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May 19, 2009

Economic Conditions: Cautiously Optimistic for a Soft 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.

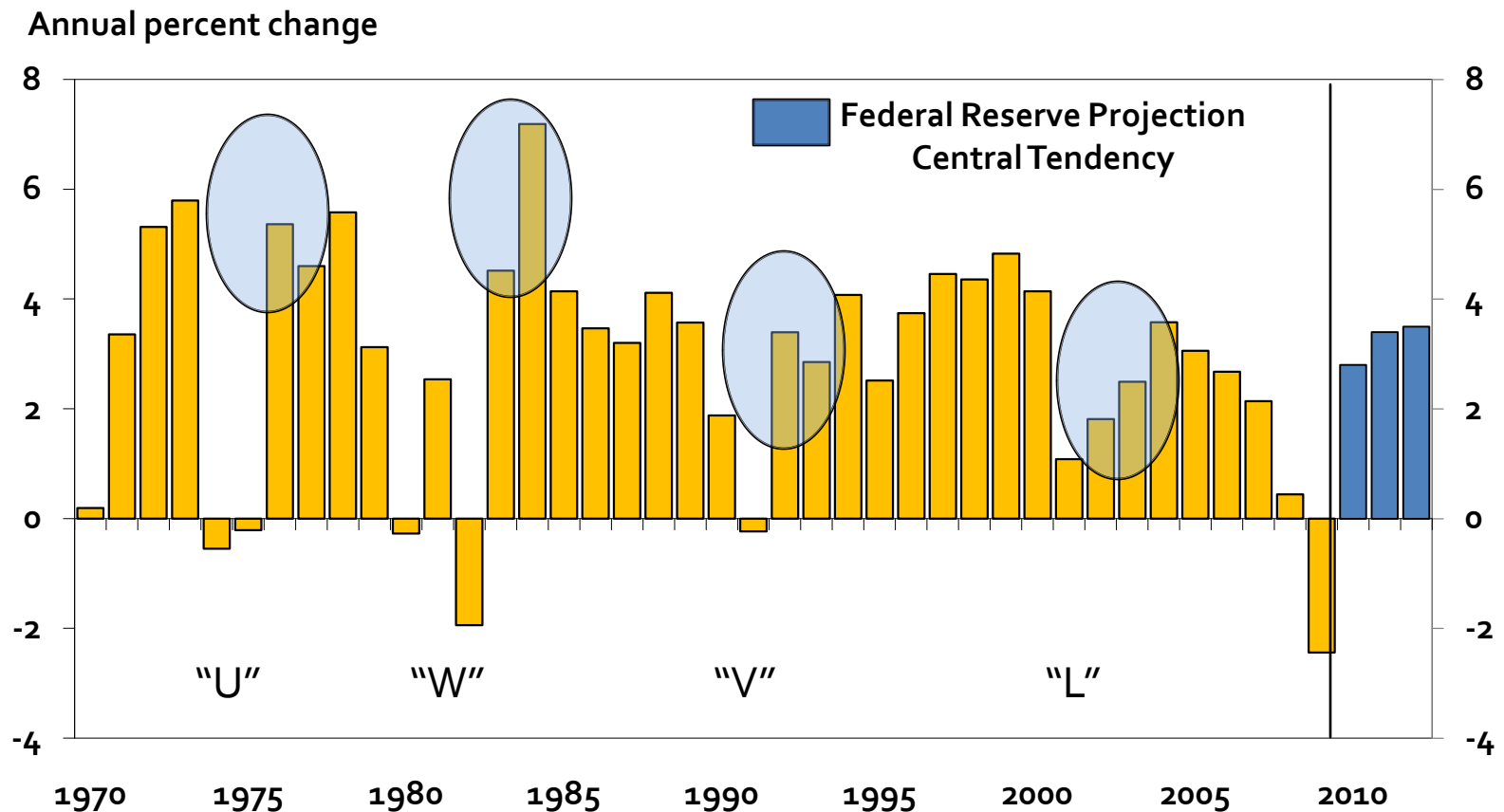
Today's Roadmap

- **The Economic Recovery is Underway**
- **Concerns Shift from Growth to Inflation**
- **Implications for Agriculture**



The U.S. economy is projected to rebound in 2010.

Real GDP Growth

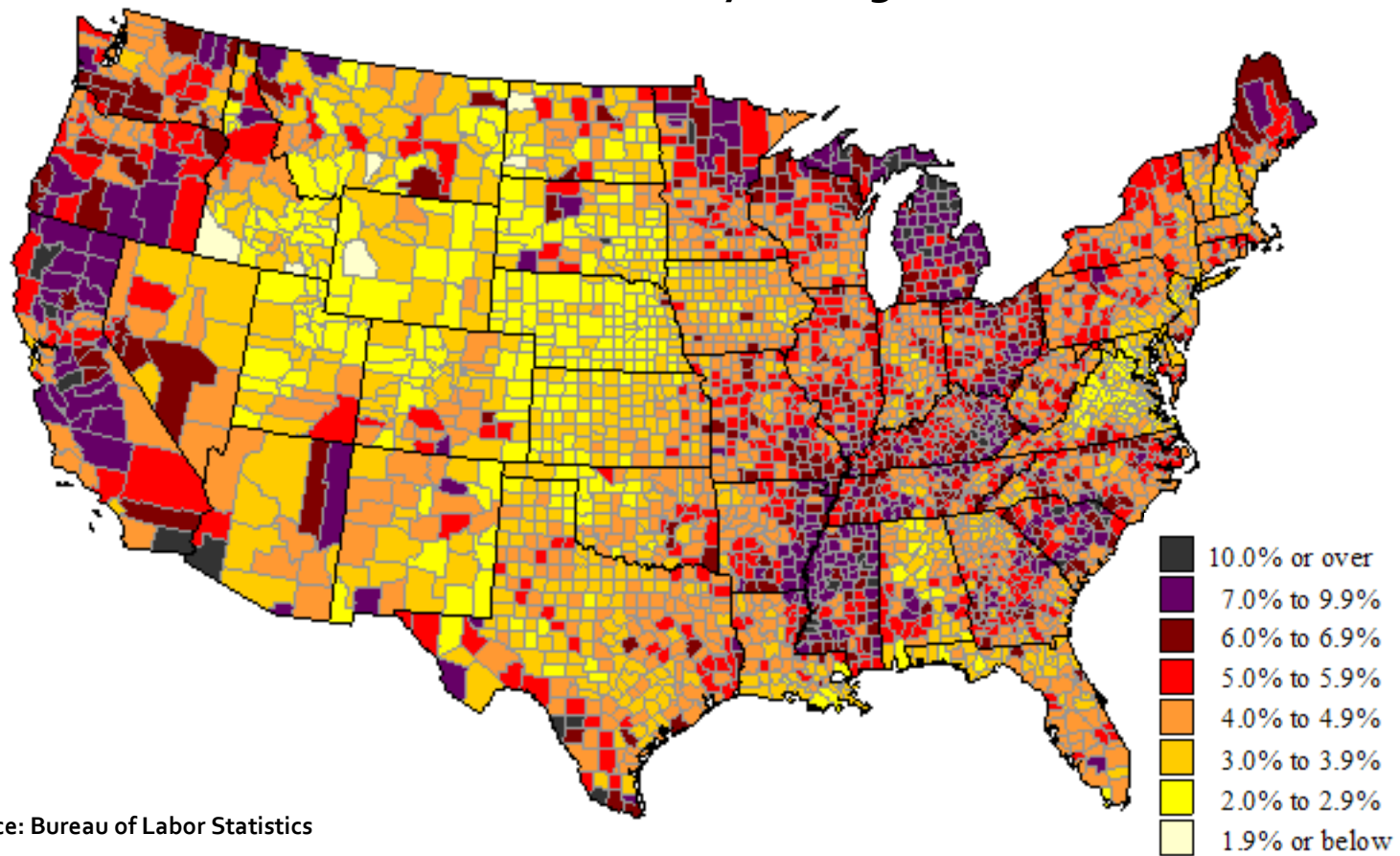


Source: Bureau of Economic Analysis Federal Reserve Board of Governors



Midwest economies are in better shape.

