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November 3, 2010

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
- Inflationary risks
 - Short-term deflation or
 - Long-term inflation
- Implications for agriculture



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



Will the summer lull persist?

Sluggish, but stronger growth is the consensus forecast.

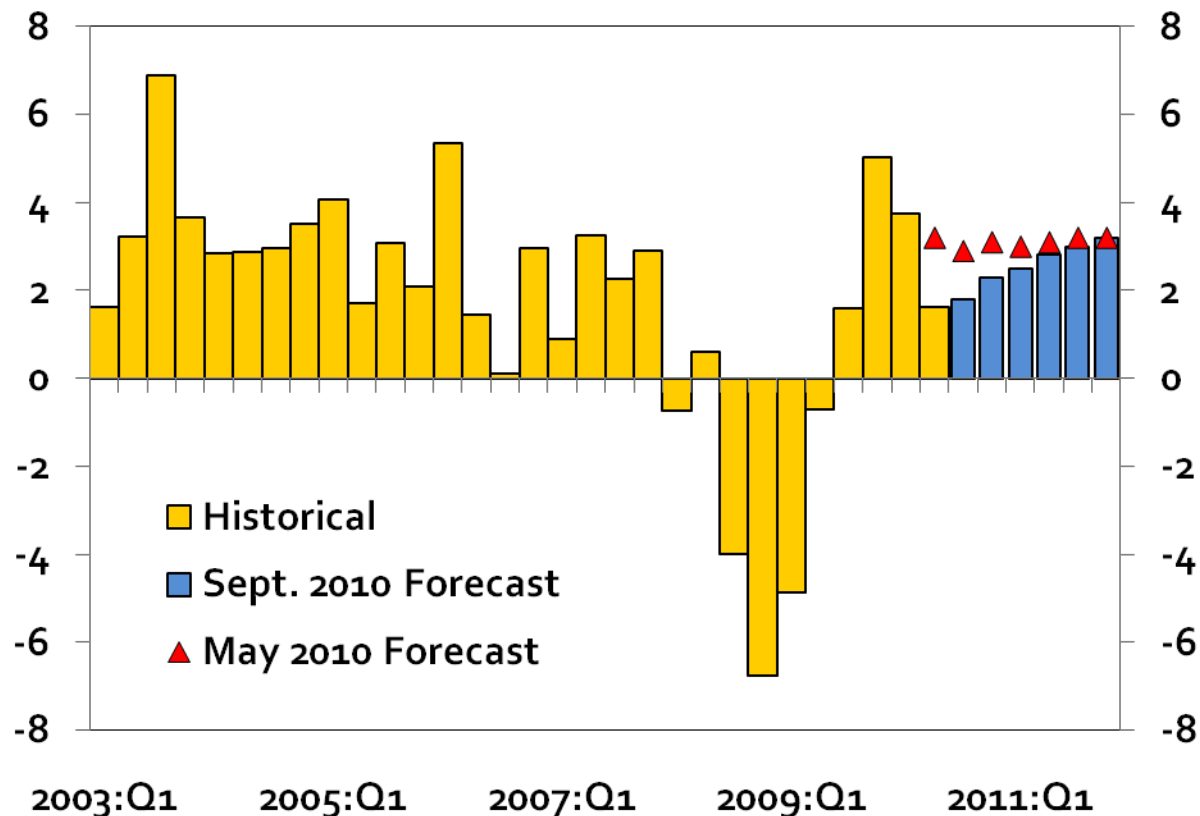
Different comparisons affect the interpretation of GDP growth.

