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Macro Economics and Its Impact on Commercial Agriculture



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

- **Macro Economics and the Federal Reserve System**
- **Financial Crisis – Disruption of Credit Markets**
- **The Macro Economy and Agriculture**
- **Inflation Concerns and Fed Exit Strategy**
- **Financial Health of Farmers (if we have time)**



Macro versus Micro

- In a nut shell...
- What is macroeconomics?
 - How the national economy functions
- What is microeconomics?
 - The study of buying and selling behavior of individuals and firms in markets and market failures



A Key Player in Managing the Macro Economy is the Federal Reserve System

- **The 'Fed' was founded in 1913 with 3 core missions:**
 - Promote an efficient payments system
 - Safeguard the competitiveness, safety and soundness of the banking system
 - Conduct monetary policy



An Independent Fed

- **The Fed is self-supporting to maintain political independence.**
- **Income sources:**
 - Interest on loans to financial institutions
 - Income from services
 - Interest income from US Treasury bonds, bills and notes
- **Balance of Power: The Political Fight for an Independent Central Bank, 1790 – Present**
 - <http://www.kc.frb.org/>



Structure of the Fed

- **Board of Governors**
- **12 Regional Reserve Banks**
- **Federal Open Market Committee**



Board of Governors

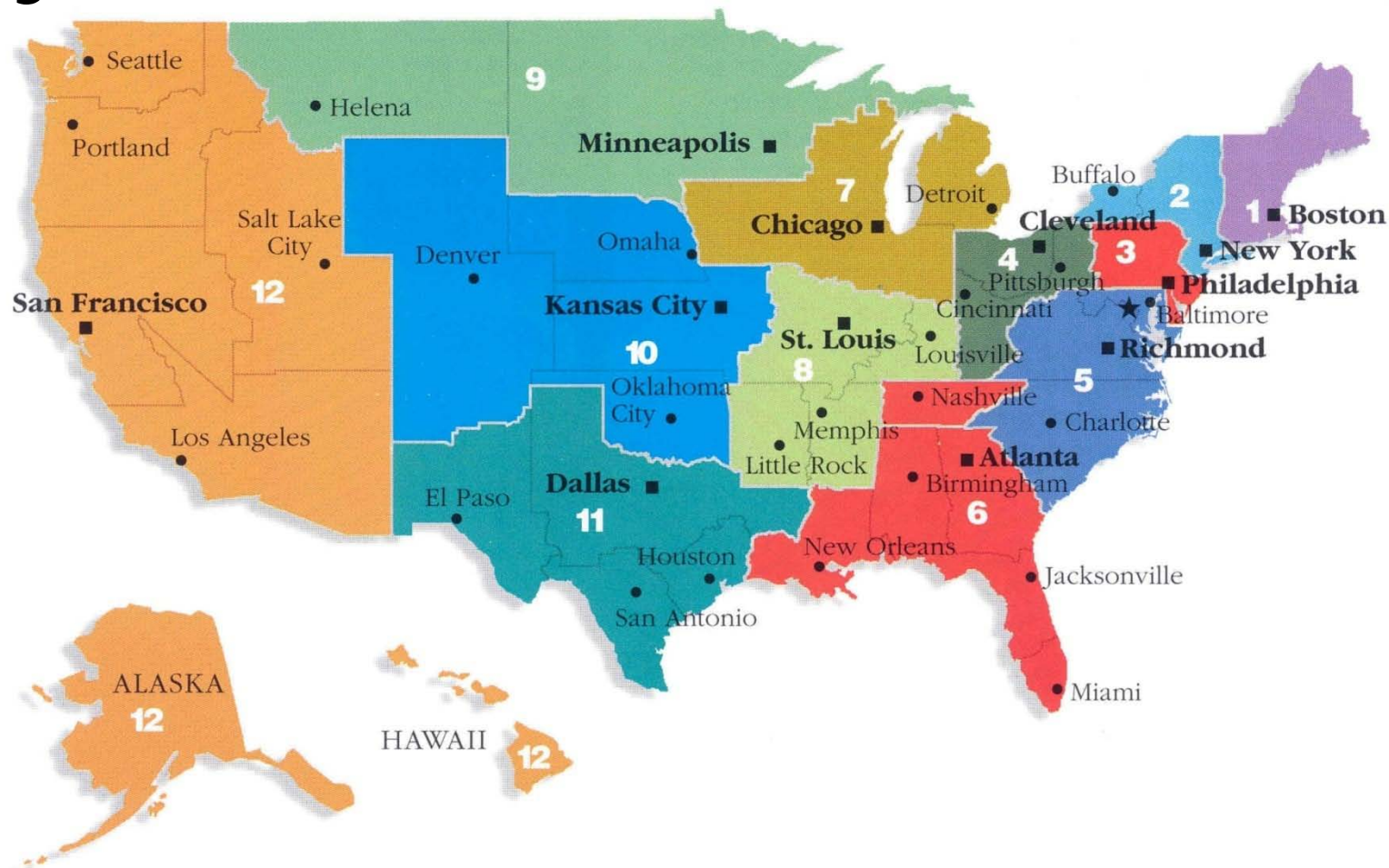
- **7 members**
 - Appointed by President, confirmed by Senate
 - 14-year terms
 - Current chairman –
Ben Bernanke
- **Supervise Reserve Banks**



Regional Reserve Banks

- 25 branch offices

- Fed member banks



Federal Open Market Committee

- Monetary policy making body
- 7 Governors, NY Fed President, 4 other Fed Presidents
- Remaining Reserve Bank presidents participate in discussions



Two Kinds of Economic Policy

■ Monetary Policy

- Changes in the level of money and credit in the economy
- Implemented by the Federal Reserve

■ Fiscal Policy

- Changes in government spending and tax programs
- Implemented by the Executive and Legislative branches



Monetary Policy Objectives

- Primarily two all encompassing objectives:
 - Price stability
 - Sustainable economic growth



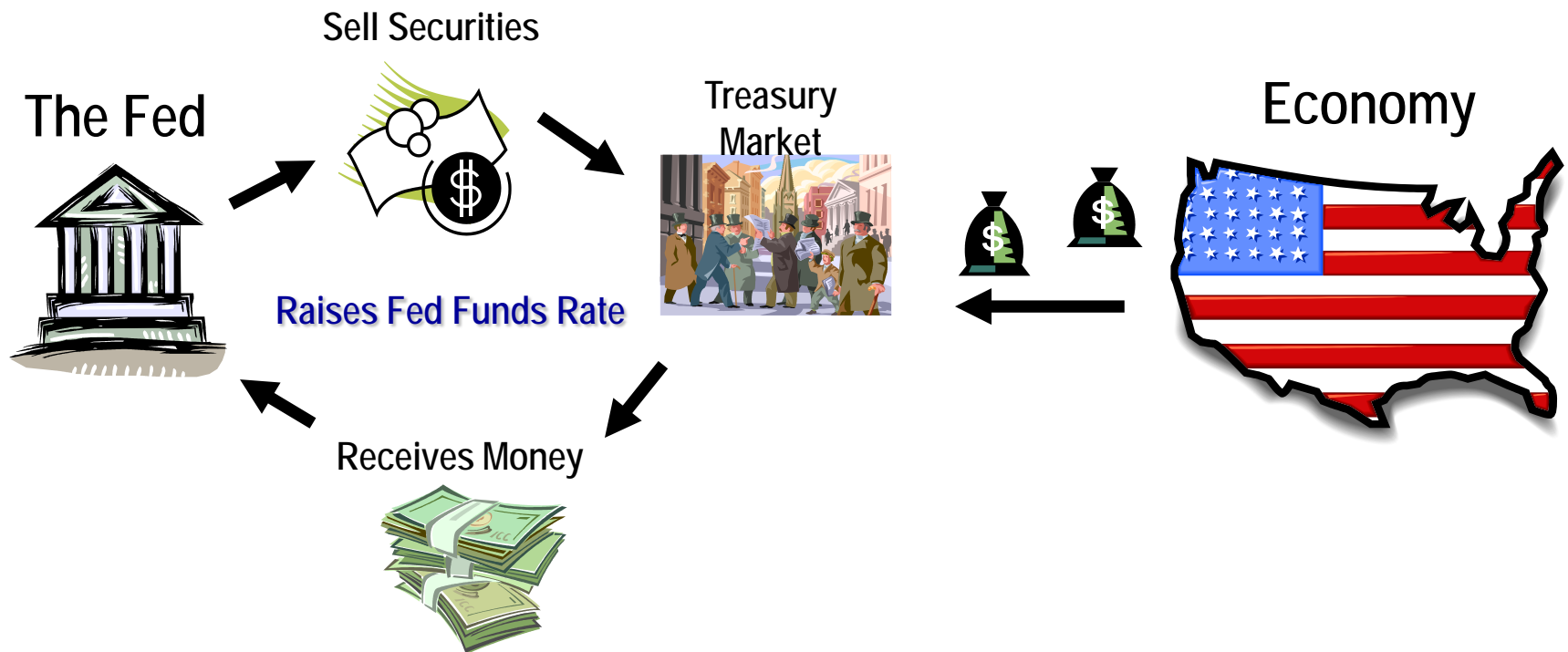
The Fed's Toolbox: Monetary Policy Tools

- Open Market Operations
- Primary Credit Rate (discount rate)
- Reserve Requirements
- Balance Sheet



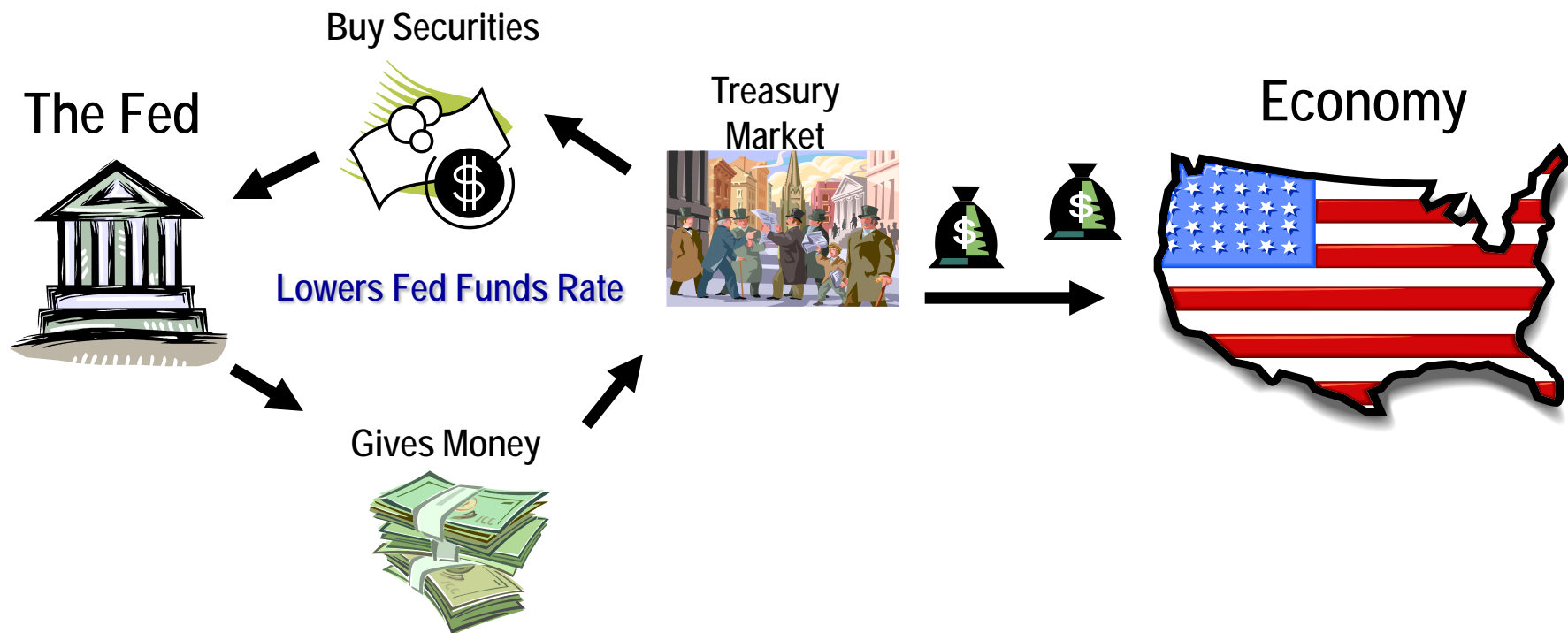
Monetary Policy Mechanism: Fed Funds Rate