Unemployment Rate 2007 Monthly Average

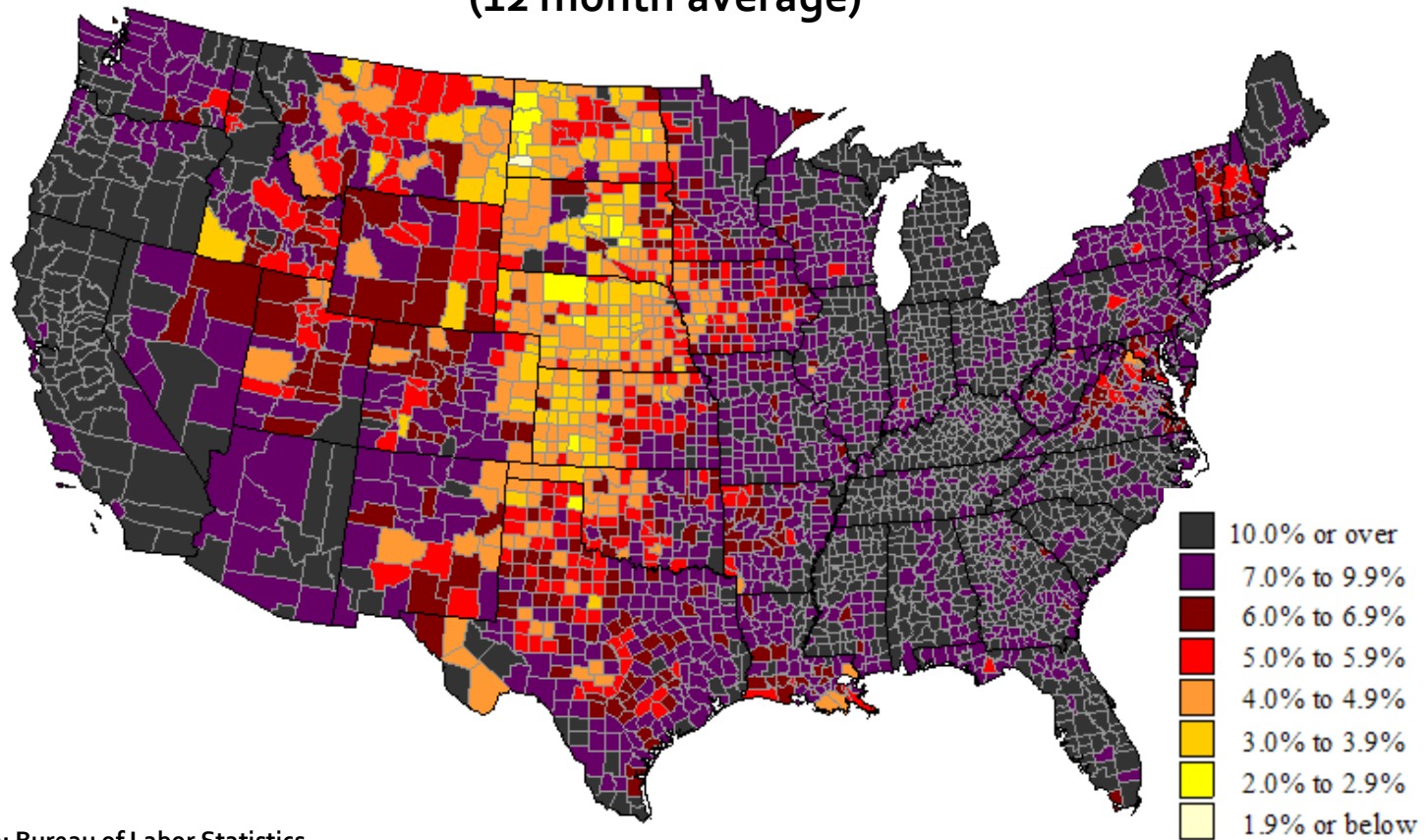


Source: Bureau of Labor Statistics



Midwest economies are in better shape.

Unemployment Rate January 2010 (12 month average)

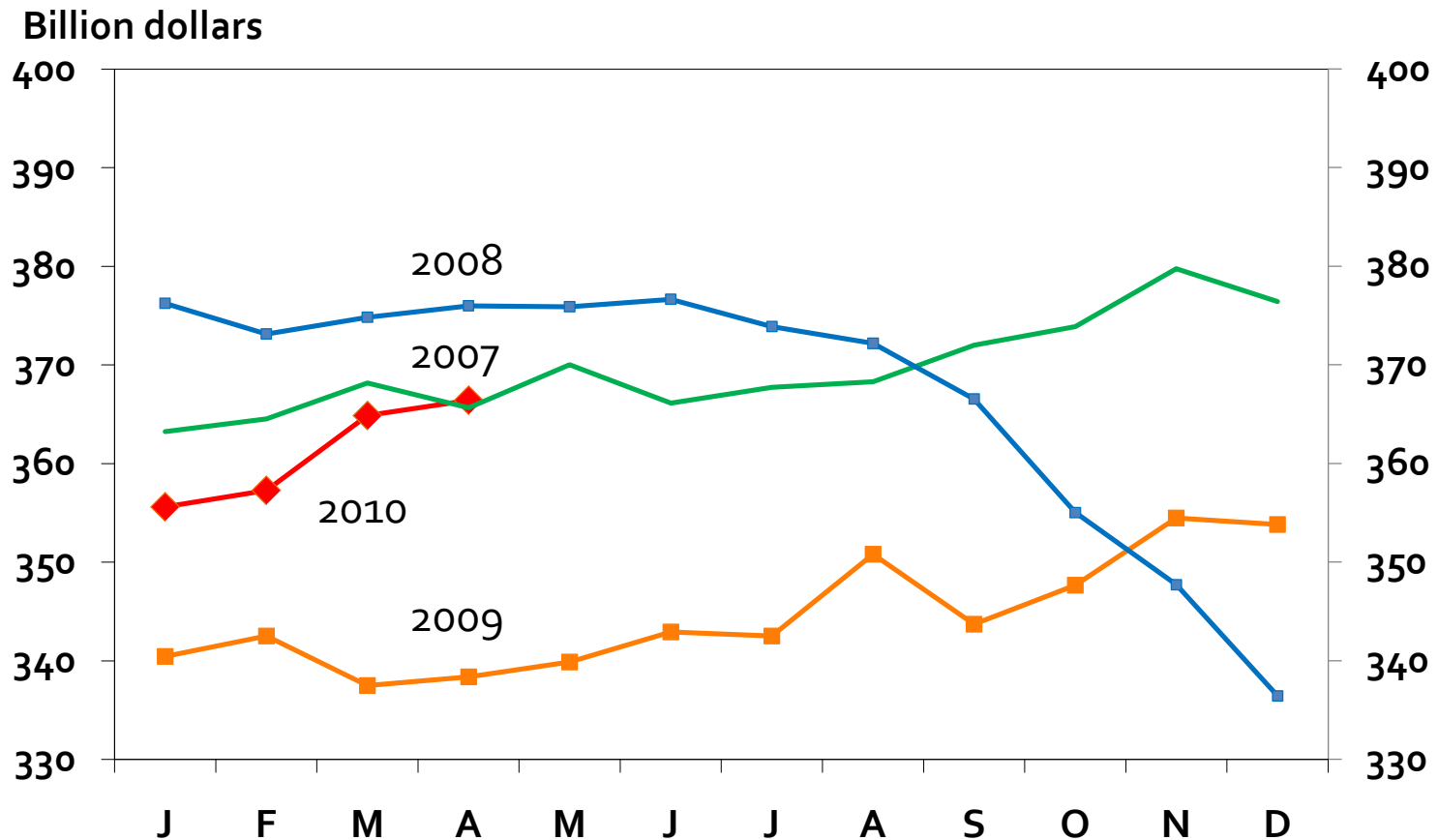


Source: Bureau of Labor Statistics



U.S. consumers are starting to spend money.

U.S. Monthly Retail and Food Sales

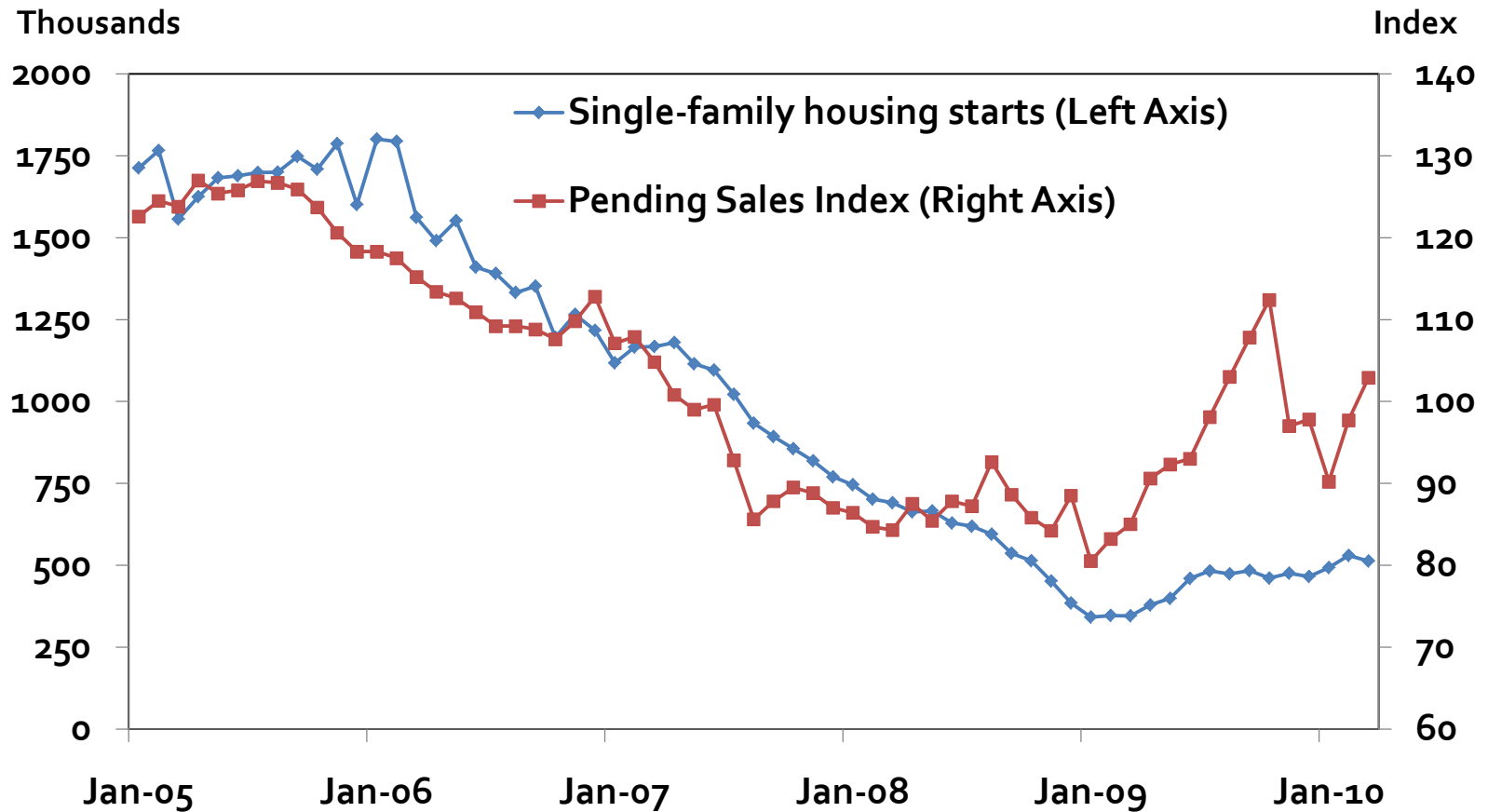


Source: U.S. Census Bureau



Have U.S. housing markets hit bottom?