-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



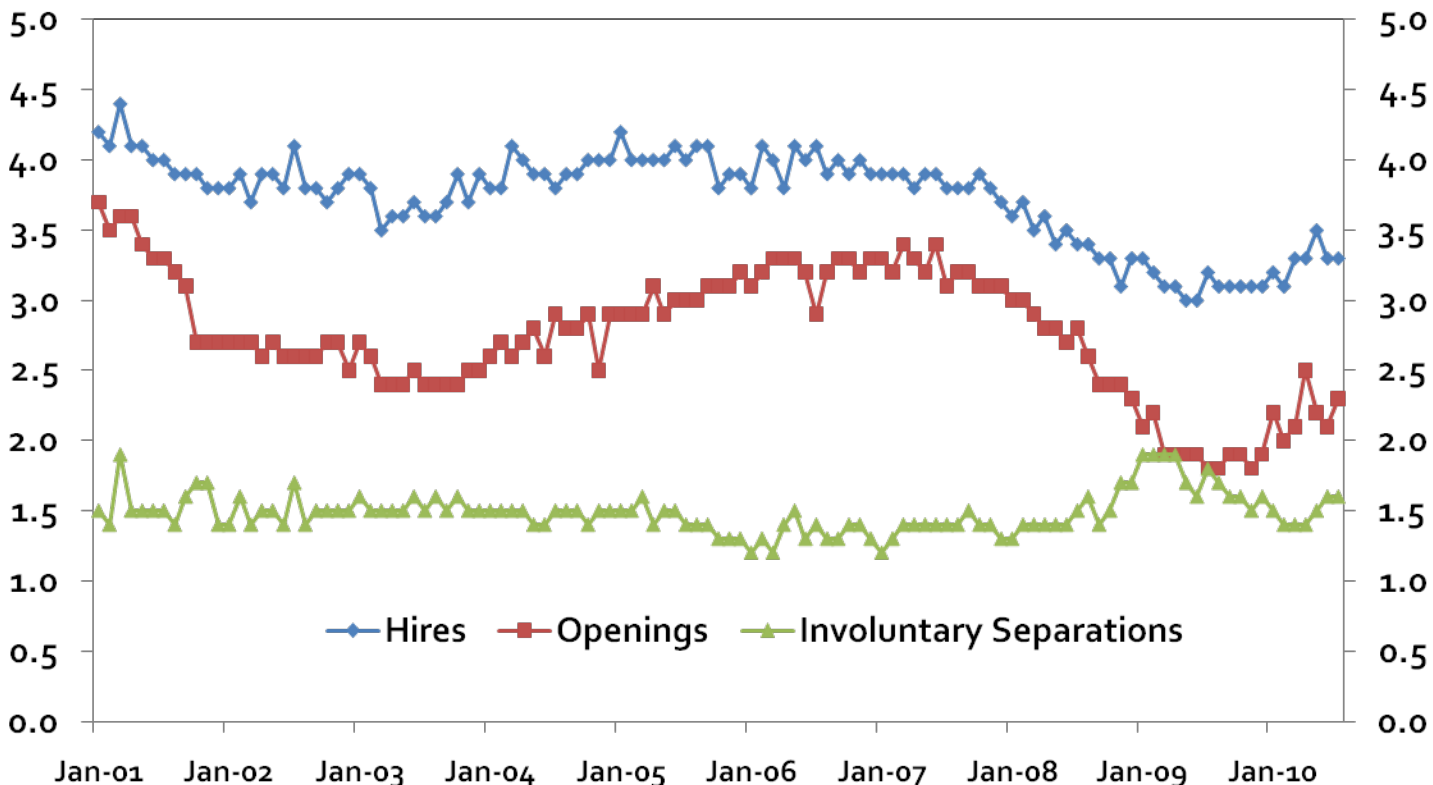
Calculations based on Bureau of Economic Analysis data