*Slow the Economy:
Take Money Out of the Economy*



Monetary Policy Mechanism: Fed Funds Rate

*Stimulate the Economy:
Place Money in the Economy*



Today's Roadmap

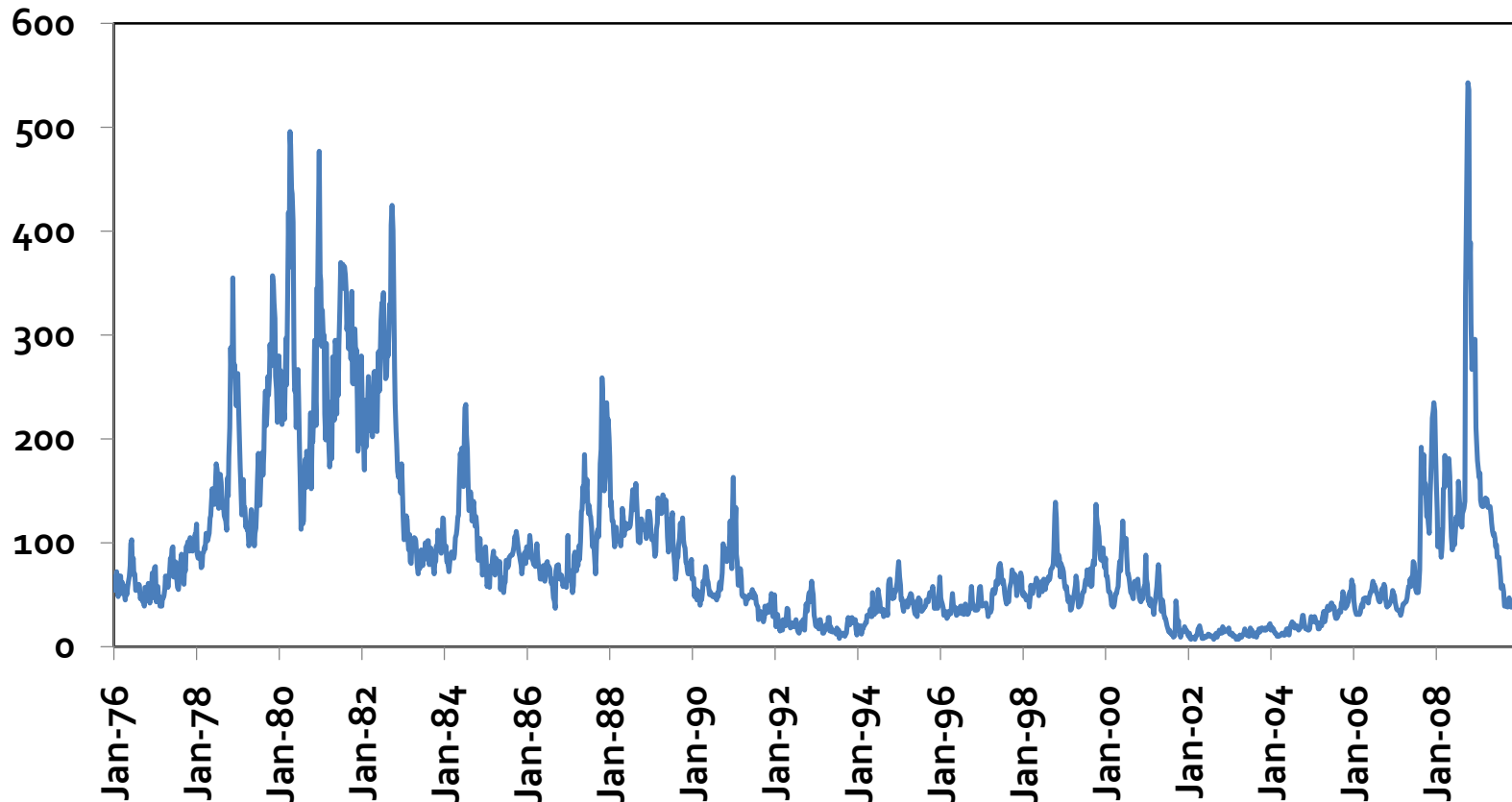
- **Macro Economics and the Federal Reserve System**
- **Financial Crisis – Disruption of Credit Markets**



The financial crisis has eased.

TED Spread

Basis Points

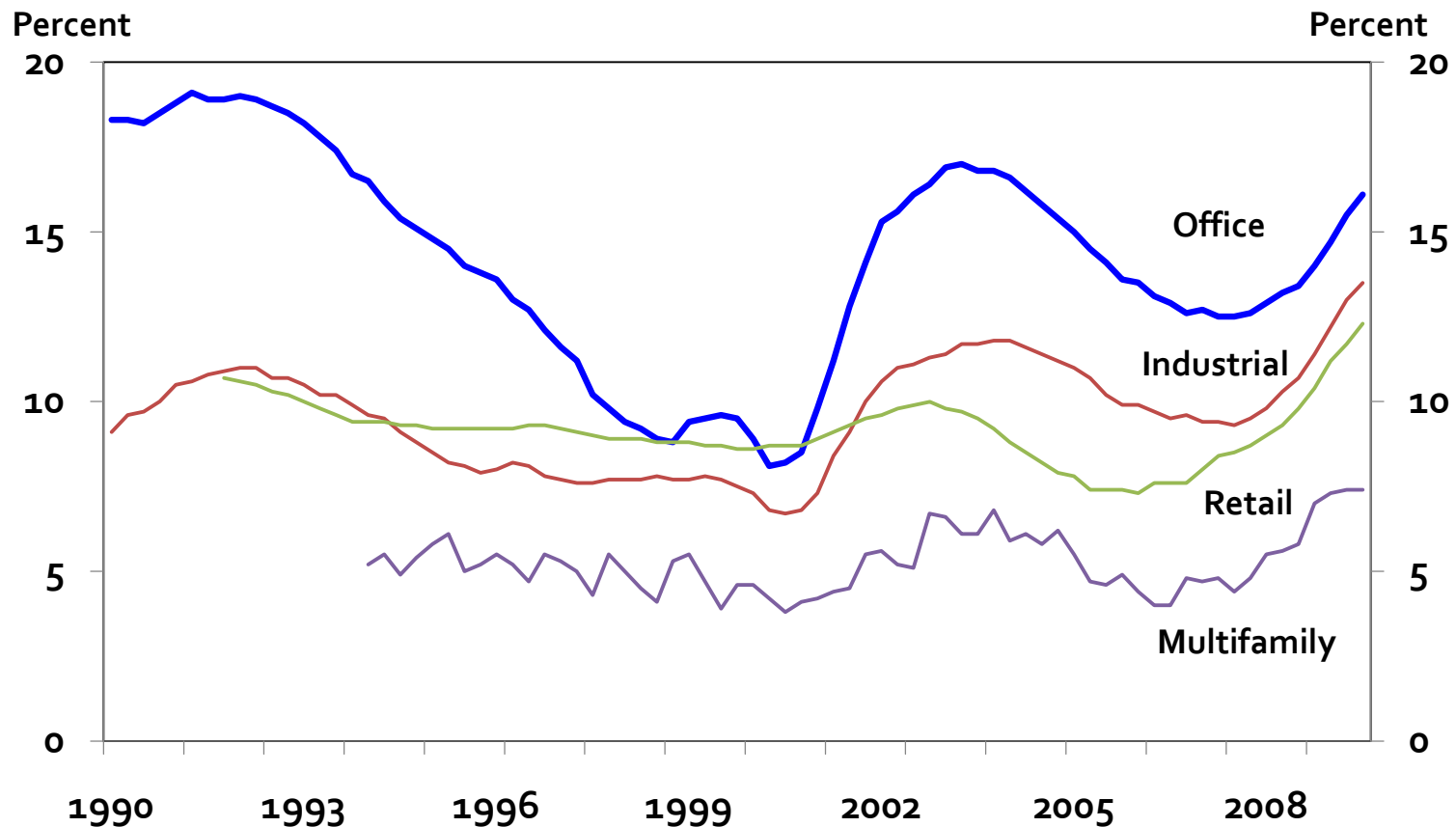


Source: Federal Reserve Board of Governors



Financial markets may not be in the clear partly because of commercial real estate.