U.S. Housing Markets

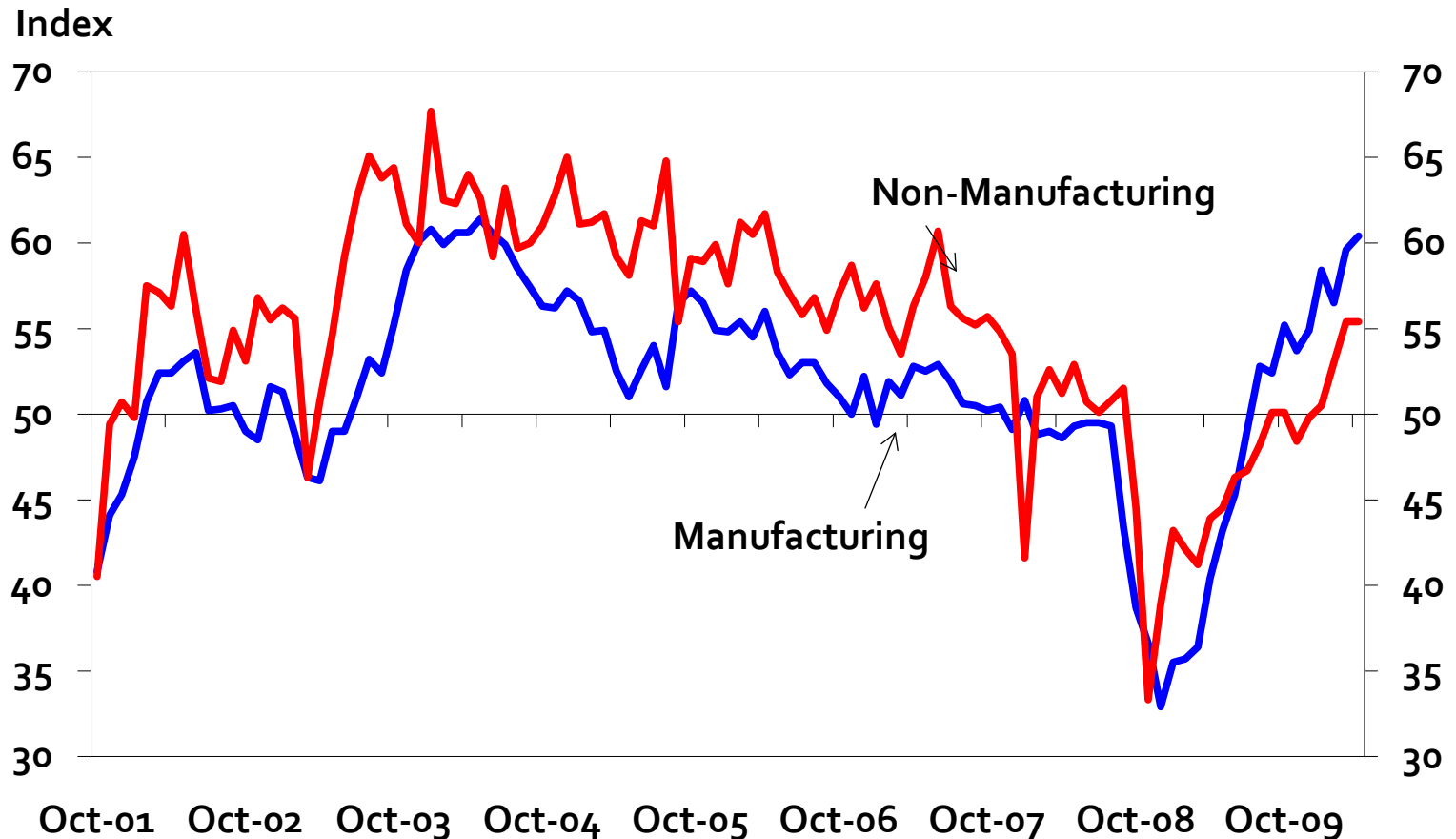


Source: U.S. Census Bureau



Business activity is expanding.

U.S. Manufacturing Activity Indices

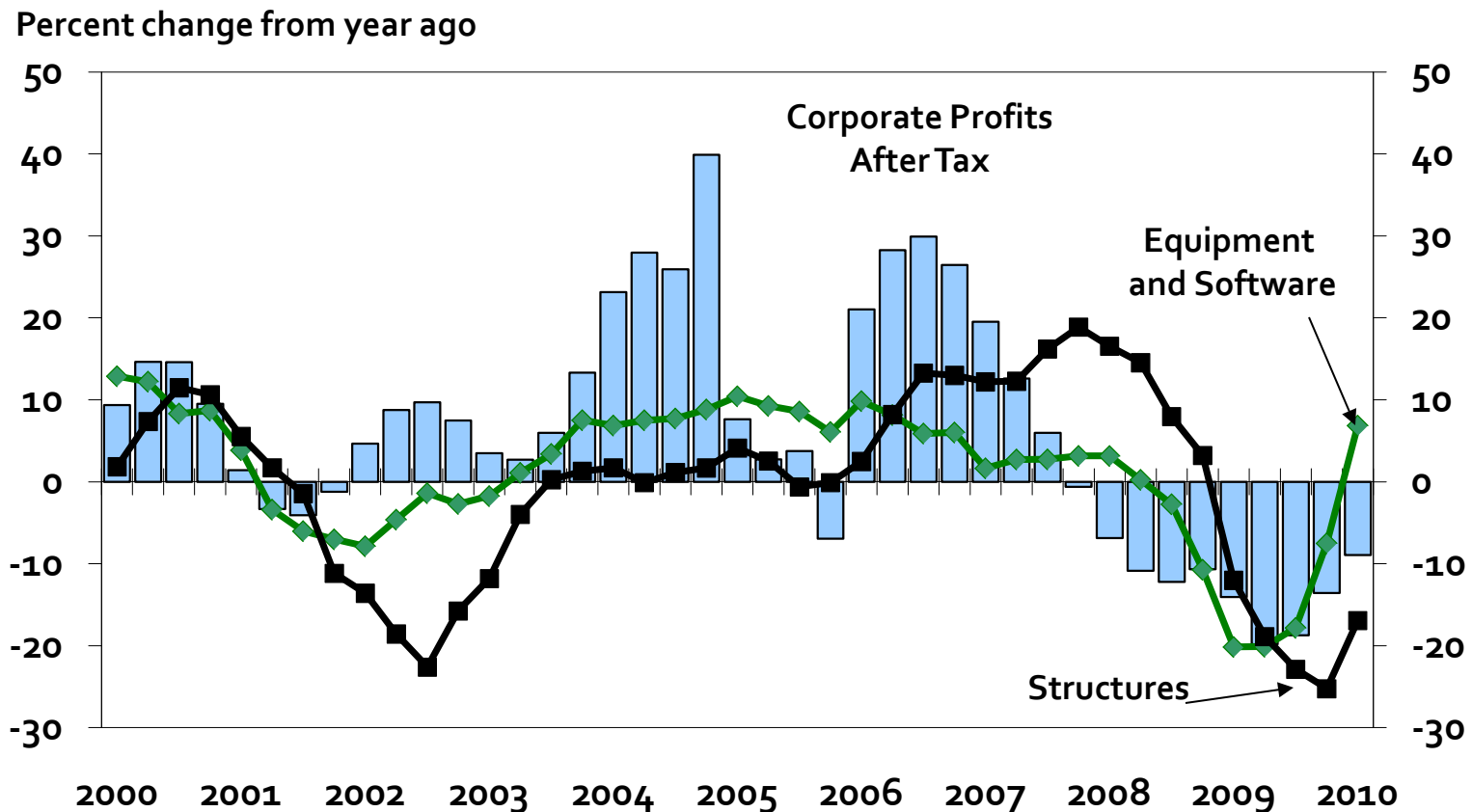


Source: Institute of Supply Management



Corporate profits and business investment are beginning to rebound.

Corporate Profits and Nonresidential Fixed Investment

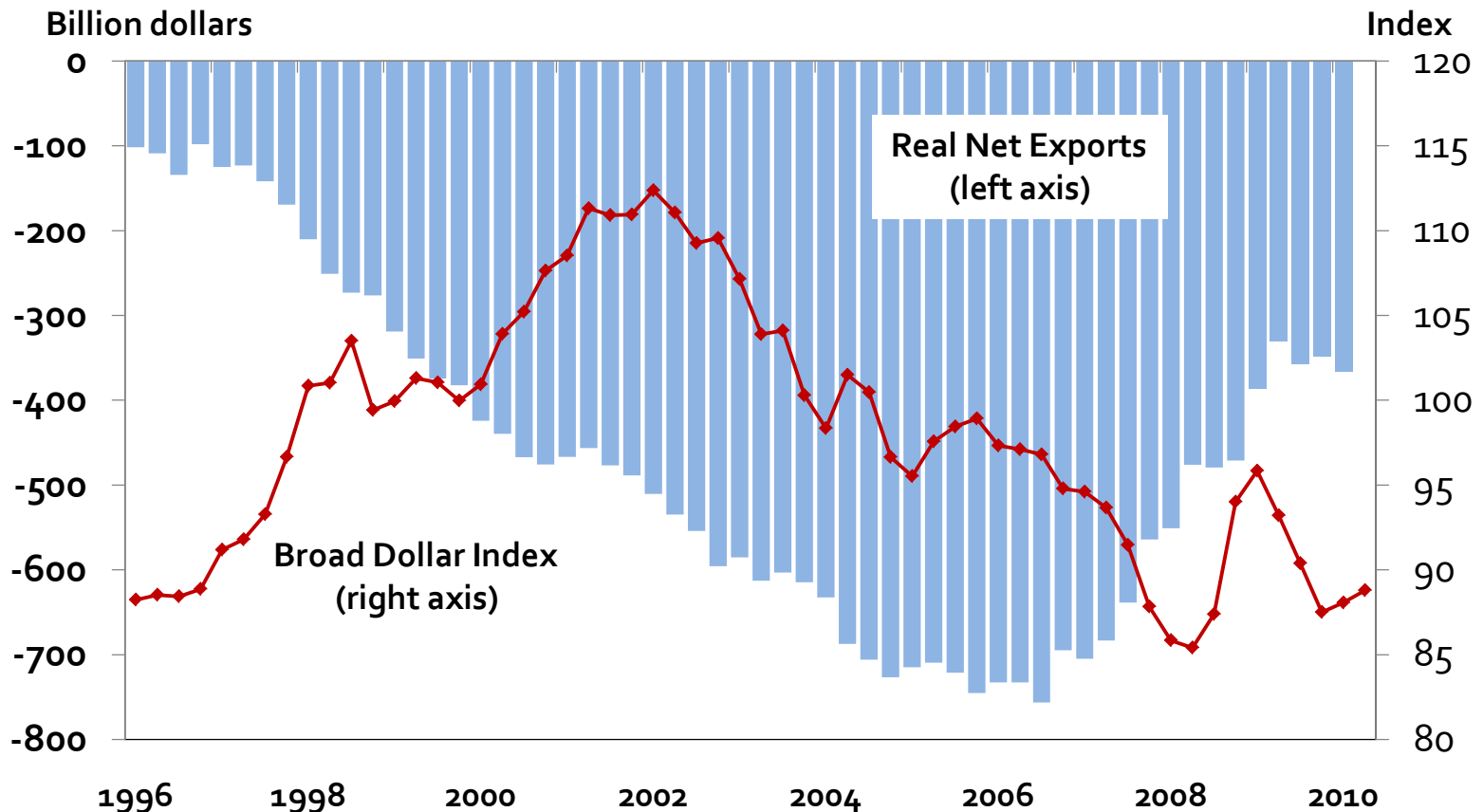


Source: Bureau of Economic Analysis



After dramatic improvements since 2007, U.S. net exports have stabilized.