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

Layoffs, Hiring, and Job Openings

Percent of employment

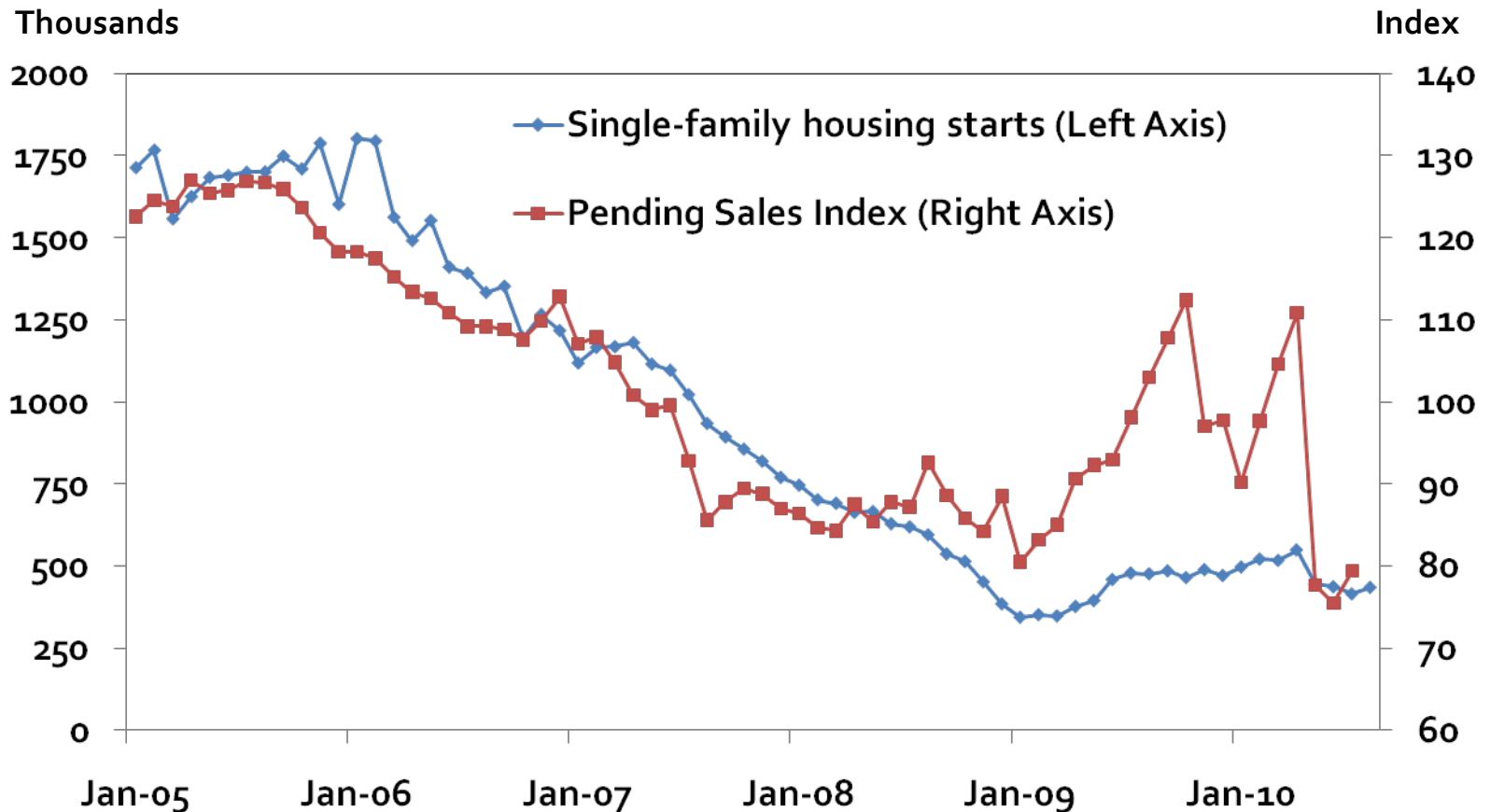


Source: Bureau of Labor Statistics



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

U.S. Housing Markets