U.S. Commercial Real Estate Vacancy Rates



Source: Torto-Wheaton Research



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How Gross Domestic Product (GDP) is Measured

$$Y = C + I + G + NX$$

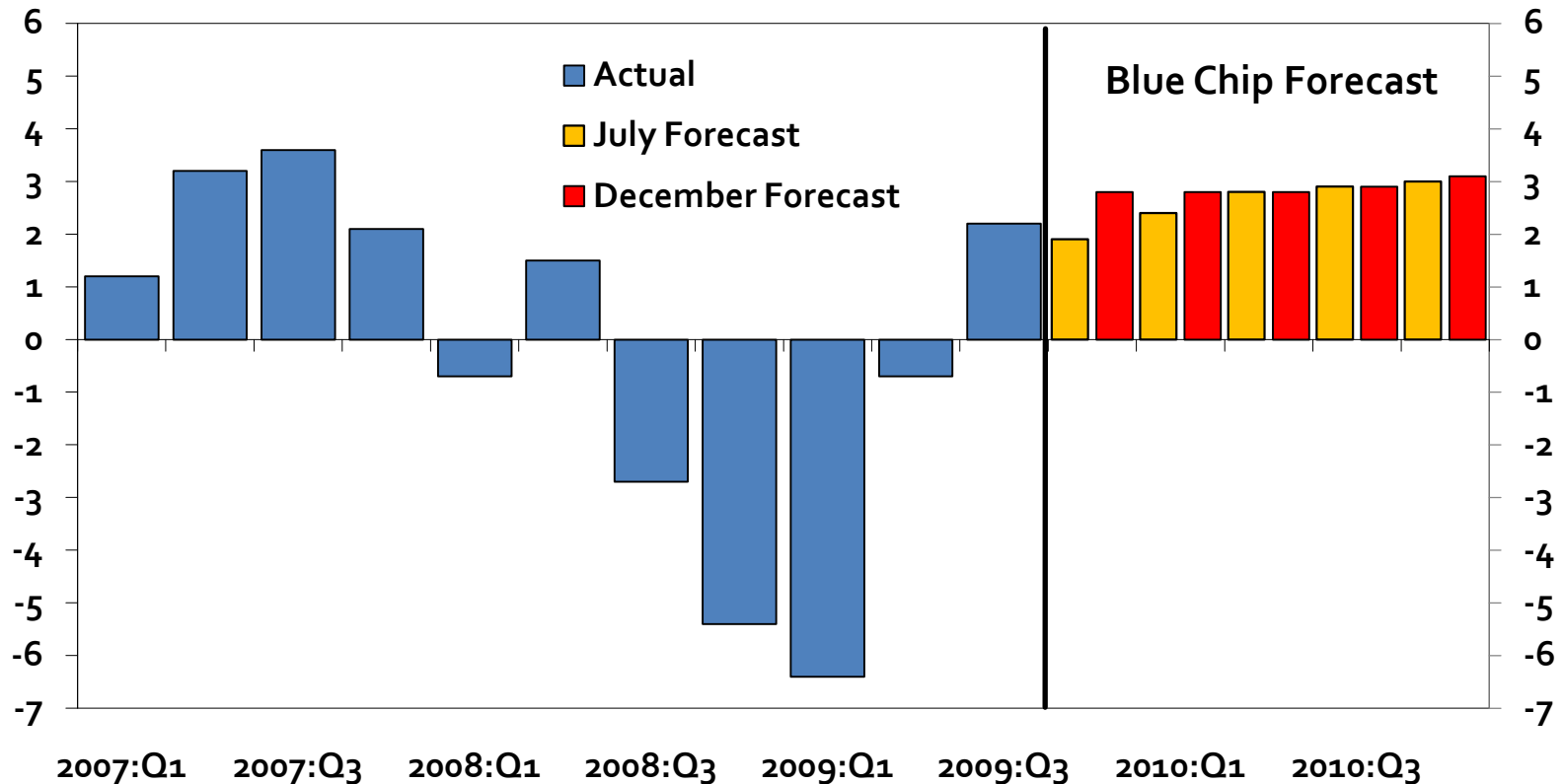
- Y is GDP
- C is Consumption (presently $\approx 70\%$ of Y)
- I is Investment (presently $\approx 15\%$ of Y)
- G is Government Spending (presently $\approx 20\%$ of Y)
- NX is Net Exports (presently $\approx -5\%$ of Y)



Forecasters expect a slow U.S. recovery.

Real GDP Growth

Annualized percent change from previous quarter

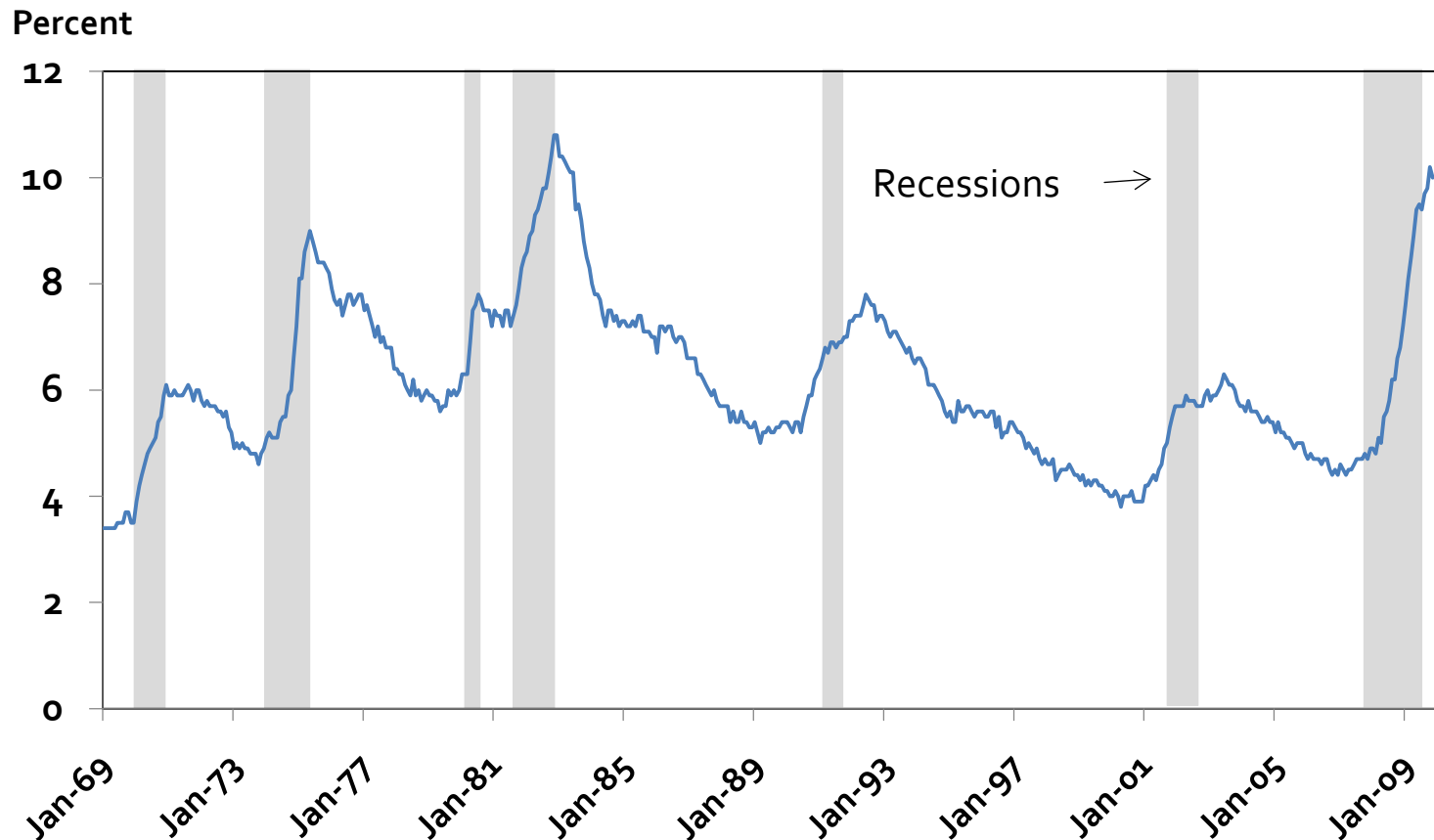


Source: Bureau of Economic Analysis and Blue Chip Economic Indicators



An elevated unemployment rate is one reason for the slow recovery.

U.S. Unemployment Rate



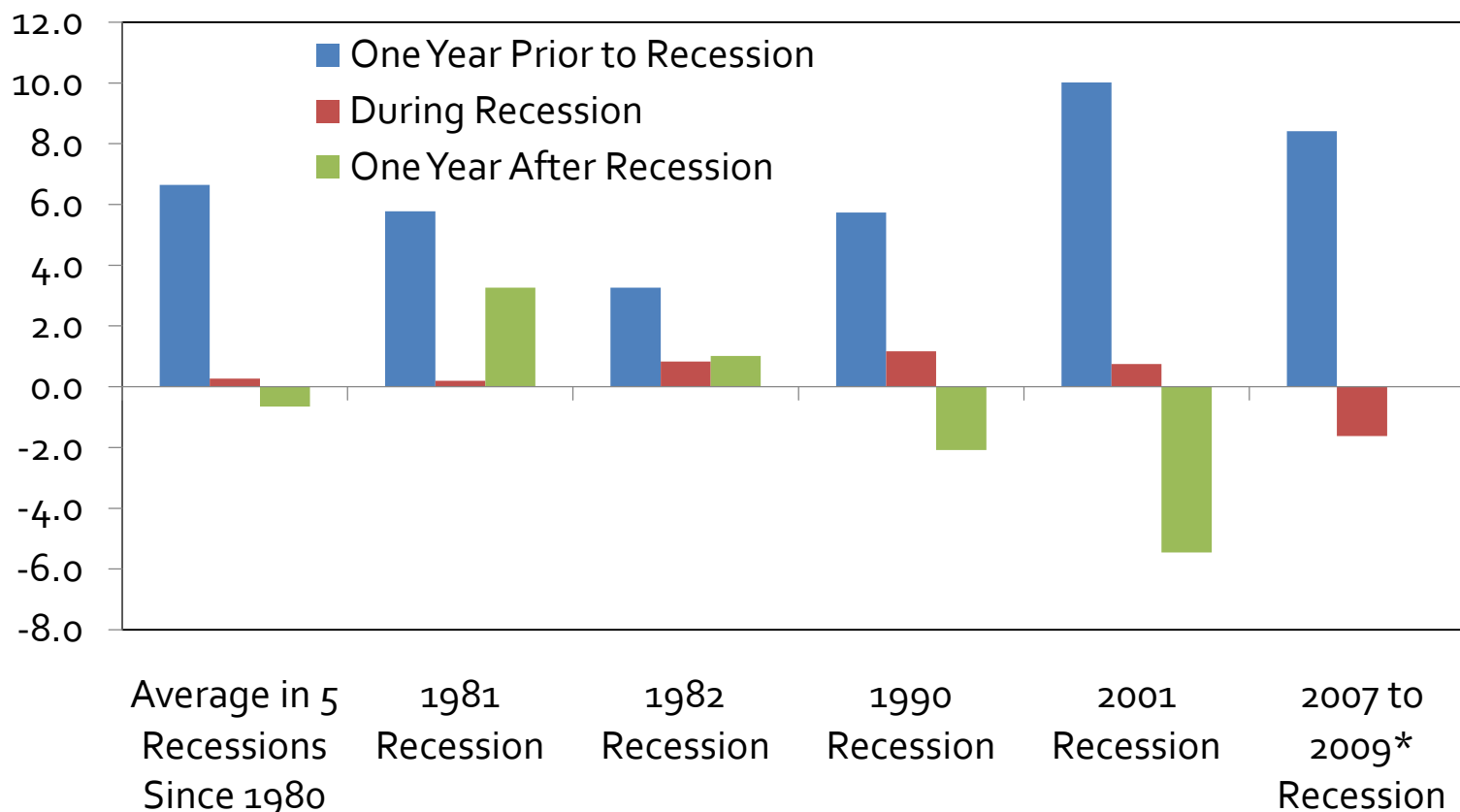
Source: Bureau of Economic Analysis



Meat and milk spending tends to decline in jobless recoveries.