U.S. Real Net Exports of Goods and Services and Value of the Dollar

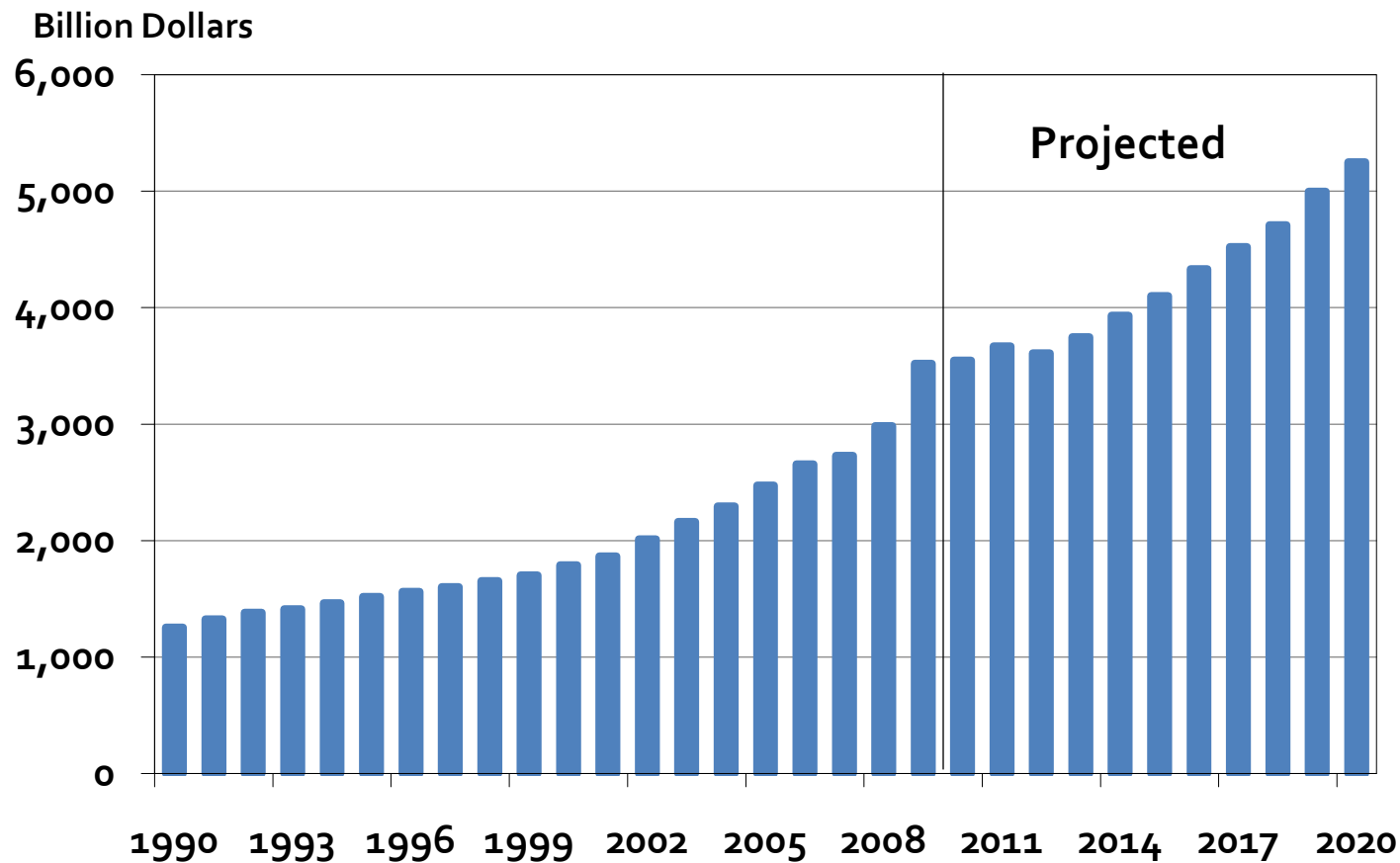


Source: Bureau of Economic Analysis and Federal Reserve Board of Governors



In the short run, deficit spending is an economic stimulus.

U.S. Government Outlays



Source: Congressional Budget Office, March 2010



Today's Roadmap

- **The Economic Recovery is Underway**
- **Concerns Shift from Growth to Inflation**



Inflation is based on money and velocity.

Quantity Theory of Money

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

Definition of Inflation:

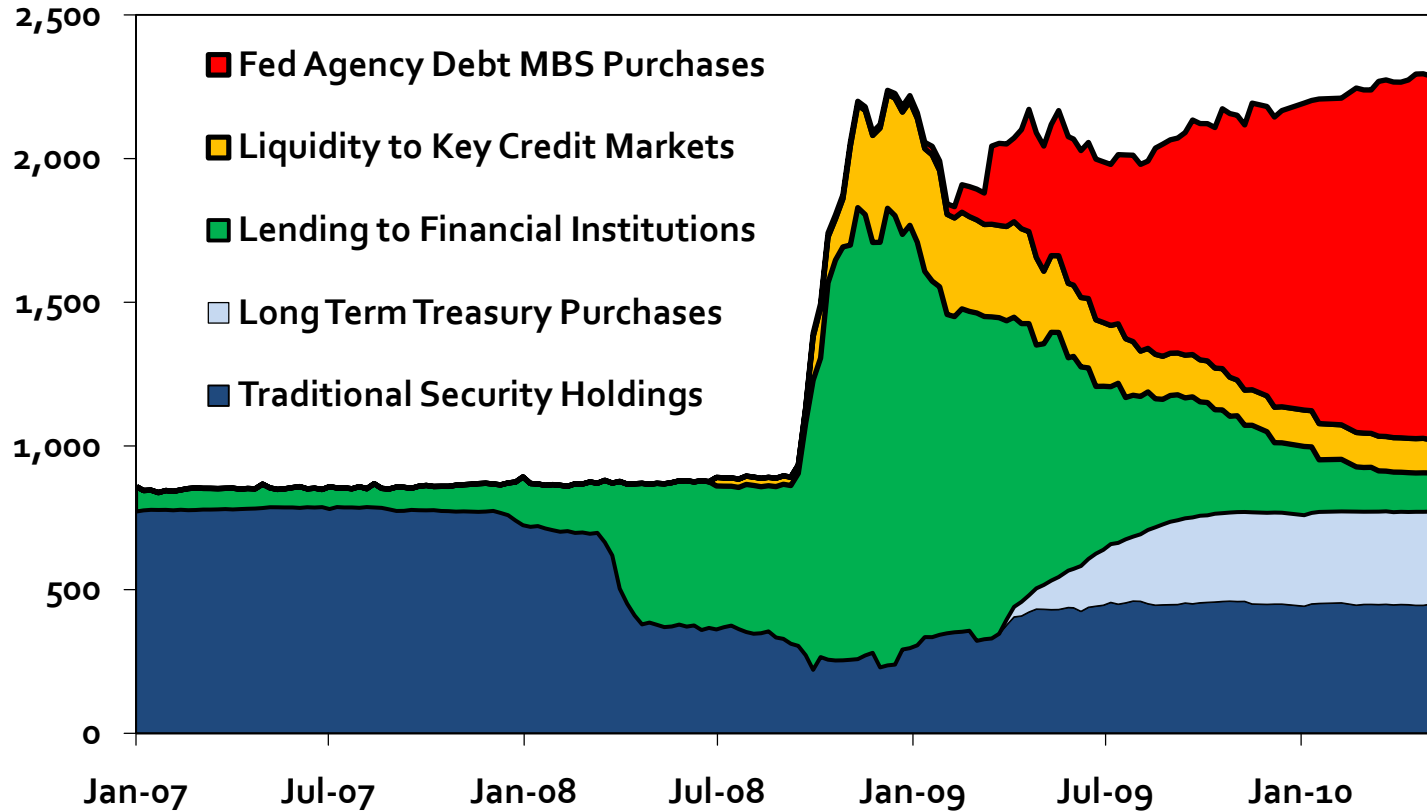
Too much money $M \uparrow$
chasing $V \uparrow$
too few goods $Q \downarrow$



*The Fed has increased the monetary base.
But, the bulk of it is in excess reserves.*