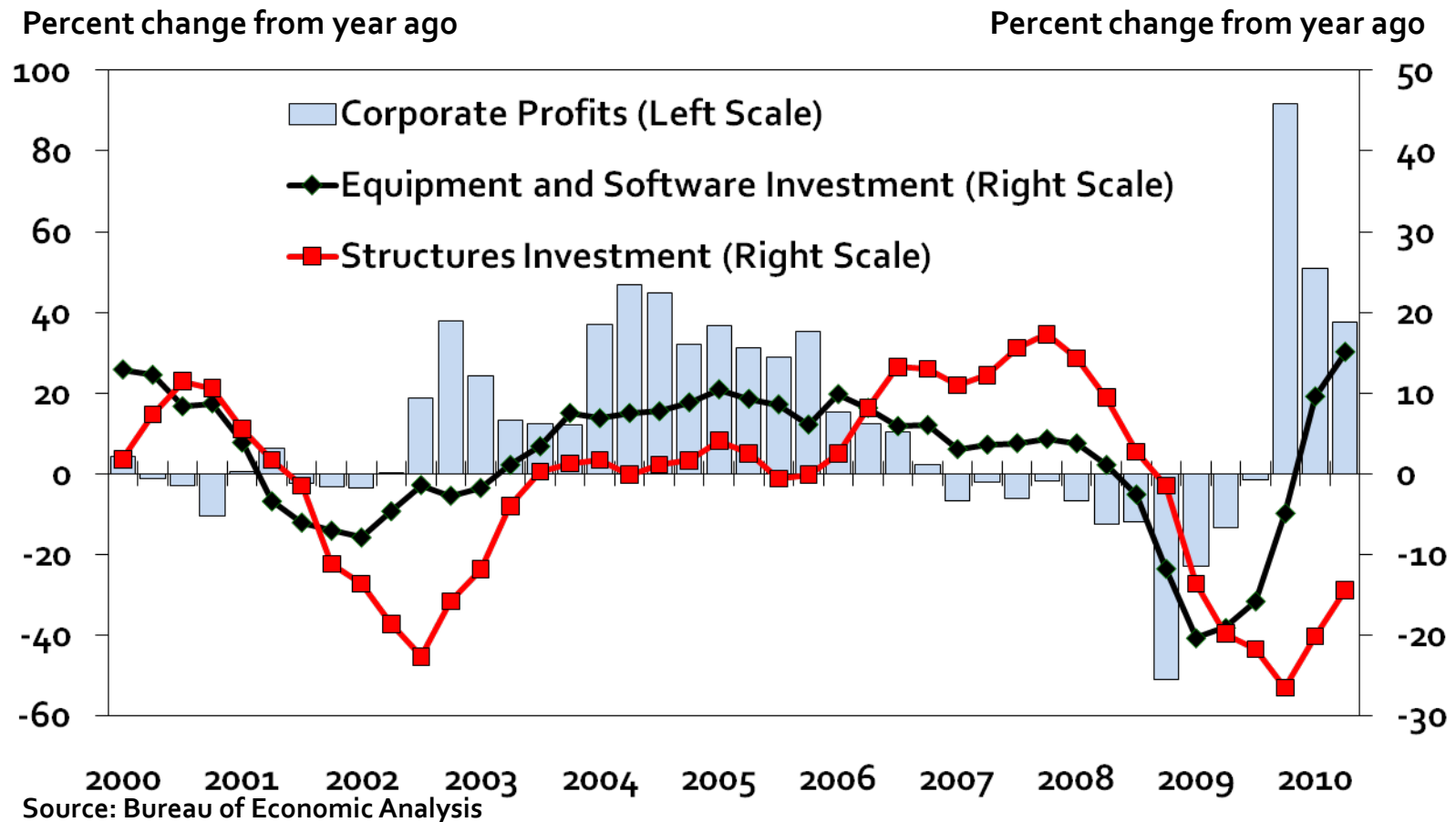


Source: U.S. Census Bureau



Corporate profits and business investment are beginning to rebound.

Corporate Profits and Nonresidential Fixed Investment



Can we expect additional support from export activity?