U.S. Per Capita Expenditures on Beef, Pork, Poultry, and Milk Products

Percent change

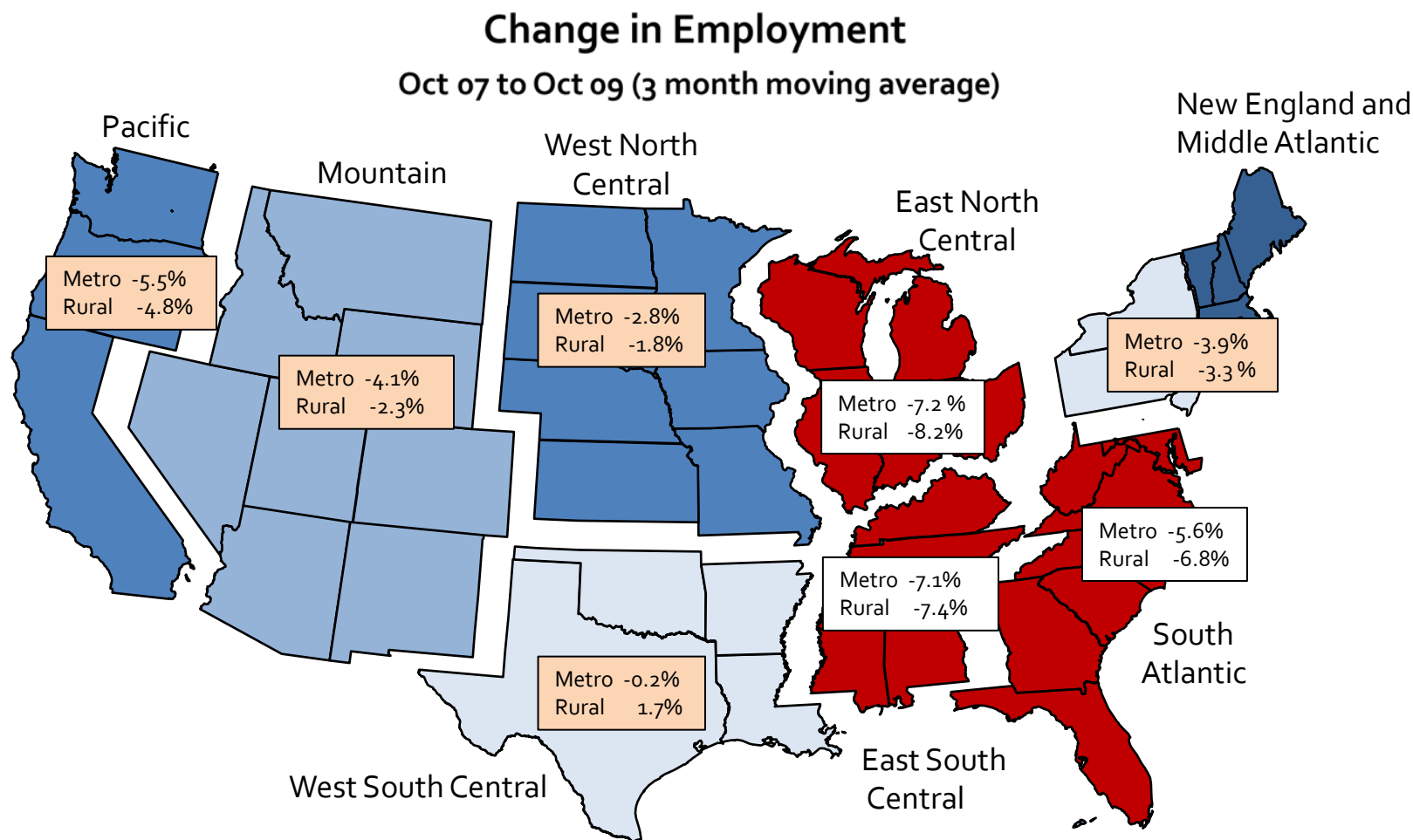


Calculations based on Bureau of Economic Analysis data

* The National Bureau of Economic Research indicates the recession started in Dec. 2007. At the time of publication, the end of the recession has yet to be specified.



Employment in rural areas has fared better than in metro areas.



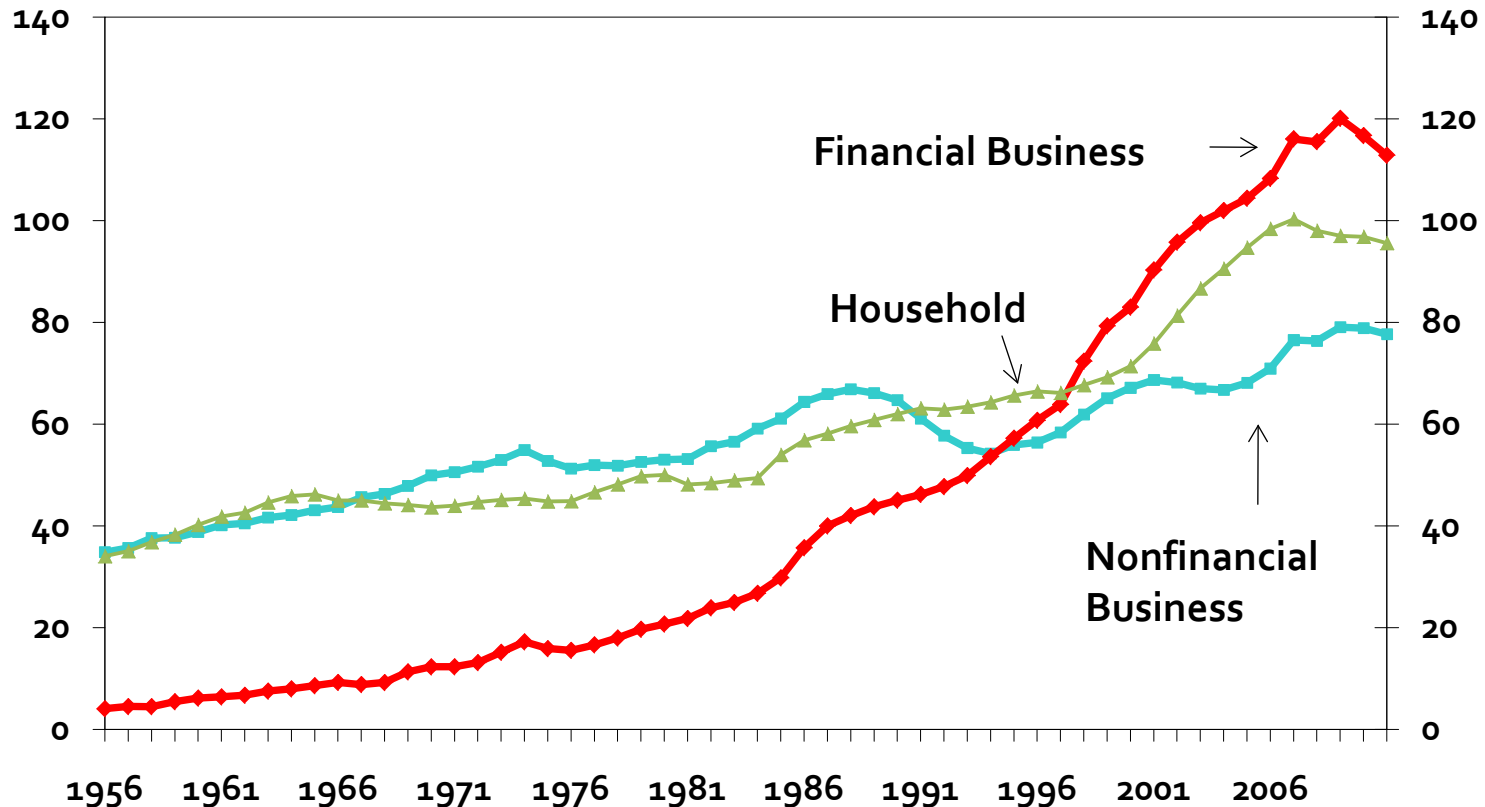
Calculations based on Bureau of Labor Statistics, LAUS data



Deleveraging should contribute to a slow recovery...returning to saving habits.

Domestic Debt Outstanding

Percent of GDP

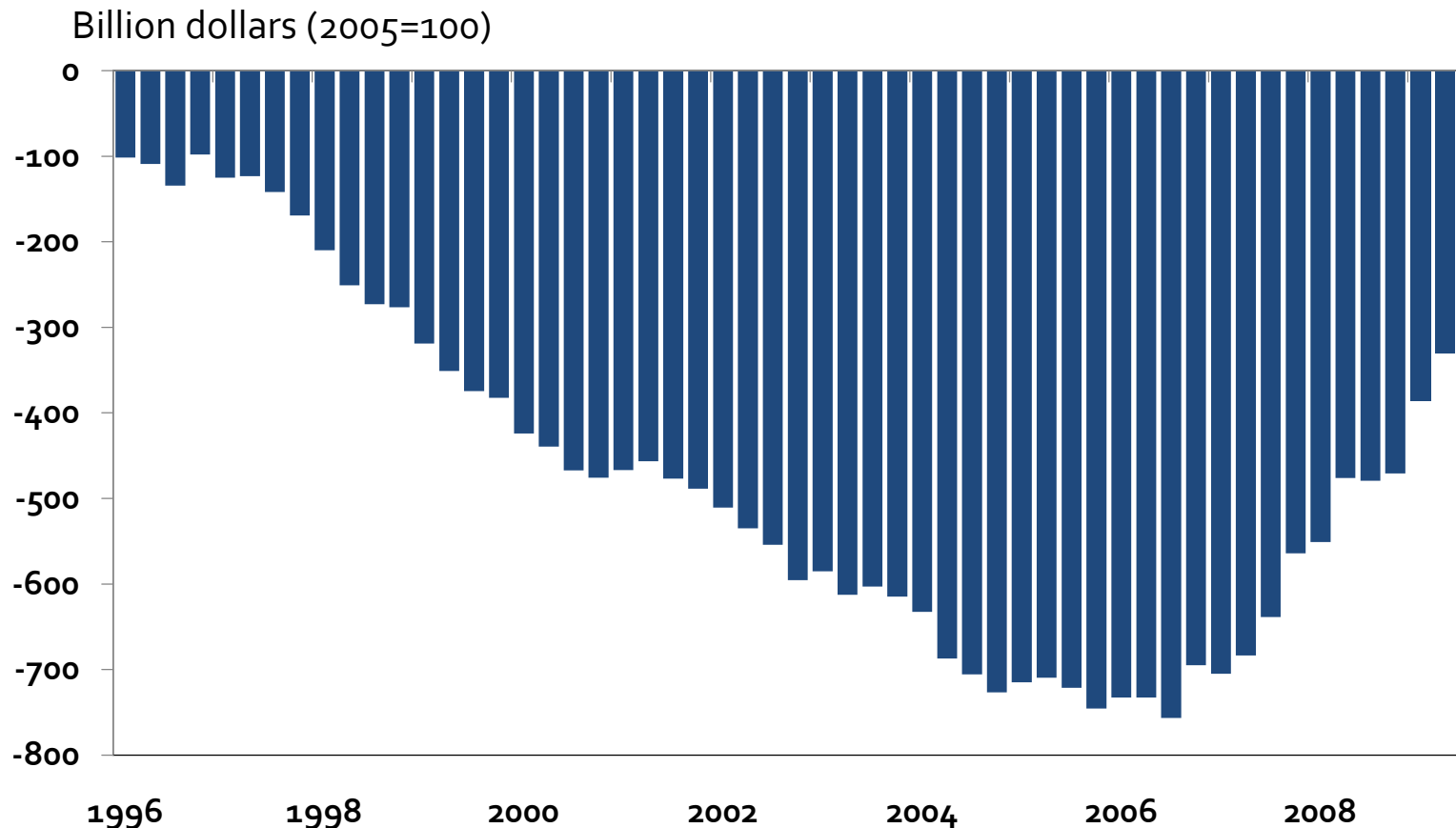


Source: Federal Reserve Board of Governors



The trade balance has improved.

