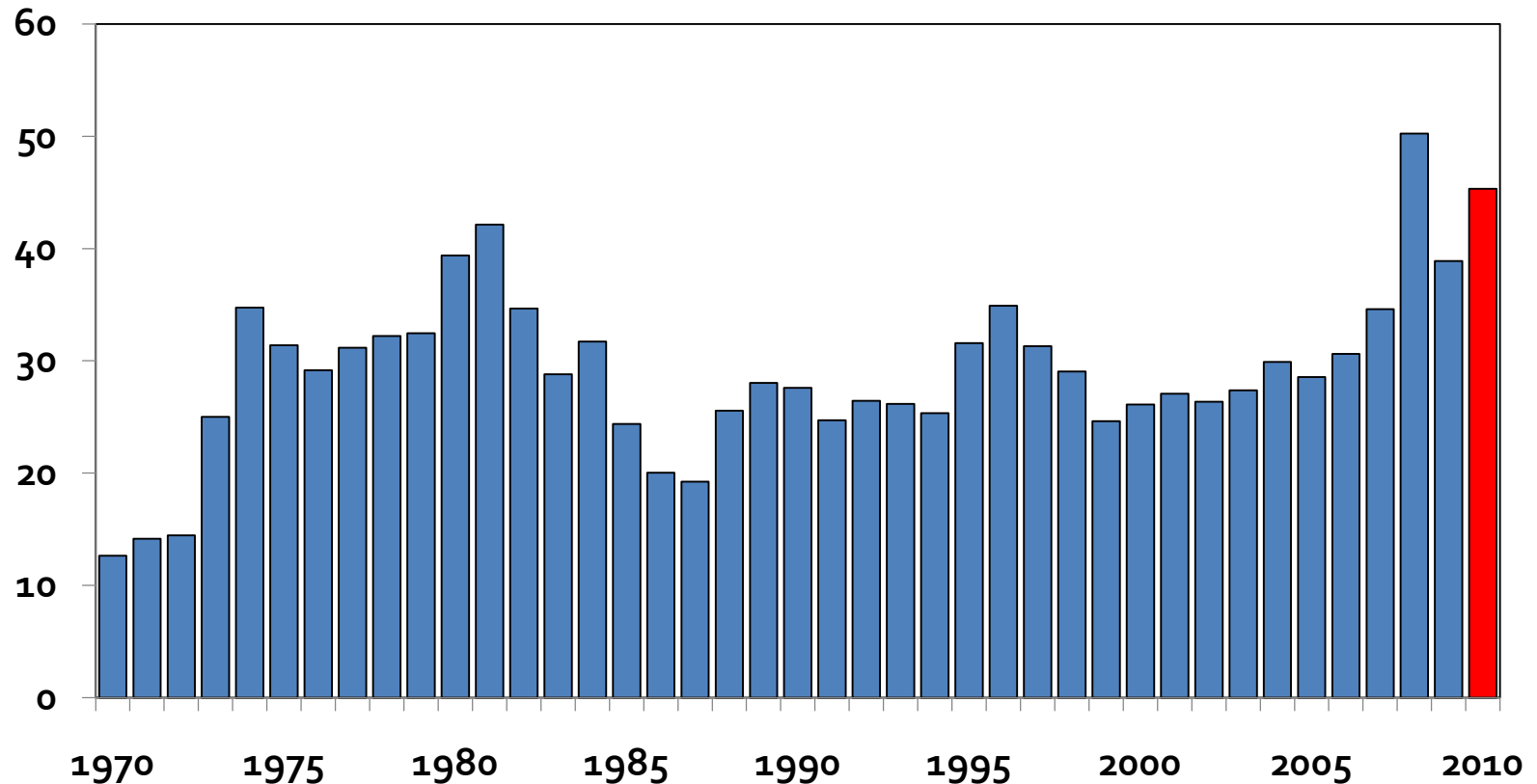
Source: Census Bureau



# U.S. agricultural exports have rebounded.

## Real U.S. Agricultural Exports (January to May data)

Billion dollars (constant 2009=100 dollars)