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

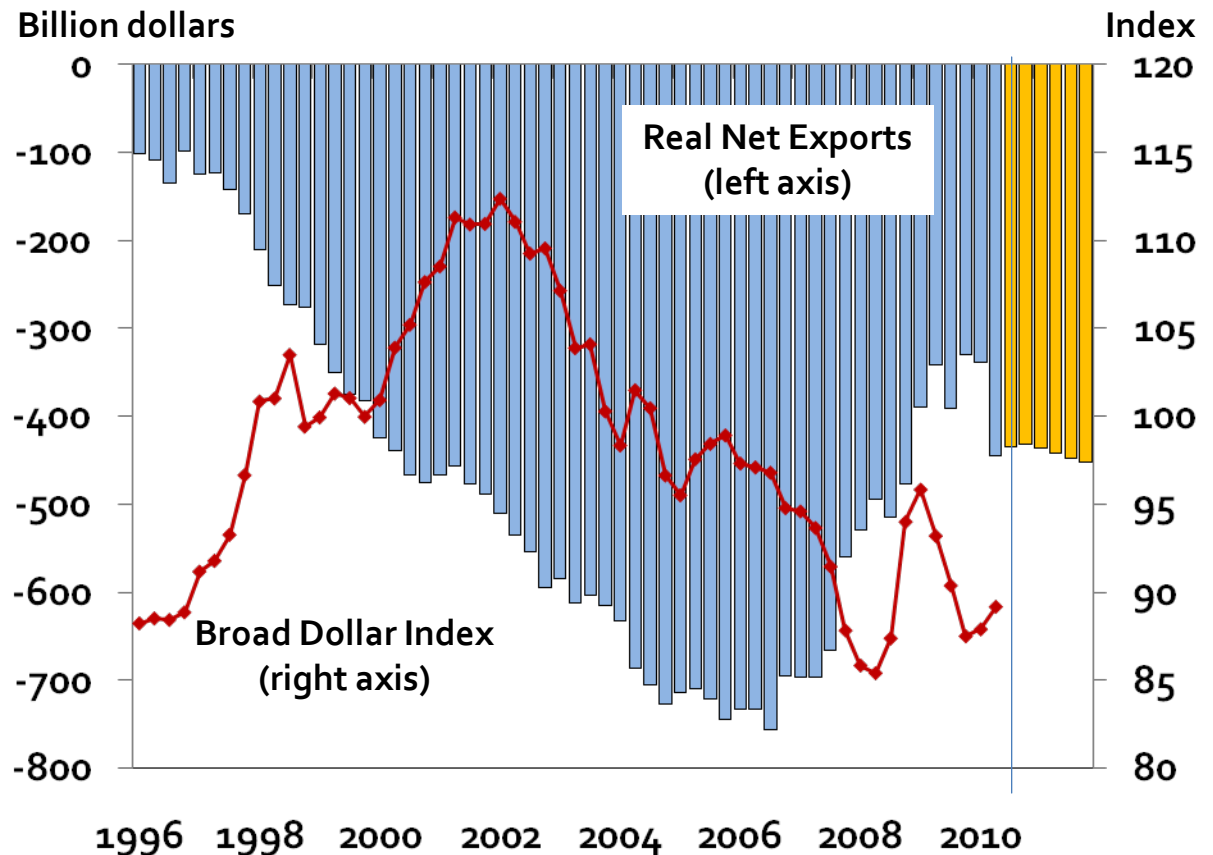
Annual GDP Growth

	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

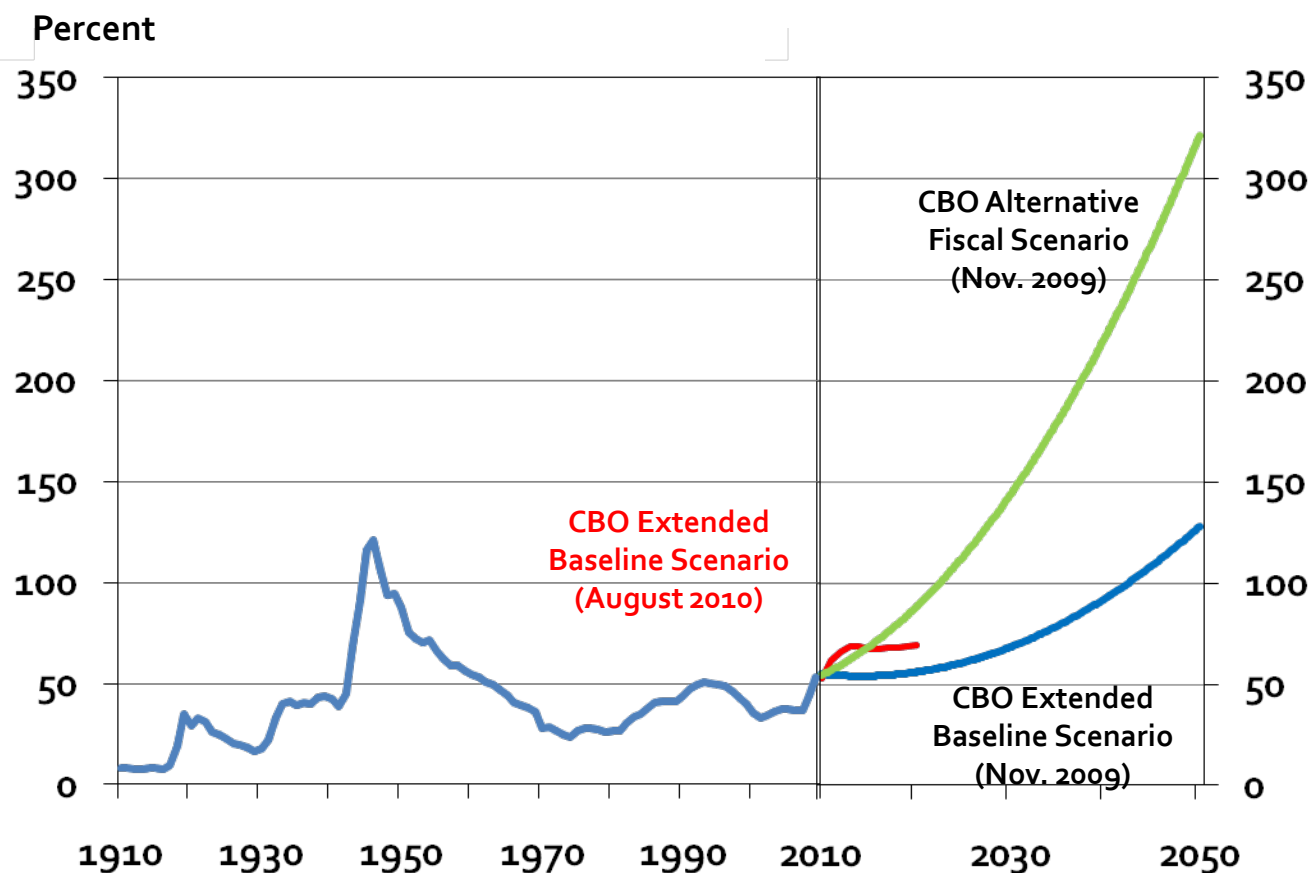


Source: Bureau of Economic Analysis, Federal Reserve