Federal Reserve Balance Sheet : Assets

Billion Dollars



Source: Federal Reserve Bank of Cleveland



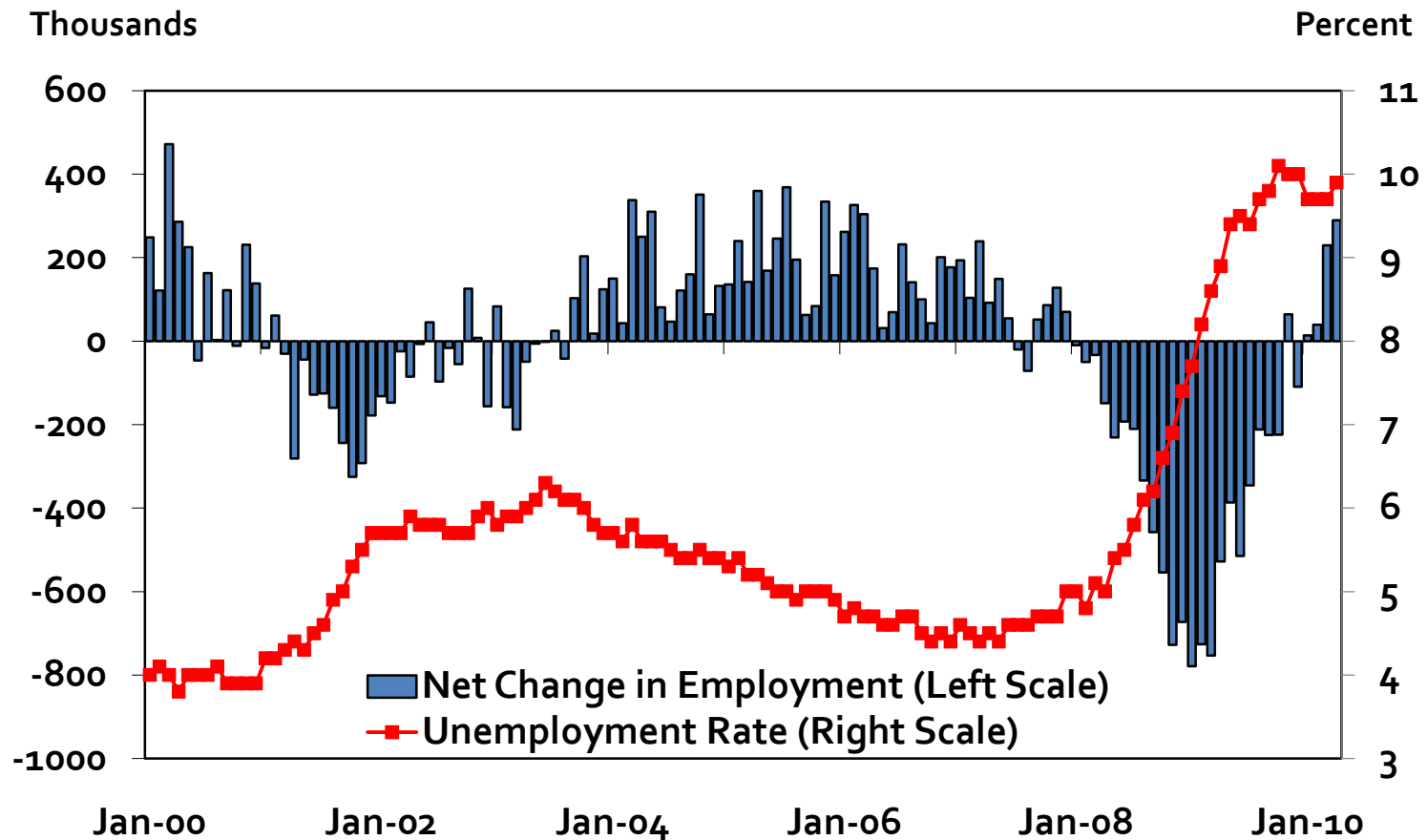
How will the Federal Reserve shrink its balance sheet with Agency and MBS debt?

- Hold to maturity
- Sell assets
- Keep reserves on deposit at the Fed.
 - **Interest on excess reserves**
 - **Reverse repurchase agreements**
 - **Term deposits**
- All strategies lead to higher interest rates.
 - **When?**
 - **How fast?**



Labor markets are key to "chasing" and inflation.

Nonfarm Employment Change and Unemployment Rate



Source: Bureau of Labor Statistics



Implications for Agriculture



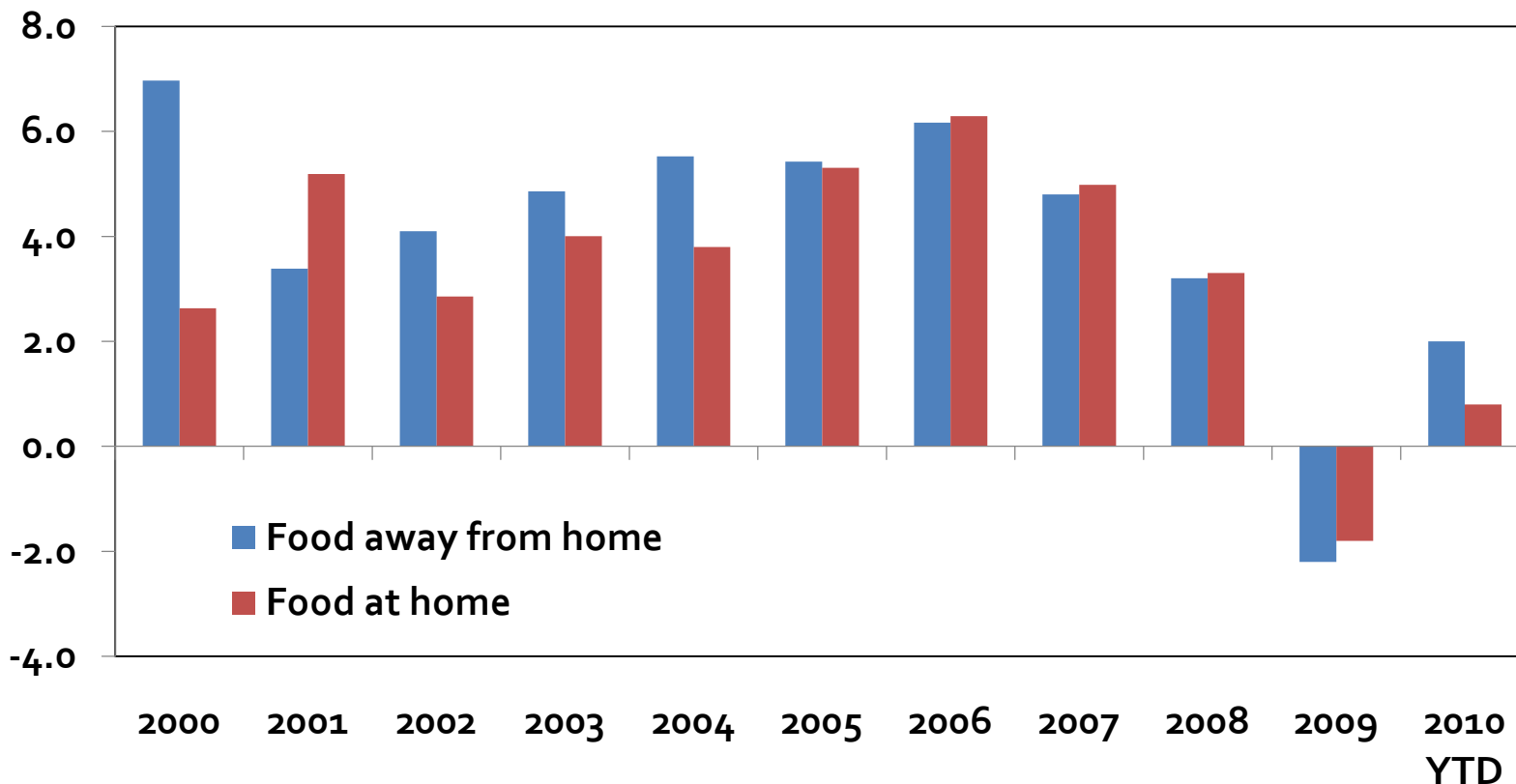
- U.S. consumer demand



How strong will U.S. food spending rebound?

U.S. Food Expenditures

Percent change from previous year



Source: USDA



Implications for Agriculture



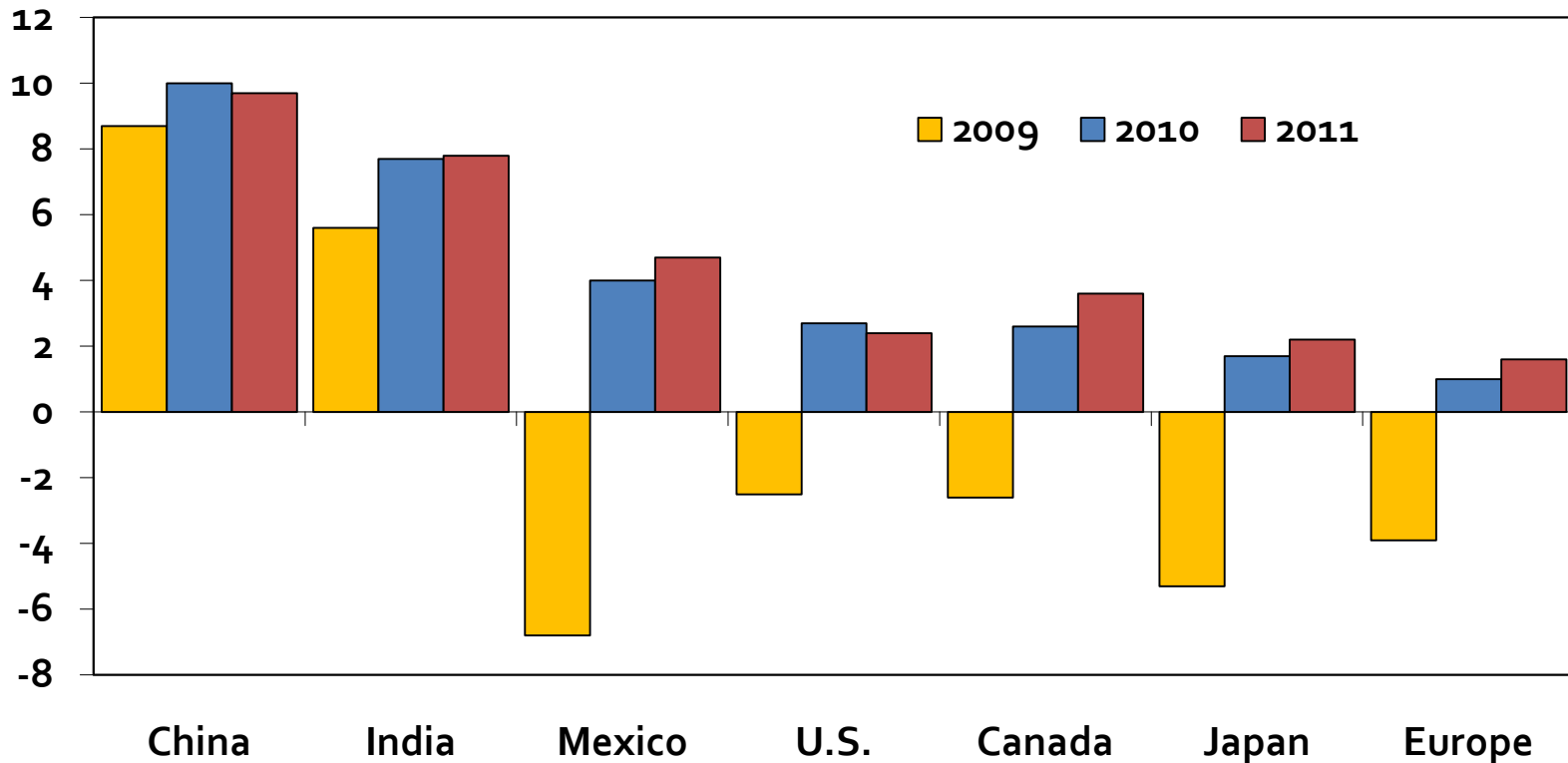
- U.S. consumer demand
- Export activity



Stronger economic growth is expected through 2011.