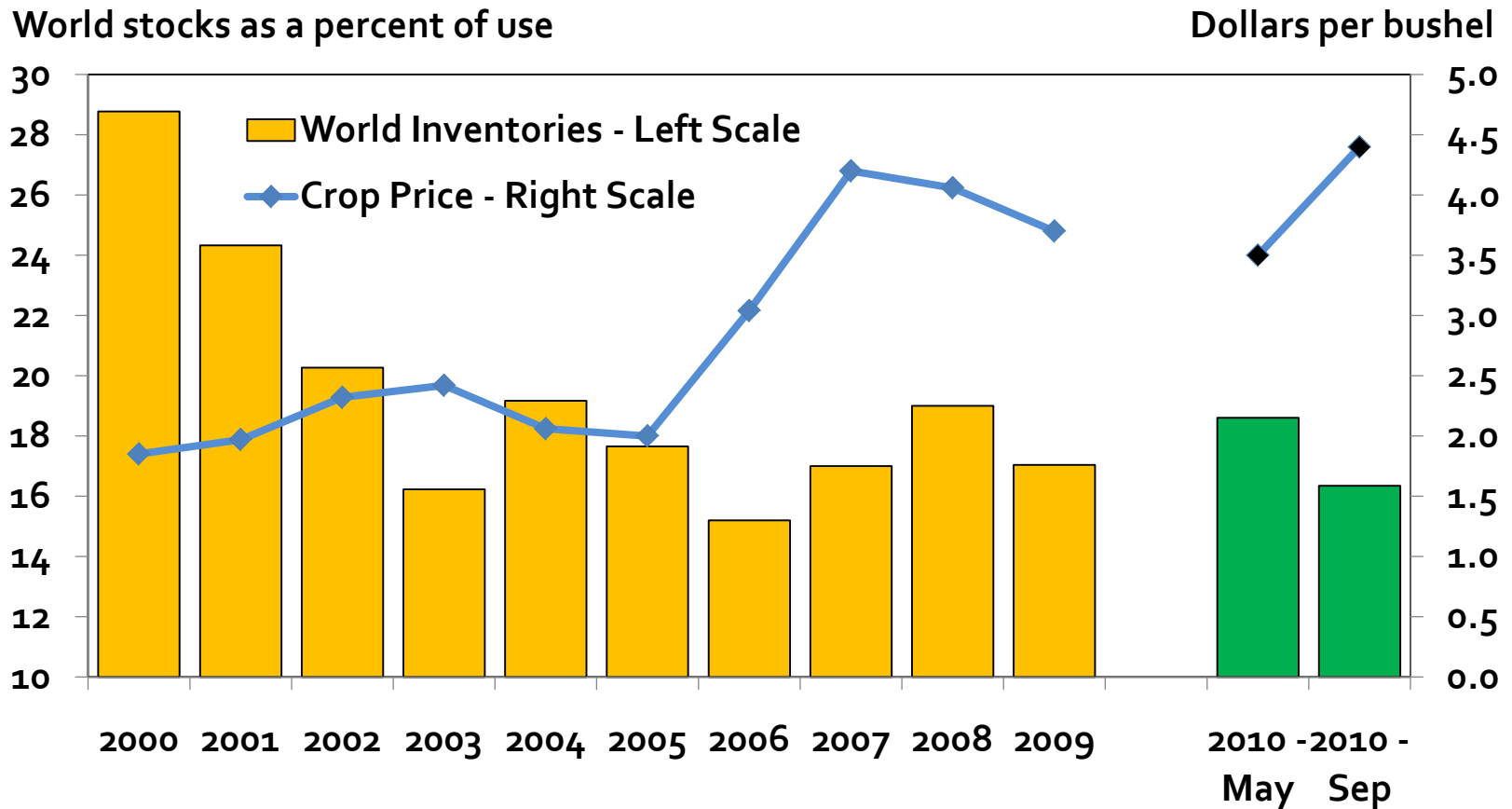


Source: USDA



# A demand shock has turning into a supply shock.

## World Corn Inventories and U.S. Corn Price

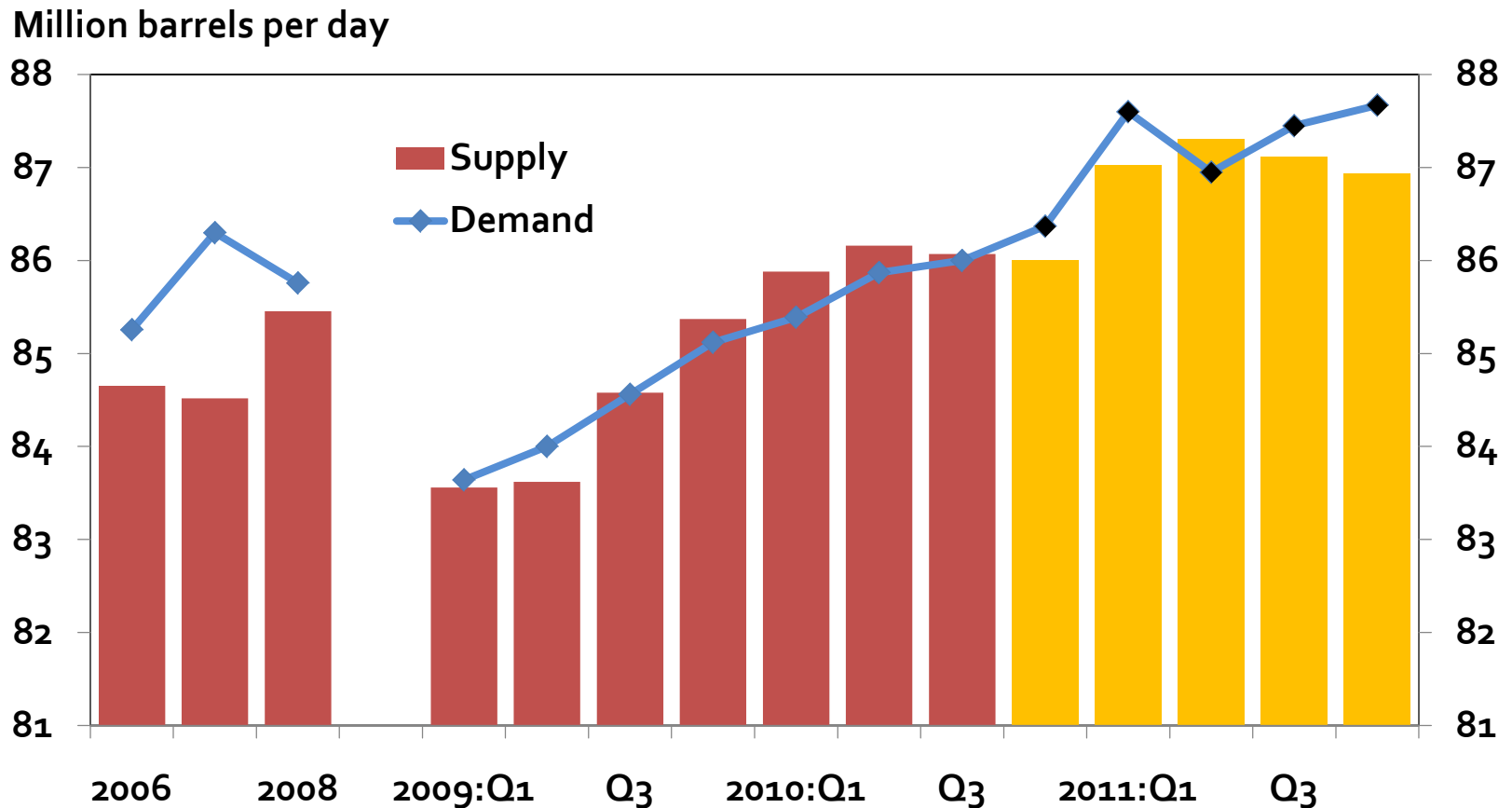


Source: USDA



# What happens to prices if crude oil demand outpaces supply?

## World Crude Oil and Liquid Fuels Balance



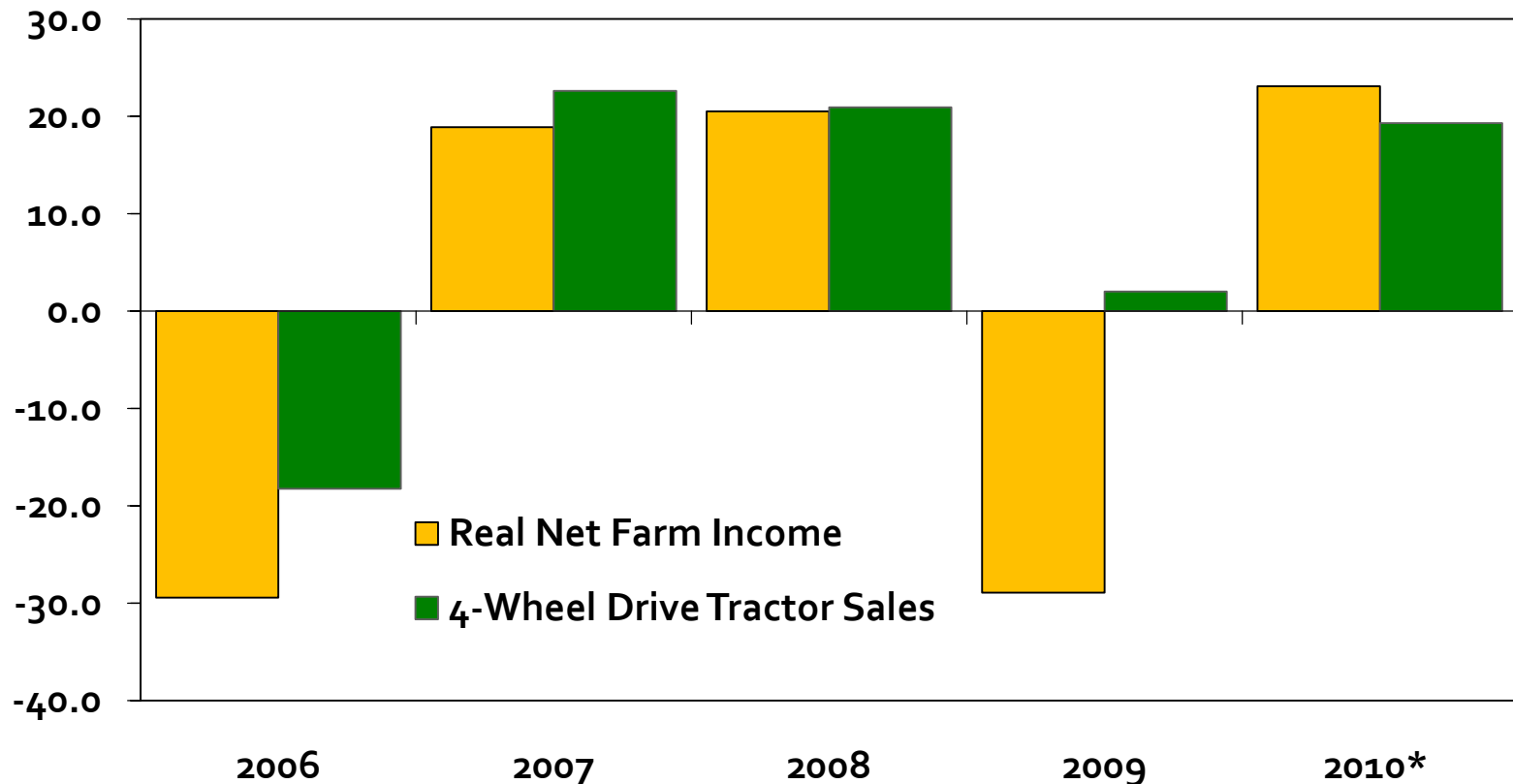
Source: Energy Information Administration



# Farm incomes and agricultural equipment sales go hand in hand.

## U.S. Real Net Farm Income and Agricultural Equipment Sales

Percent change from previous year



Source: Association of Equipment Manufacturers and USDA

\* Tractor Sales data are year-to-date through July and Net Farm Income forecast for 2010 dated August 31, 2010.



# Conclusions

- Economists are two-handed, and the result is wide differences of opinion.
  - Near-term vs. long term focus
  - Growth vs. inflation
  - Deflation vs. inflation
  - Financial imbalances: to prick or not to prick
  - Supply shocks, demand shocks, or speculators
- A new golden era for agriculture?  
How long will it last this time?





# Federal Reserve Bank of Kansas City Omaha Branch

**The Main Street Economist:**  
a bi-monthly publication discussing agriculture and rural America

**Agricultural Credit Survey:**  
a quarterly survey of agricultural credit conditions in the Tenth Federal Reserve District

*Coming this fall* - **Agricultural Finance Databook:**  
a quarterly summary of national agricultural finance conditions

**For Additional Information on  
Agricultural and Rural Issues**

**[www.kansascityfed.org/omaha](http://www.kansascityfed.org/omaha)**