Board of Governors, and Blue Chip forecast



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

U.S. Debt as a Percent of GDP

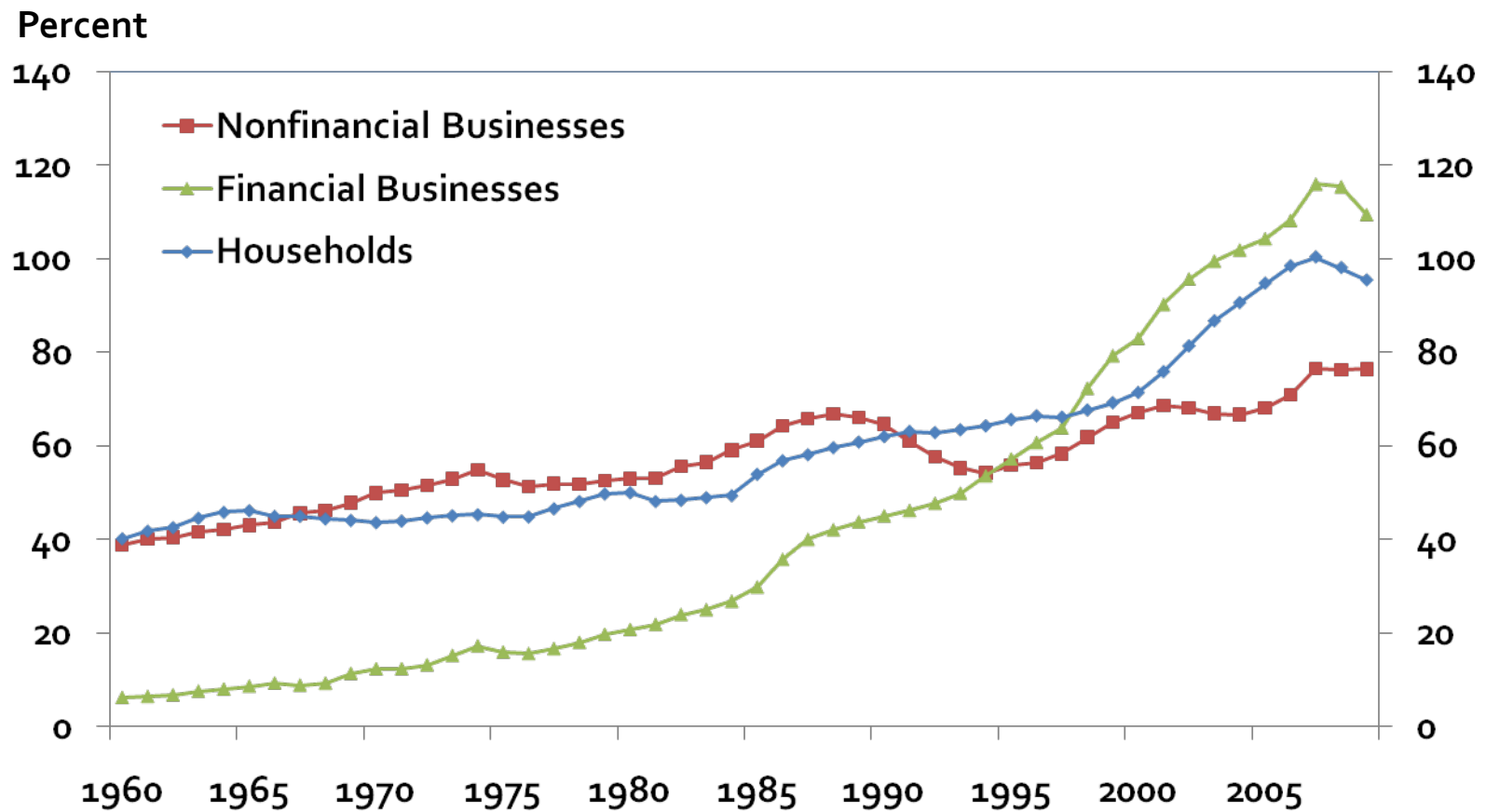


Source: Congressional Budget Office



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:

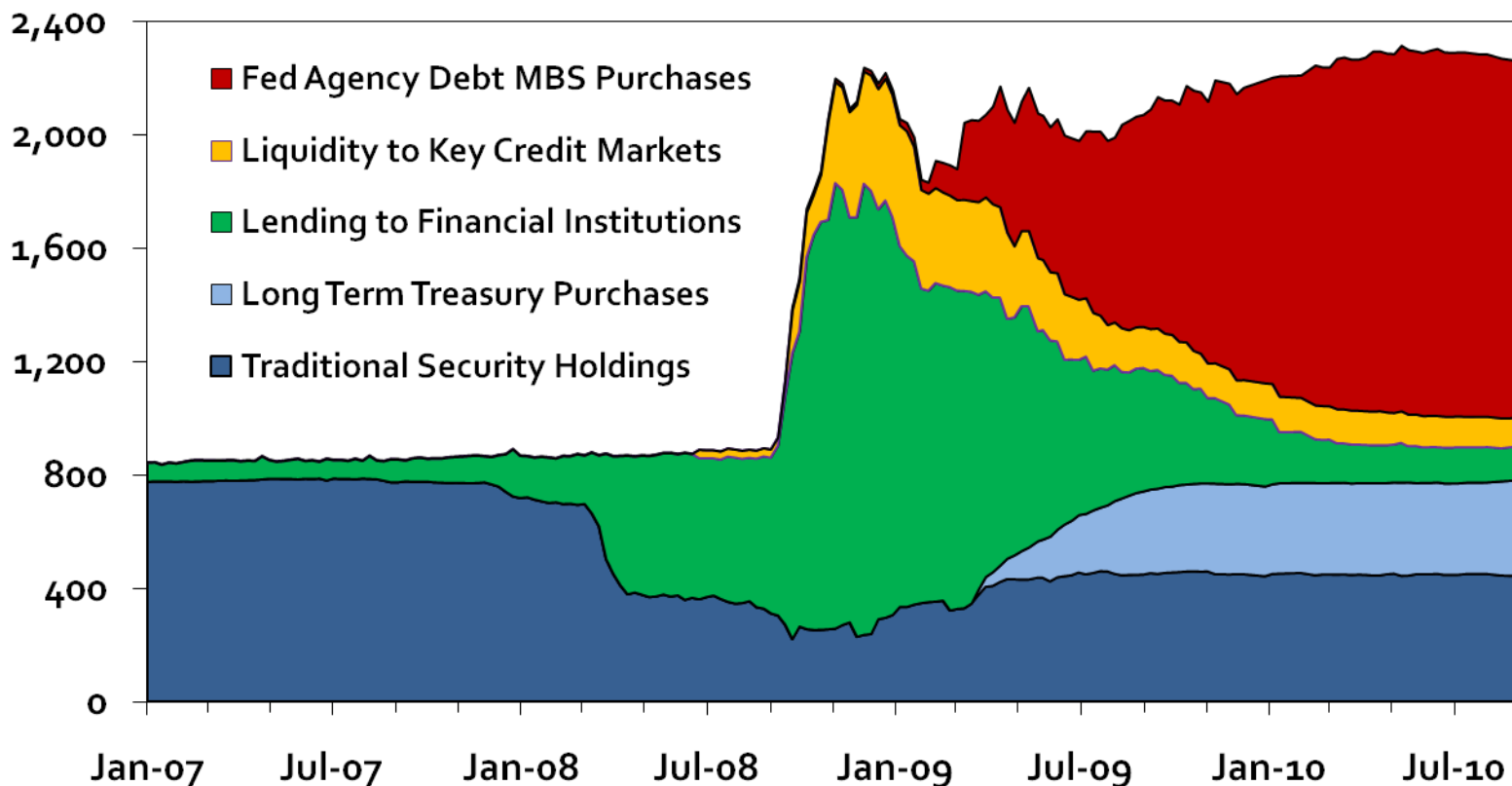
Too much money $M \uparrow$
chasing $V \uparrow$
too few goods $Q \downarrow$



Quantitative easing (QE) is the expansion of the Federal Reserve Balance sheet.