GDP Growth

Percent Change



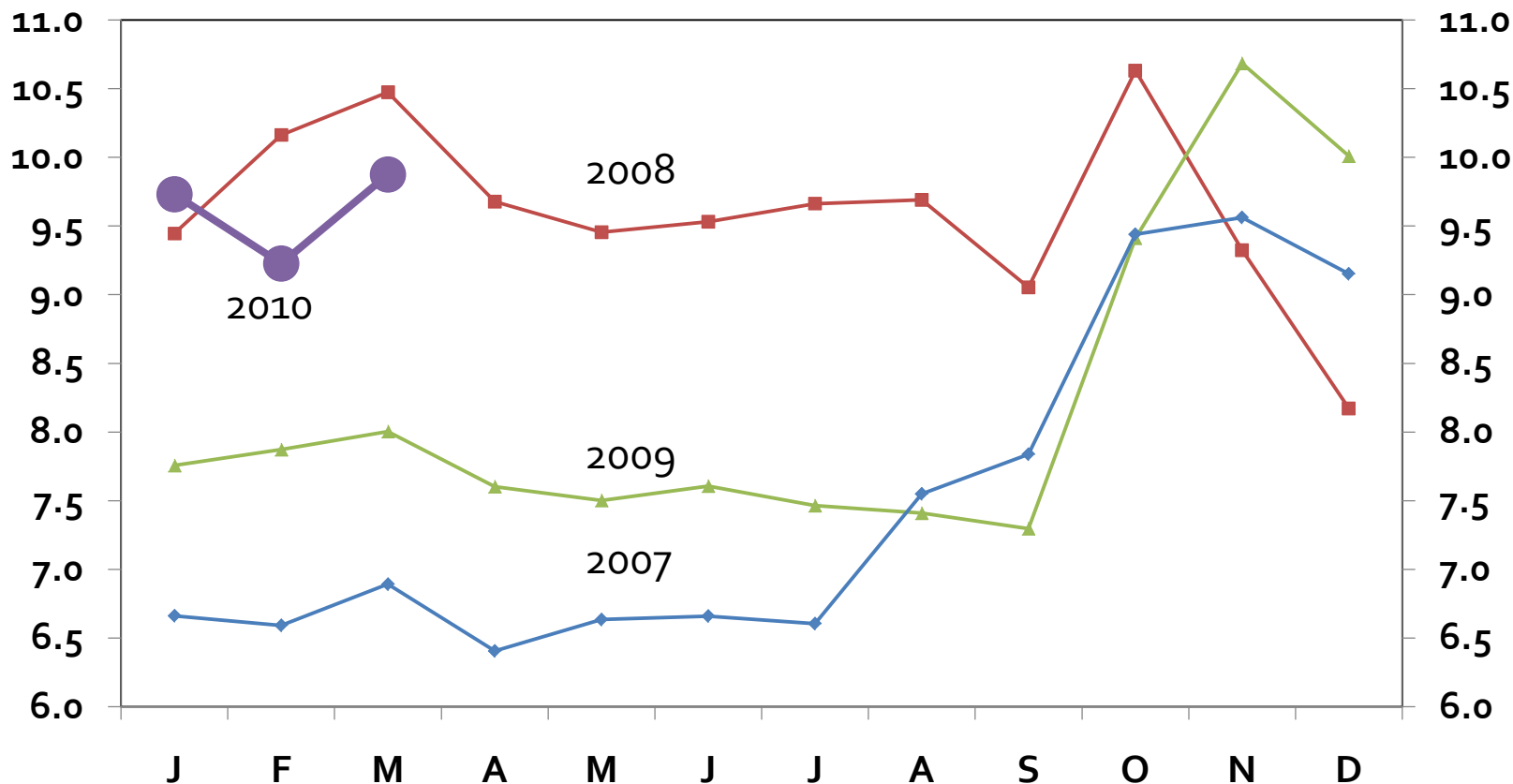
Source: IMF, January 2010



Can agricultural exports rebound to 2008 record highs?

U.S. Agricultural Exports

Billion dollars

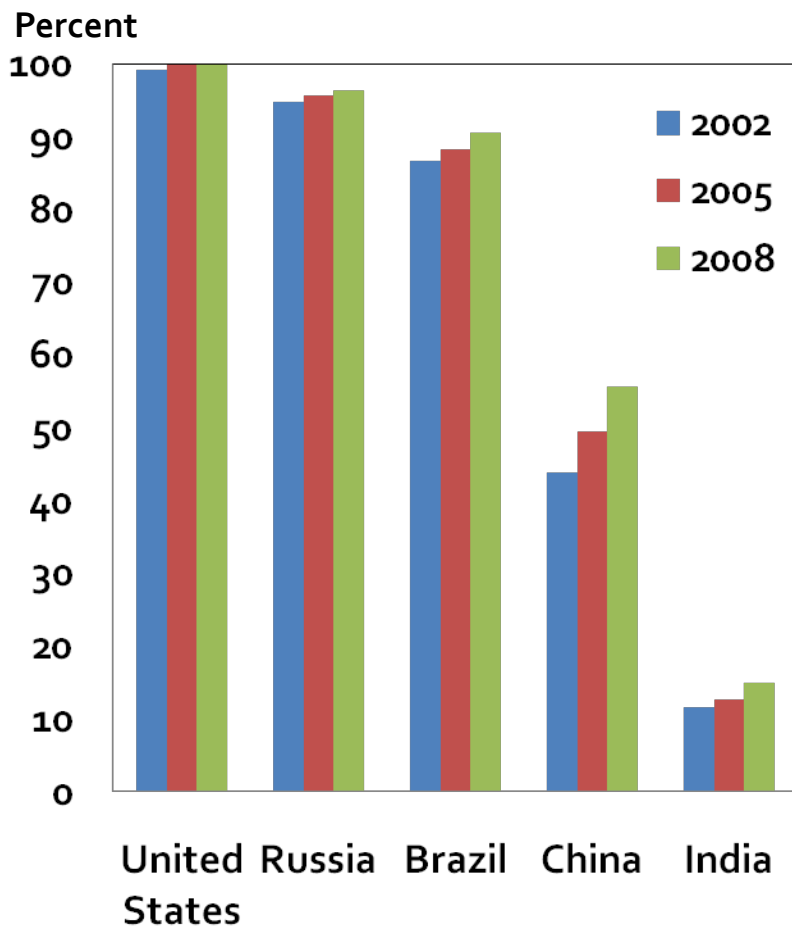


Source: USDA

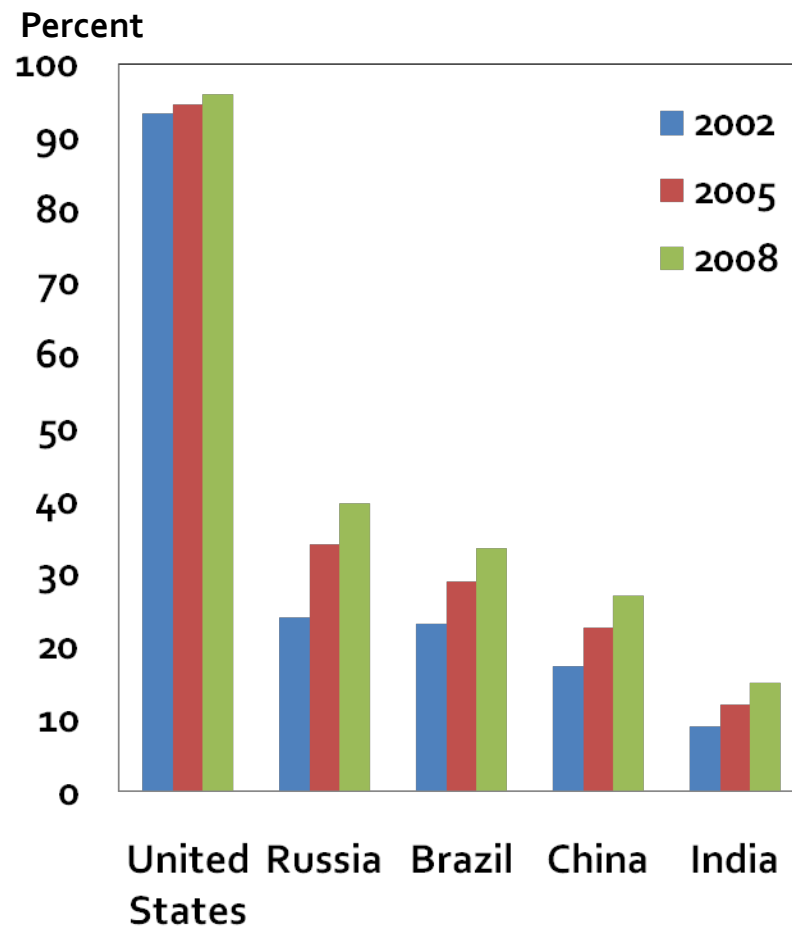


How will the types of food exports change?