Real Net Exports of Goods and Services



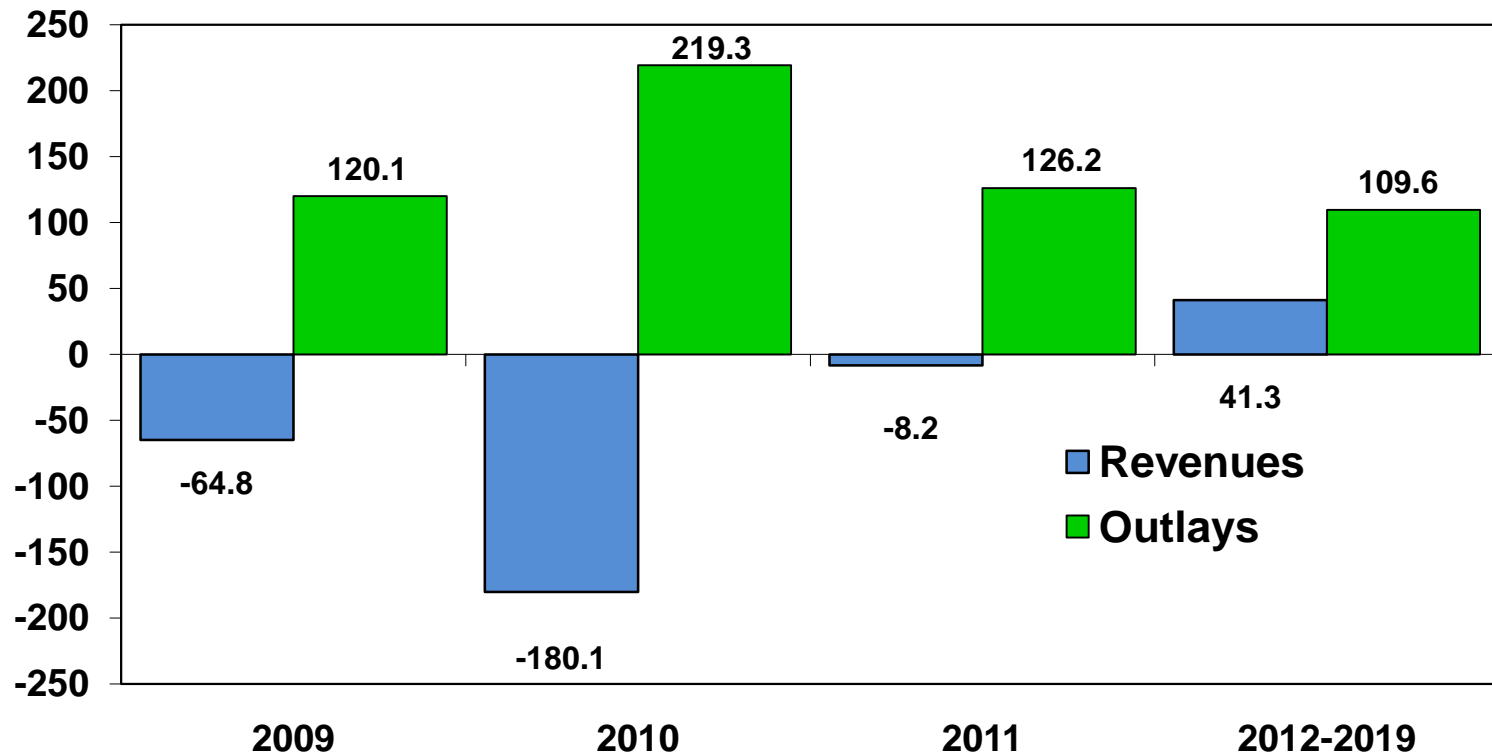
Source: Bureau of Economic Analysis



Will the stimulus package spur growth in 2010?

Estimated Budget Impact of American Recovery and Reinvestment Act (ARRA) of 2009

Billion Dollars



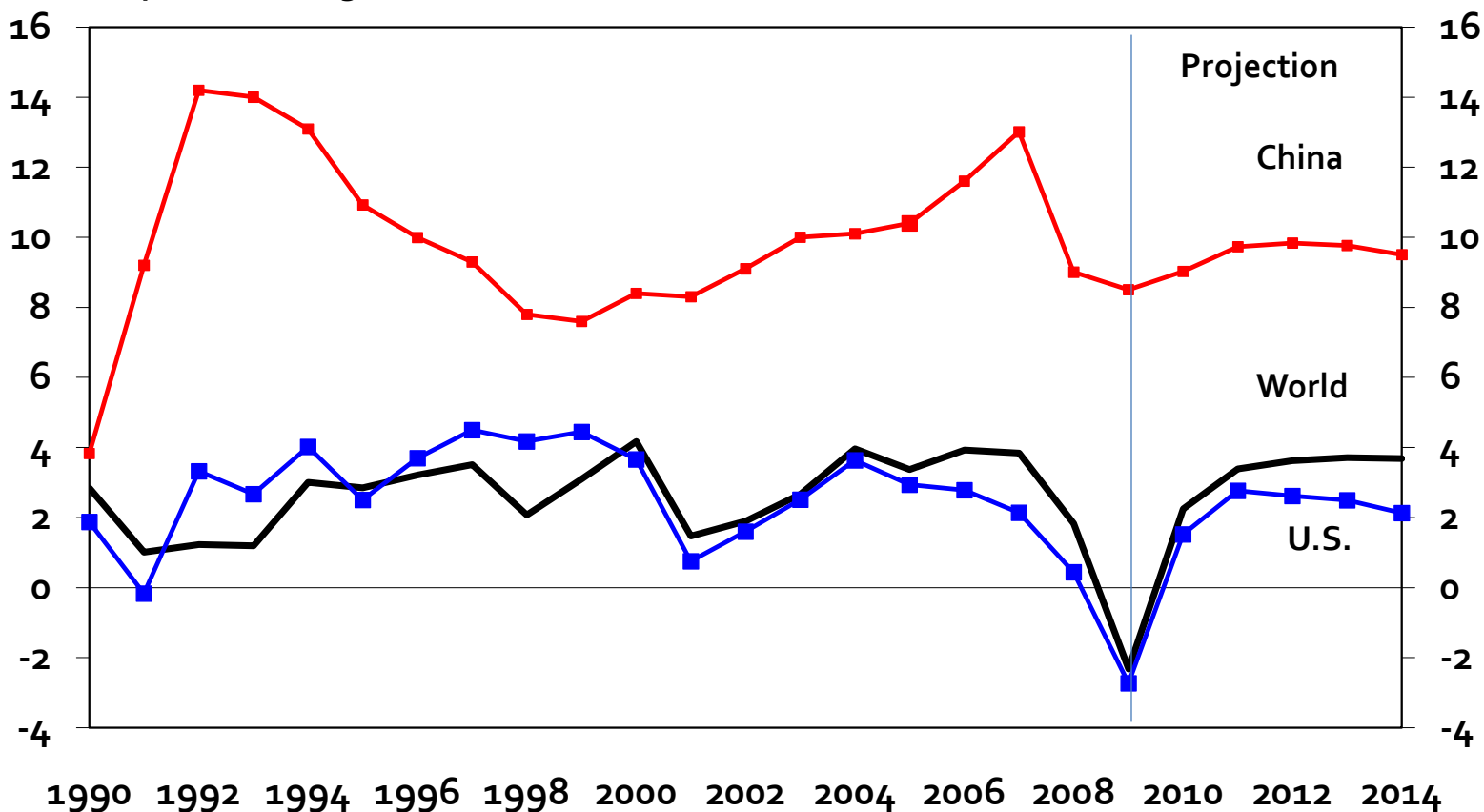
Source: Congressional Budget Office, February 13, 2009



Will emerging and developing countries lead the global recovery?

GDP Growth

Annual percent change, constant dollars

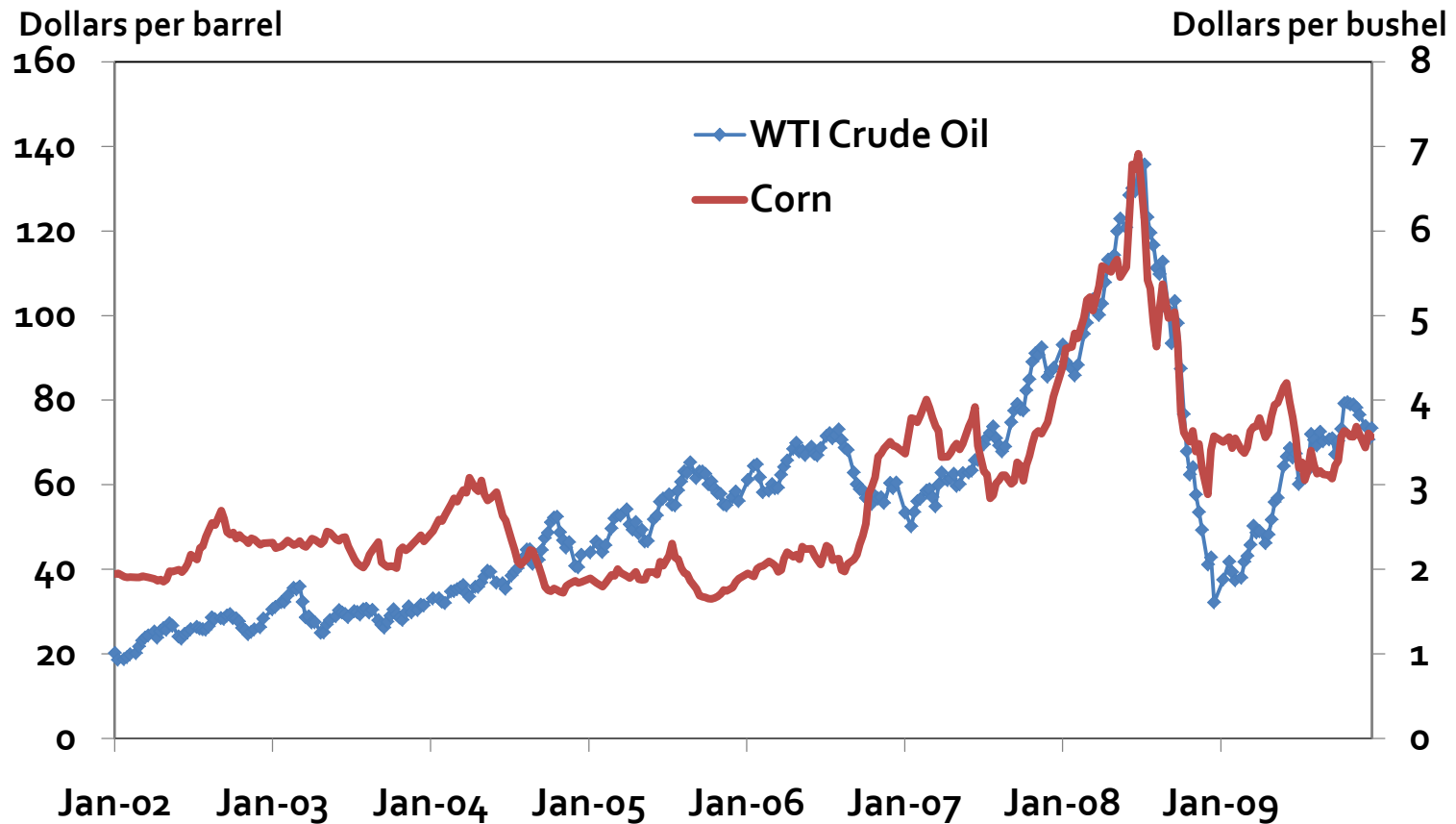


Source: International Monetary Fund, October 2009



Will foreign growth drive commodity markets?

Crude Oil and Corn Prices



Source: Commodity Research Bureau



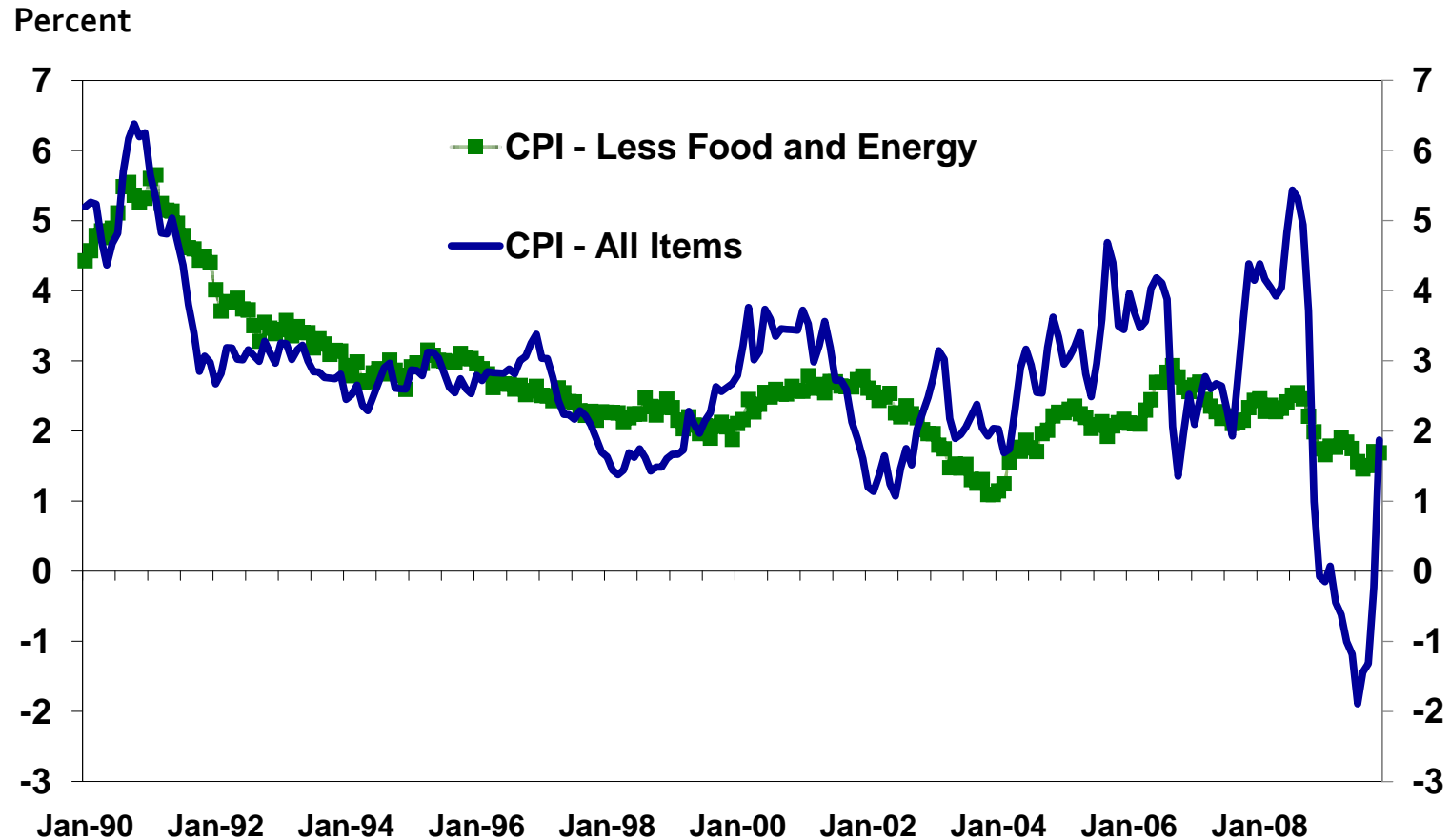
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The U.S. is experiencing disinflation.

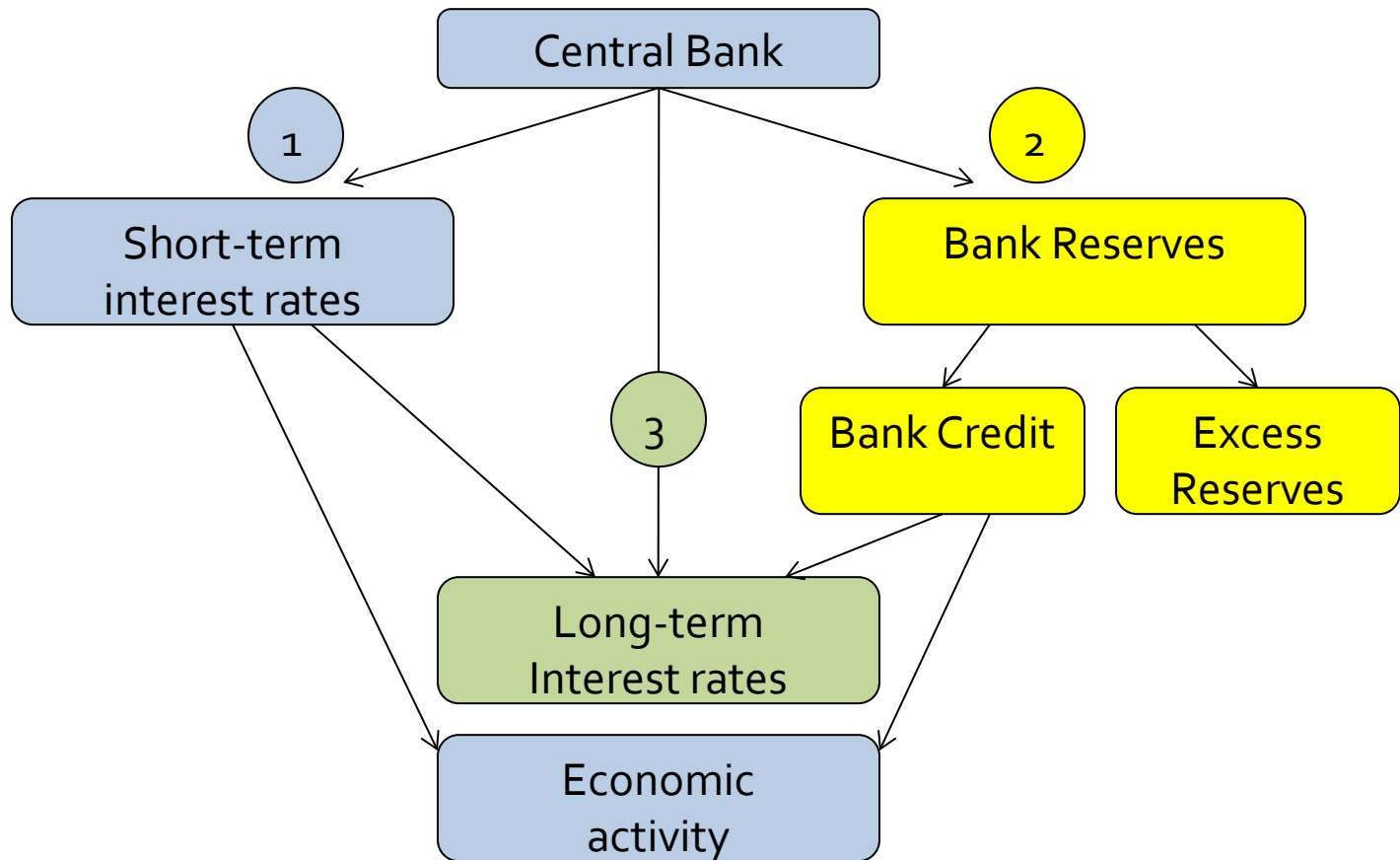
Consumer Price Inflation



Source: Bureau of Labor Statistics



Monetary Policy Transmission Mechanisms



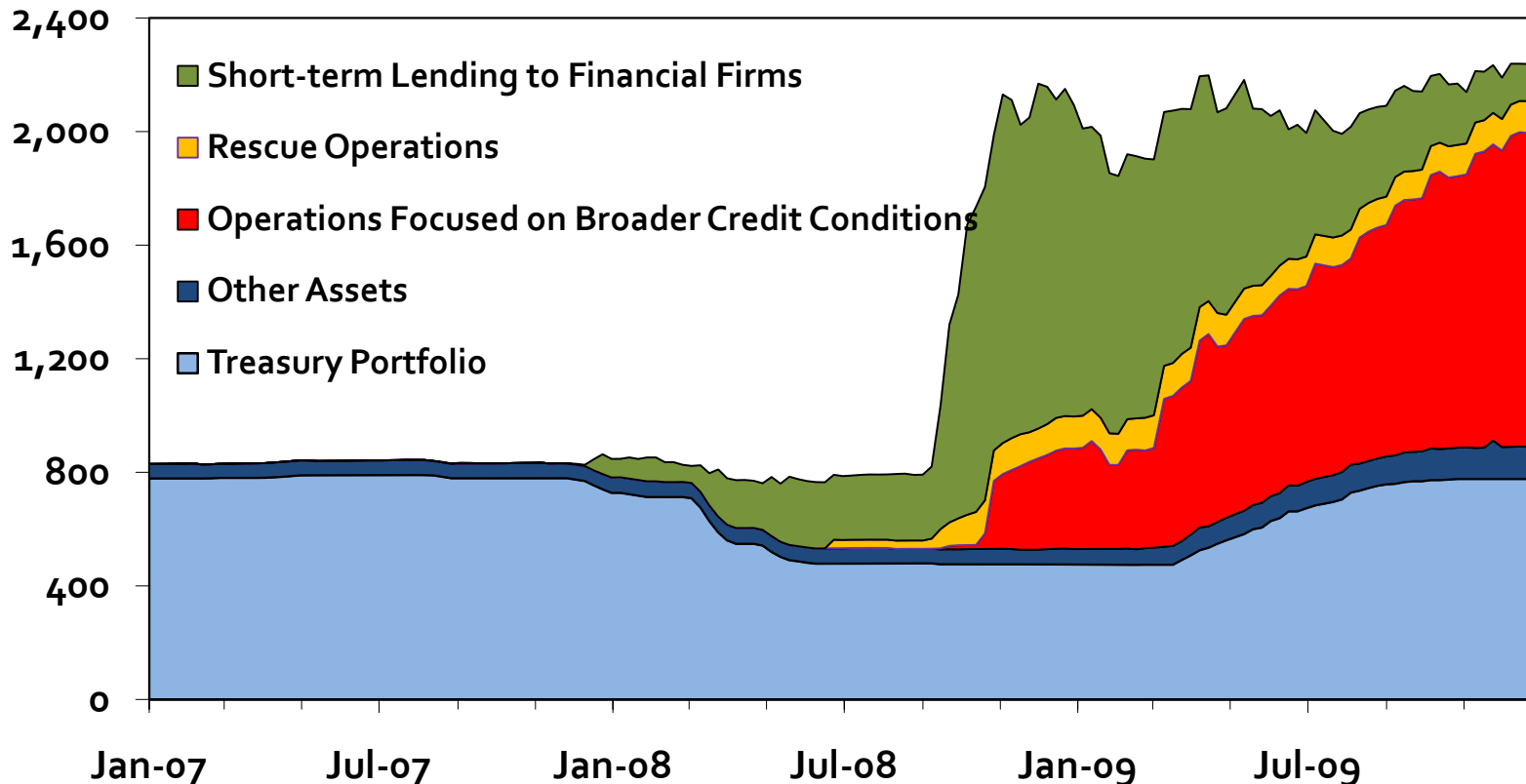
Source: Gordon Sellon (2003) "Monetary Policy and the Zero Bound: Policy Options When Short-Term Rates Reach Zero"
Economic Review <http://www.kansascityfed.org/Publicat/ECONREV/PDF/4q03sell.pdf>