Households Owning a Refrigerator



Households Owning a Microwave Oven



Source: USDA, Euromonitor



Implications for Agriculture

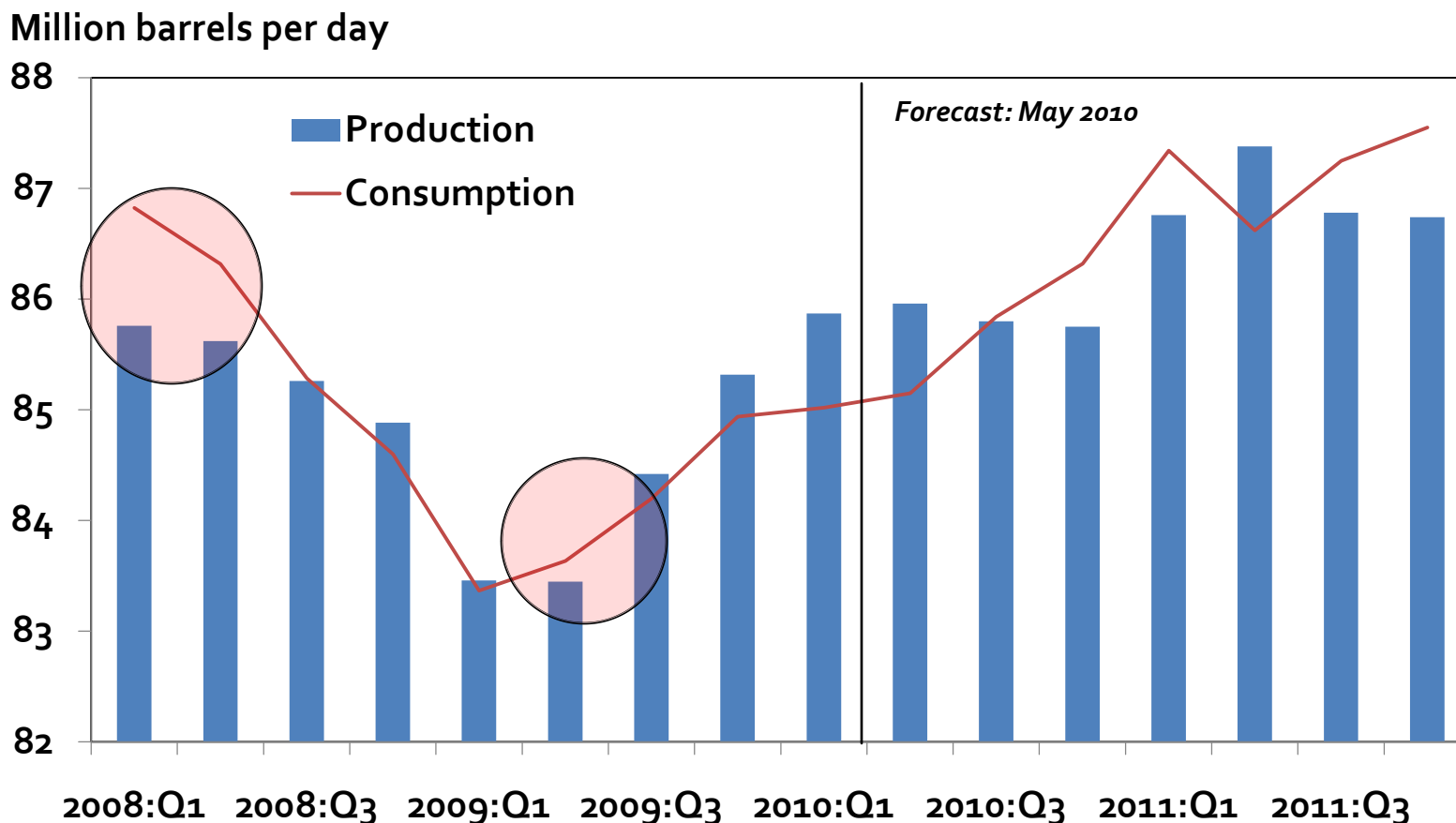


- U.S. consumer demand
- Export activity
- Energy markets



What will happen to crude oil prices if consumption outpaces production?

World Crude Oil Supply Balance

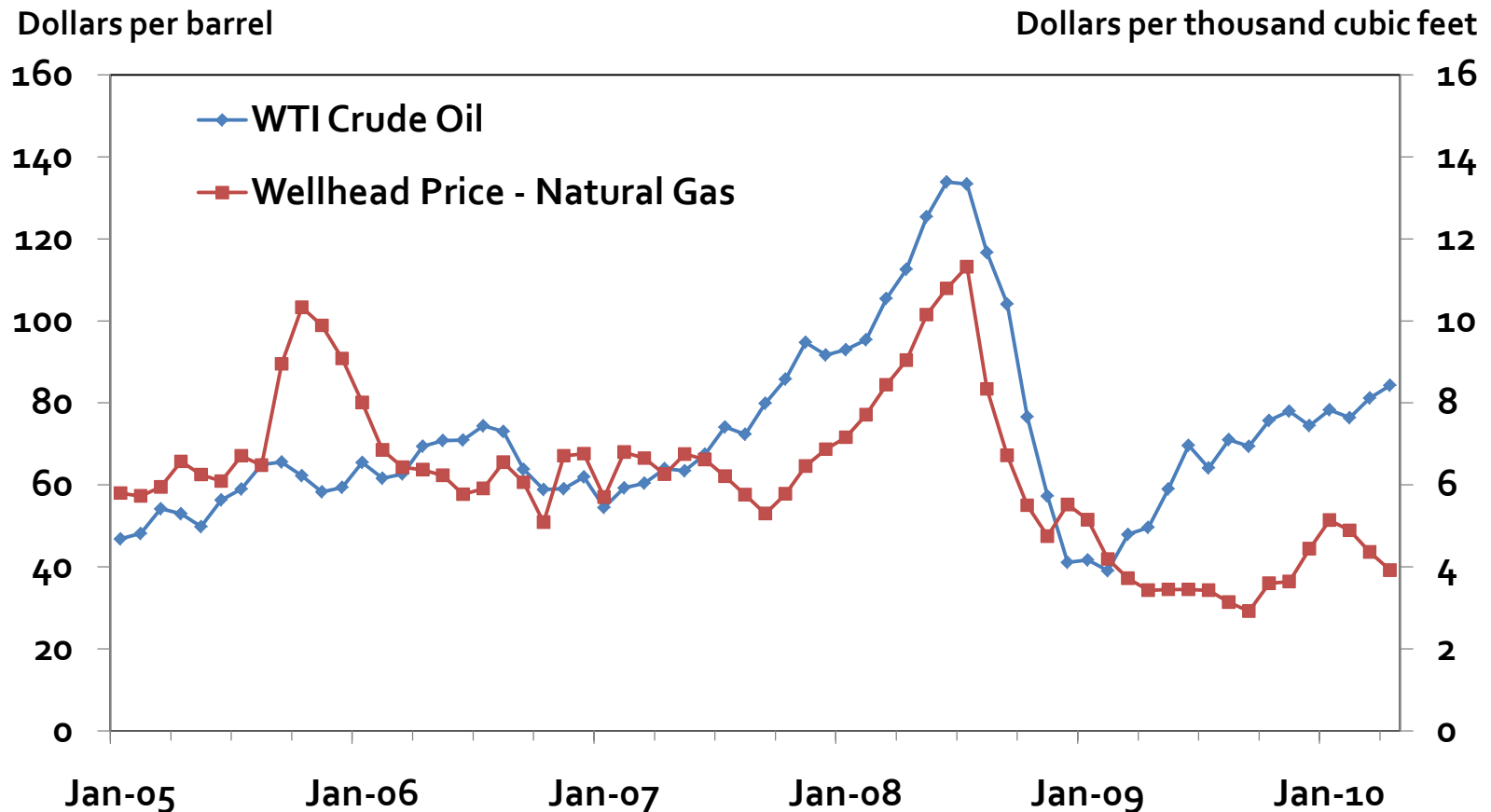


Source: Energy Information Administration



Energy markets: A boon or bane for agriculture?