To combat the financial crisis and recession, the Federal Reserve has expanded its balance sheet

Federal Reserve Balance Sheet: Assets

Billion Dollars

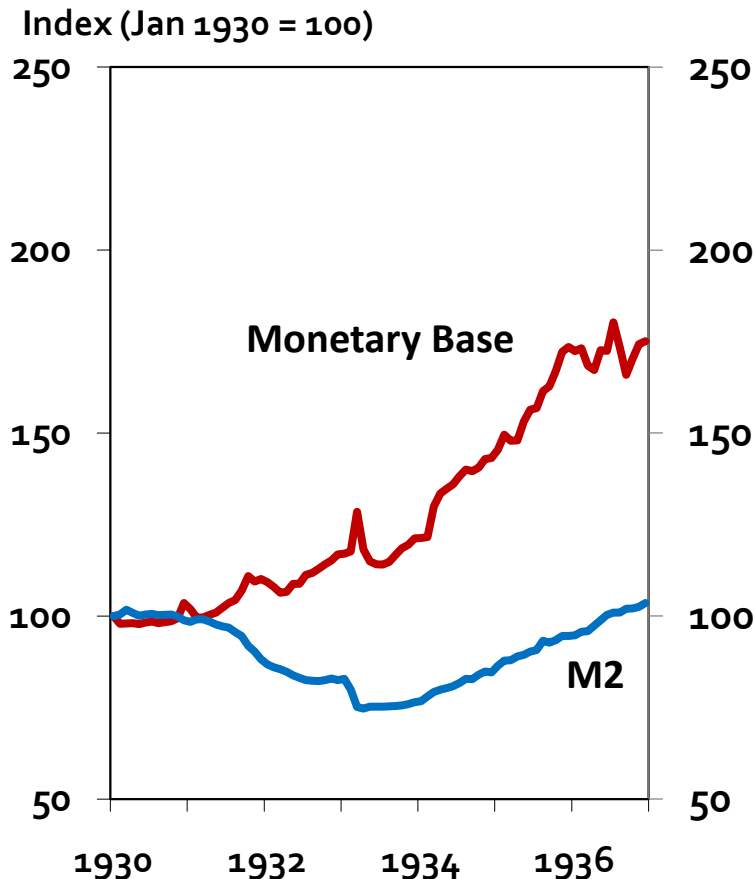


Source: Federal Reserve Board of Governors

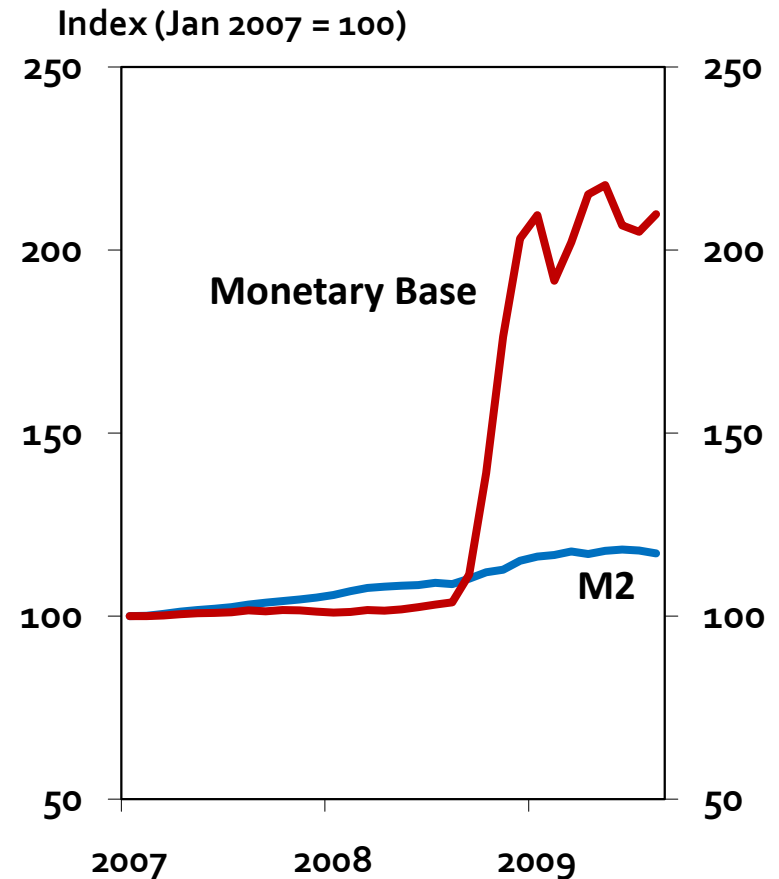


Despite a surging monetary base, inflation has been subdued.

Growth in Monetary Aggregates



Source: Federal Reserve Bank of St. Louis, Friedman and Schwartz

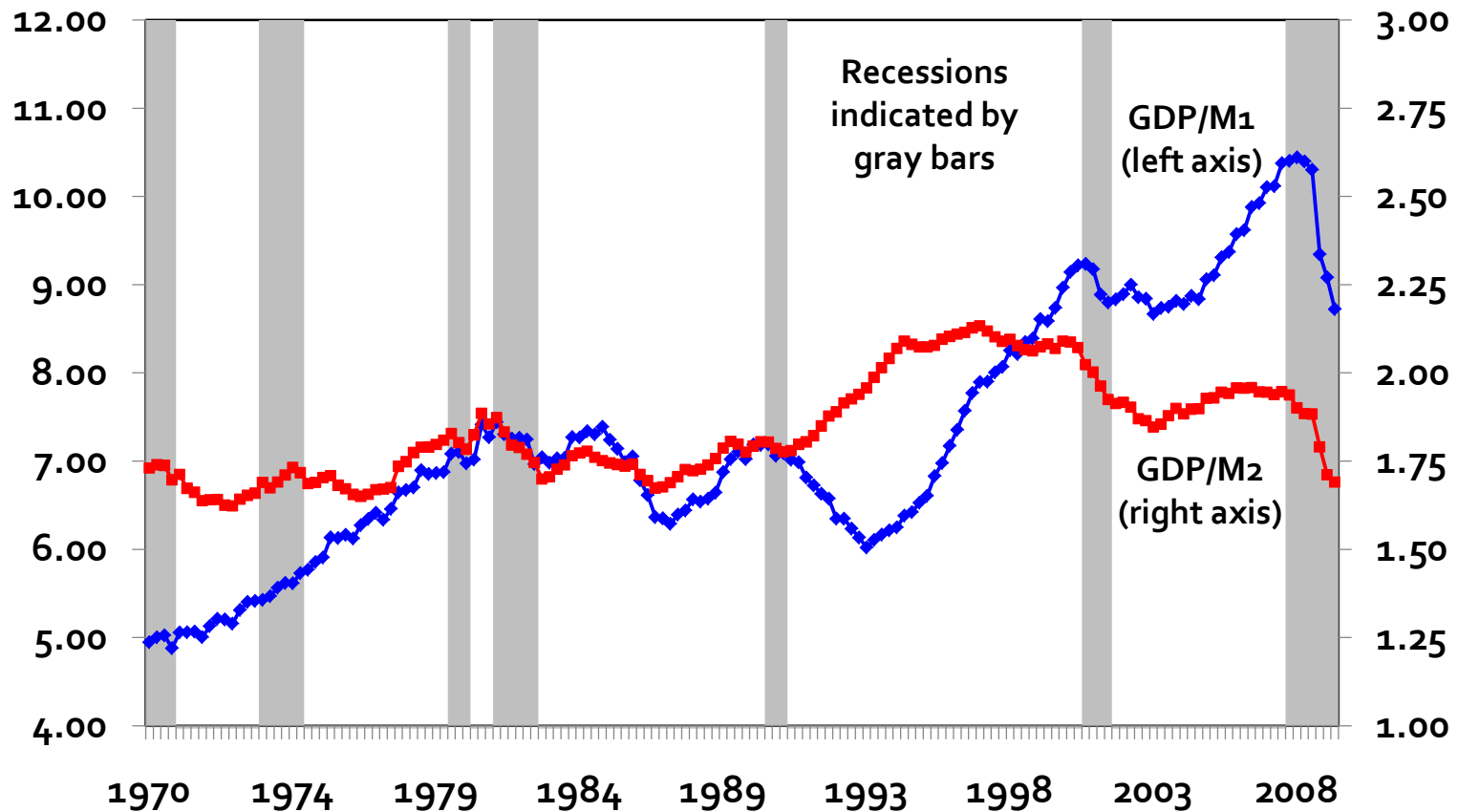


Source: Federal Reserve Board of Governors



Inflation has been subdued because the velocity of money has plummeted.

U.S. Velocity of Money



Source: BEA and Federal Reserve Board of Governors



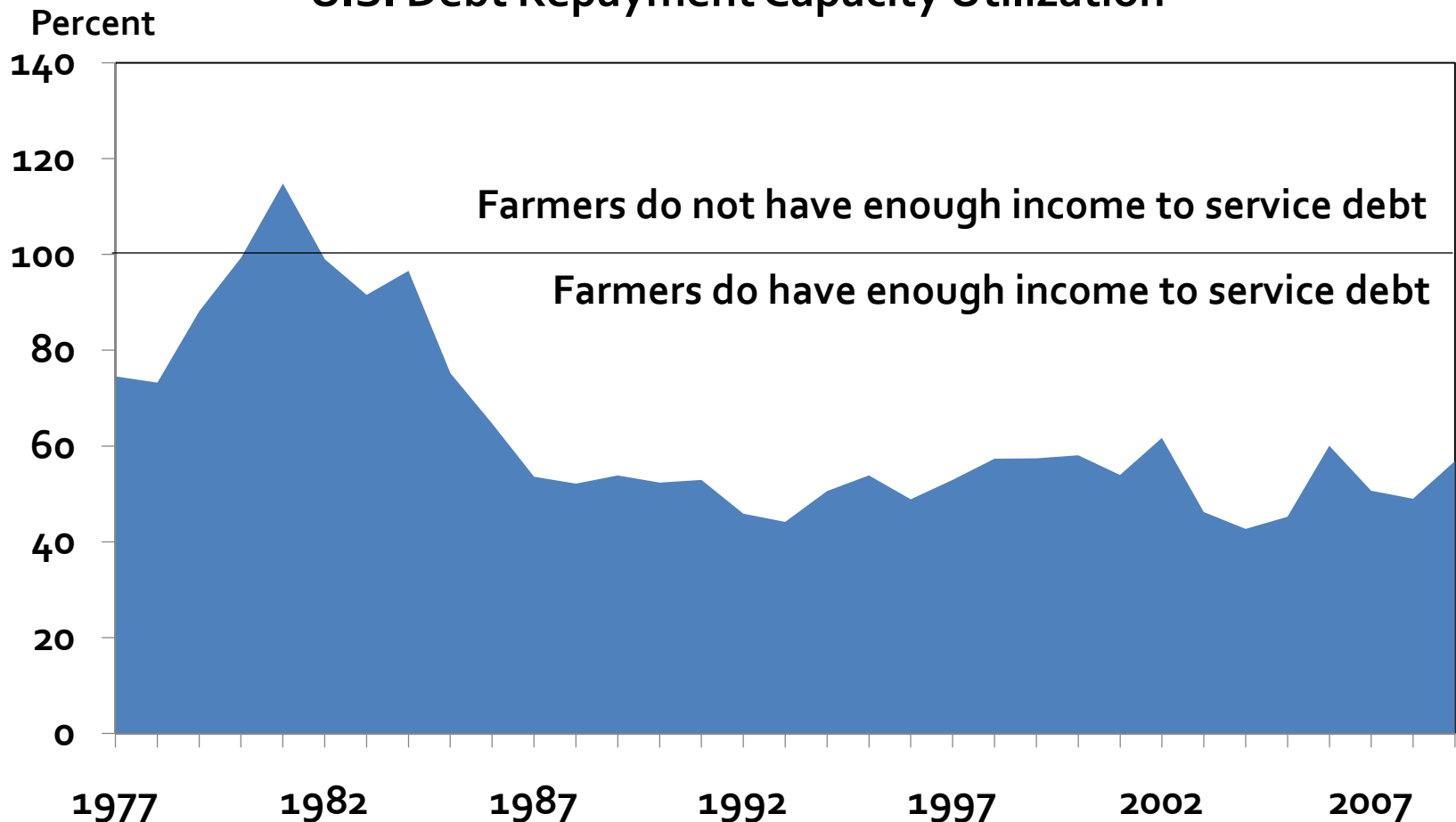
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In general, farmers are financially sound.

U.S. Debt Repayment Capacity Utilization

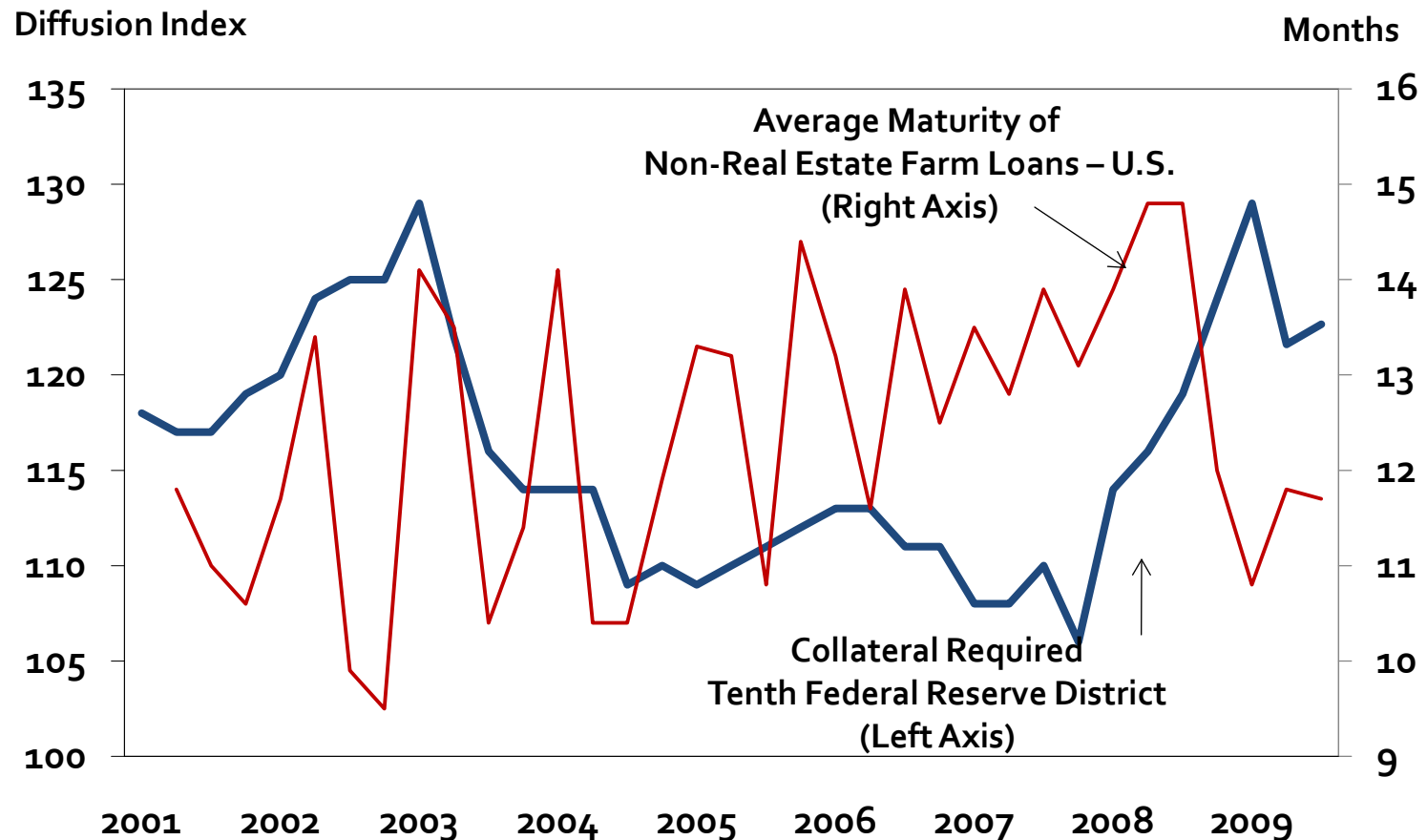


Source: USDA



Collateral requirements have tightened and loan maturities have fallen.

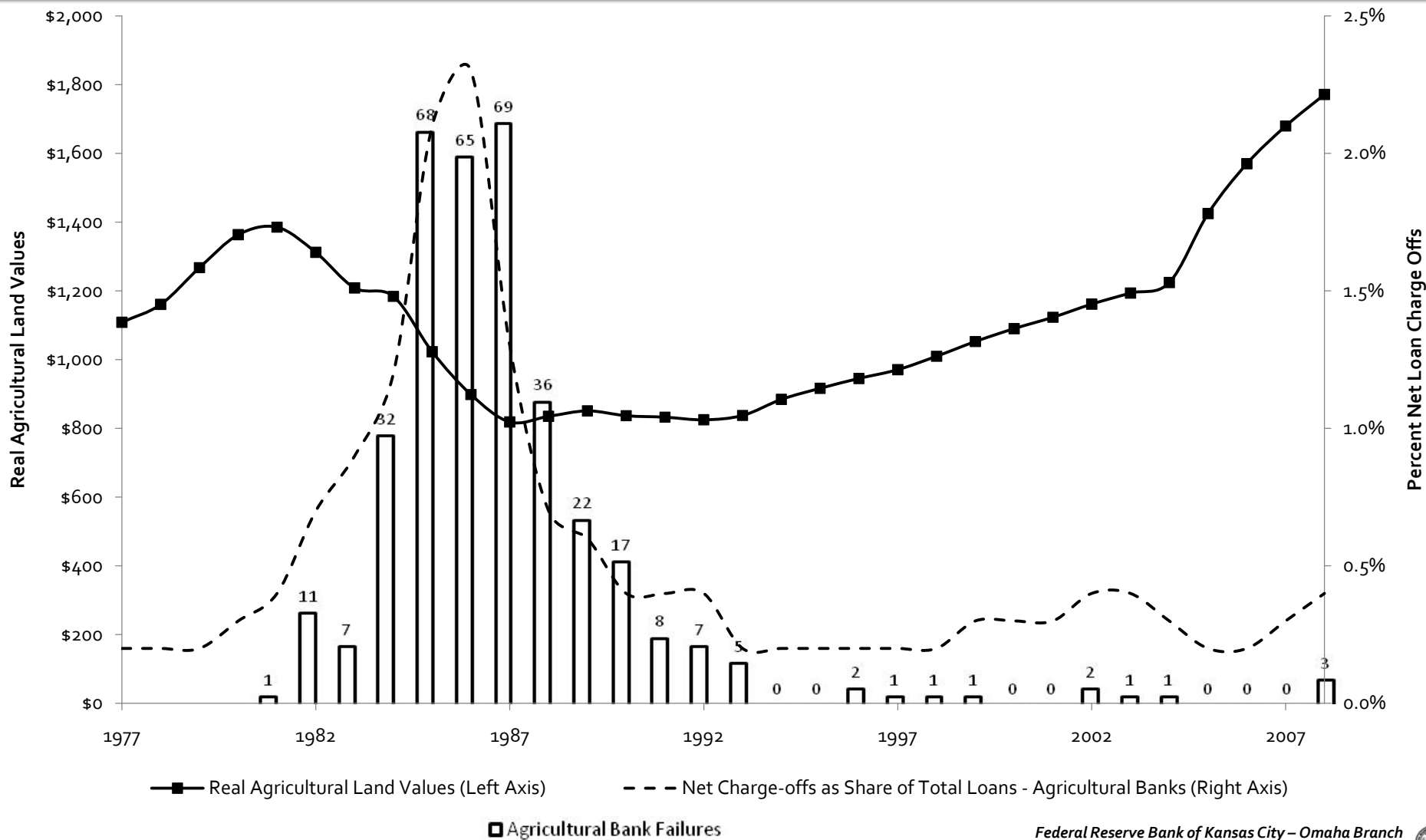
Collateral Requirements and Loan Maturity on Non-Real Estate Farm Loans



Source: Federal Reserve Bank of Kansas City and Agricultural Finance Databook



Historically, agricultural land values were related to much stress for agricultural lenders.



Questions?

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