Crude Oil and Natural Gas Prices



Source: Energy Information Administration



Implications for Agriculture

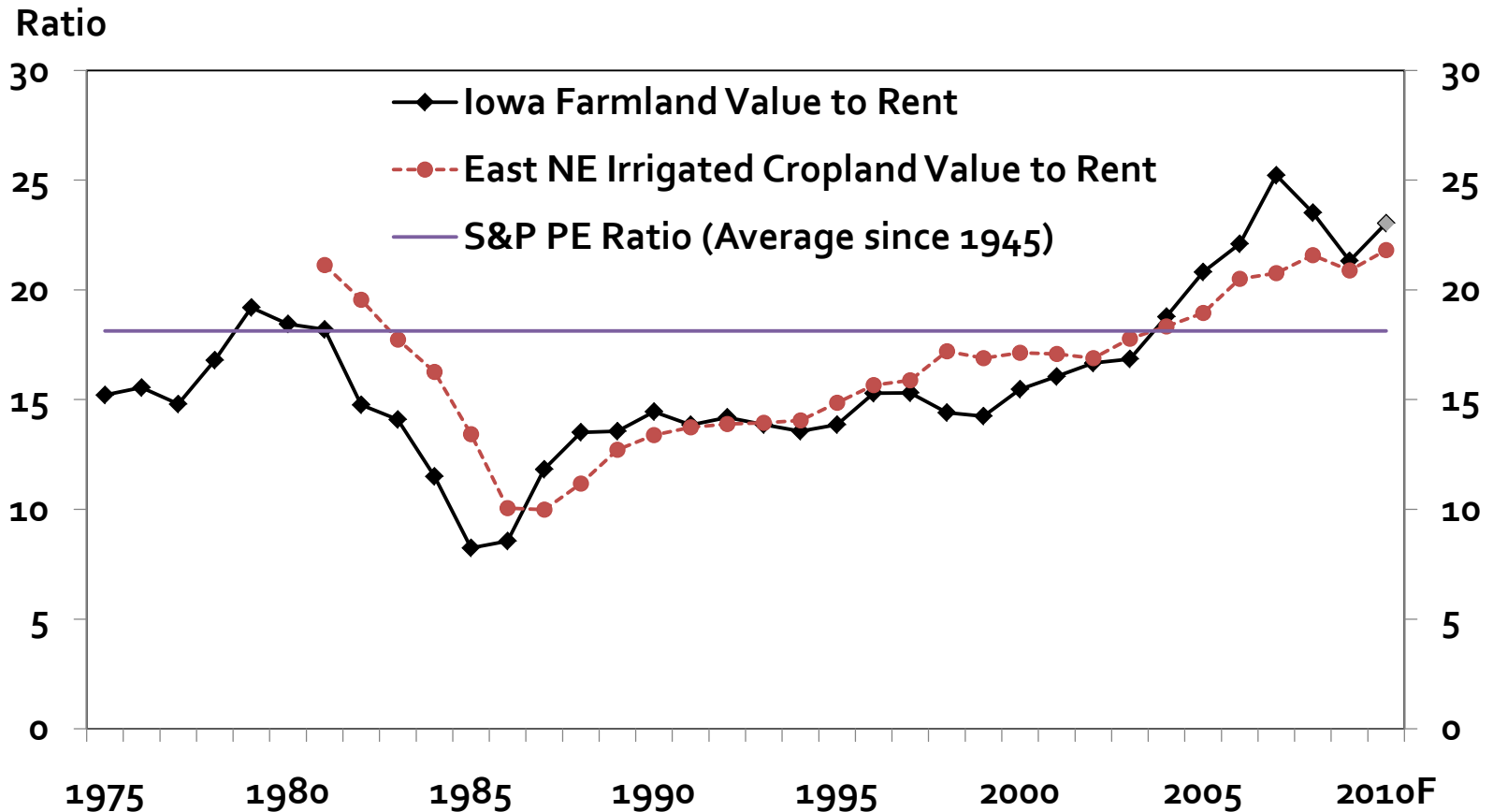


- U.S. consumer demand
- Export activity
- Energy markets
- Farmland values



Is a farmland bubble brewing?

Farmland Values to Rent Ratio

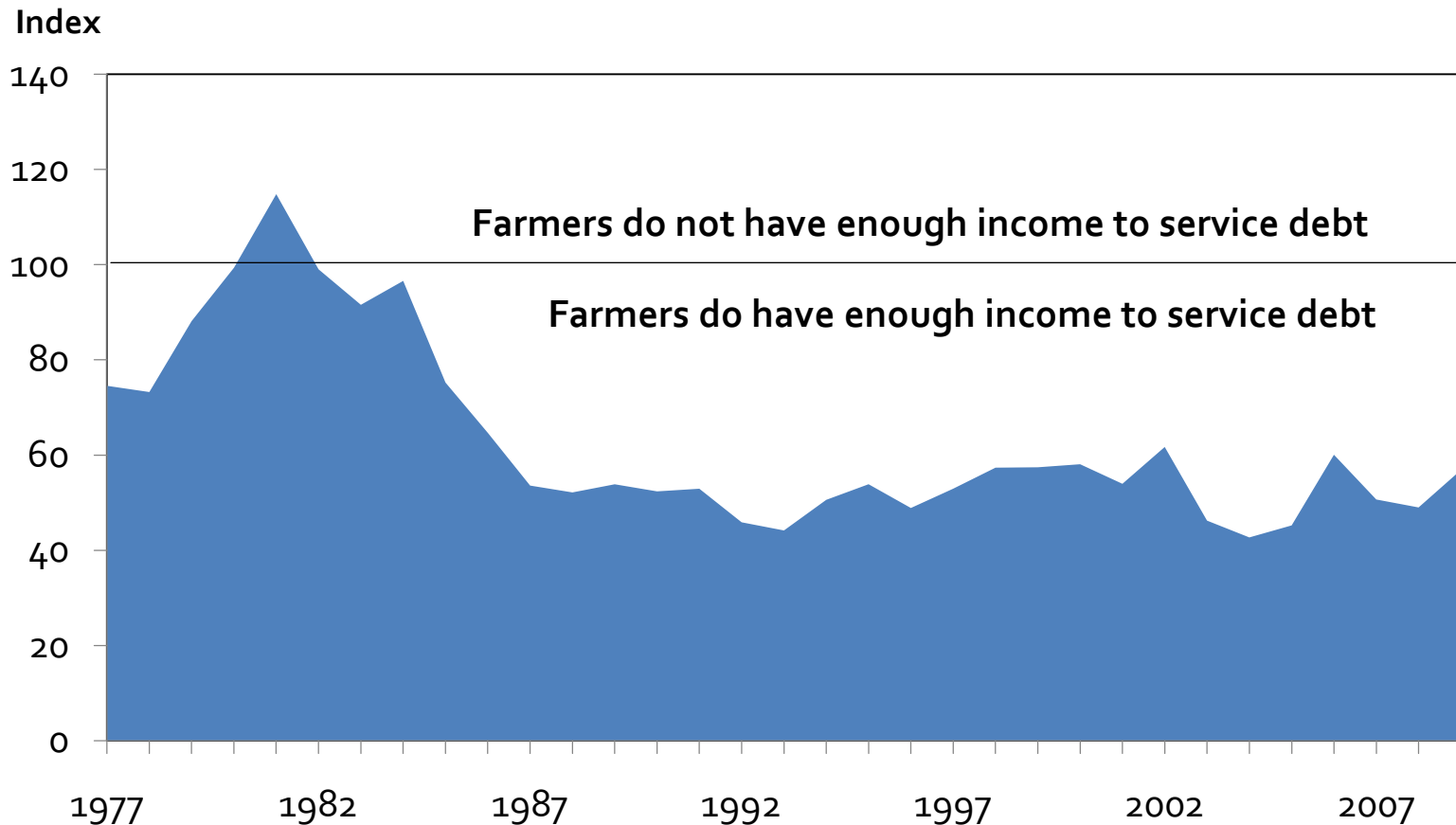


Calculations based on Iowa State University and University of Nebraska data



To identify a bubble, follow the debt.

U.S. Debt Repayment Capacity Utilization



Source: USDA



Implications for Agriculture

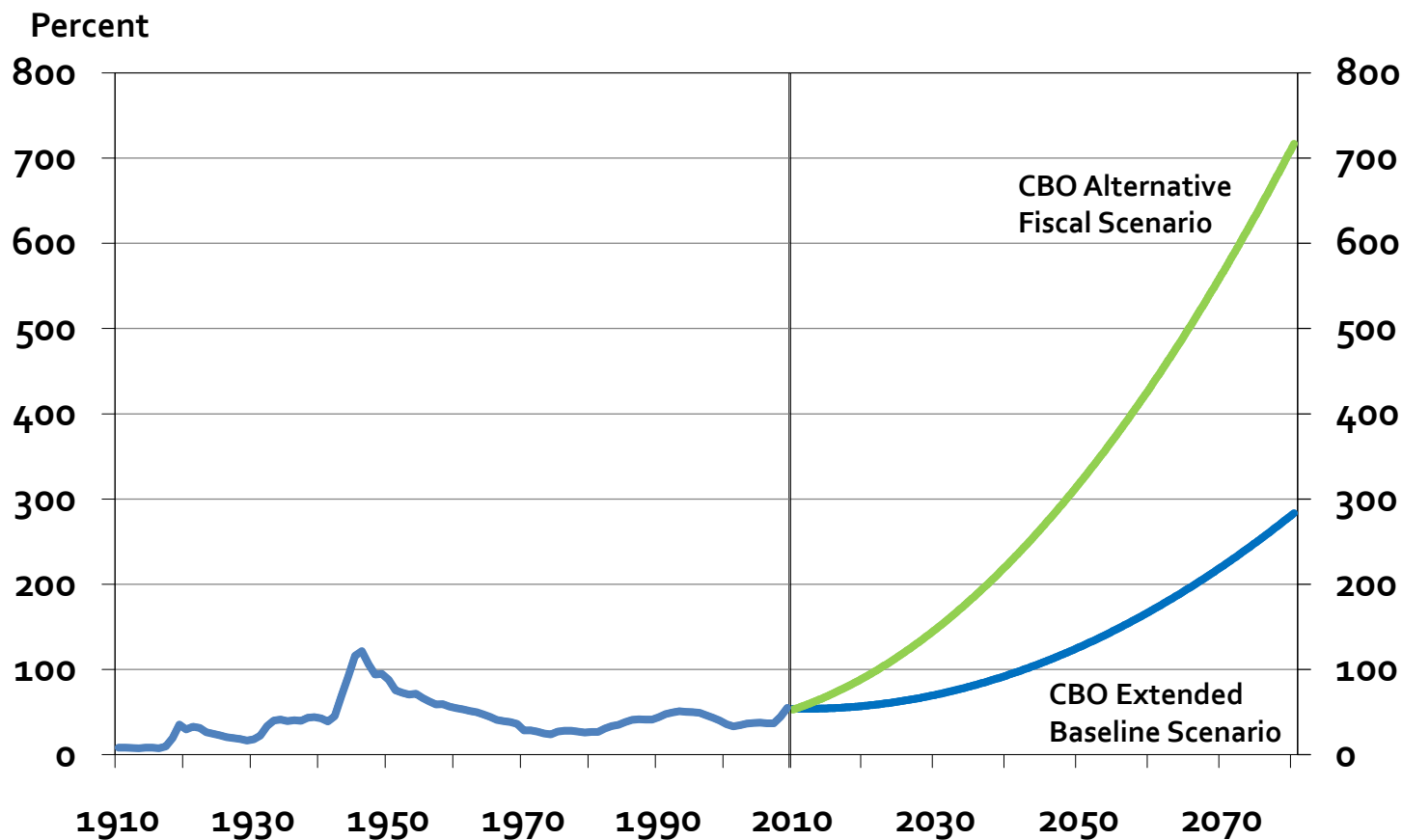


- U.S. consumer demand
- Export activity
- Energy markets
- Farmland values
- Government policy



How will surging federal debt levels affect farm policy?

U.S. Debt as a Percent of GDP



Source: Congressional Budget Office, November 2009



Conclusions

- **The economic recovery is underway.**
 - Stronger consumer demand is boosting business activity.
 - But, deleveraging will limit the recovery.
- **Questions will switch from growth to inflation.**
 - Will high unemployment limit inflation?
 - What will start the “chasing”?
- **The recovery brings opportunities and risks to the farm sector.**