Federal Reserve Balance Sheet: Assets

Billion Dollars



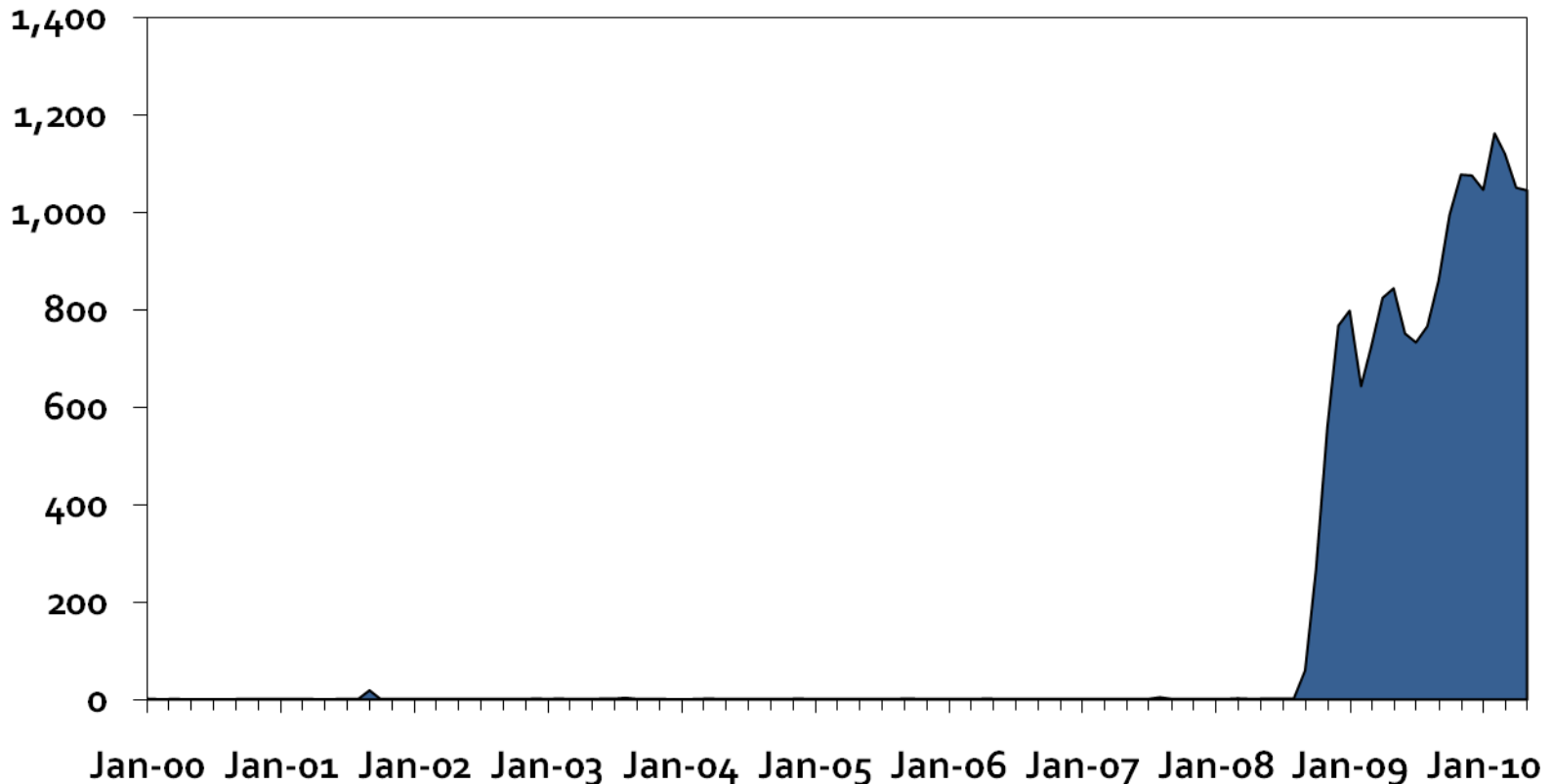
Source: Federal Reserve Bank of Cleveland



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

Excess Reserves of Depository Institutions

Billion Dollars

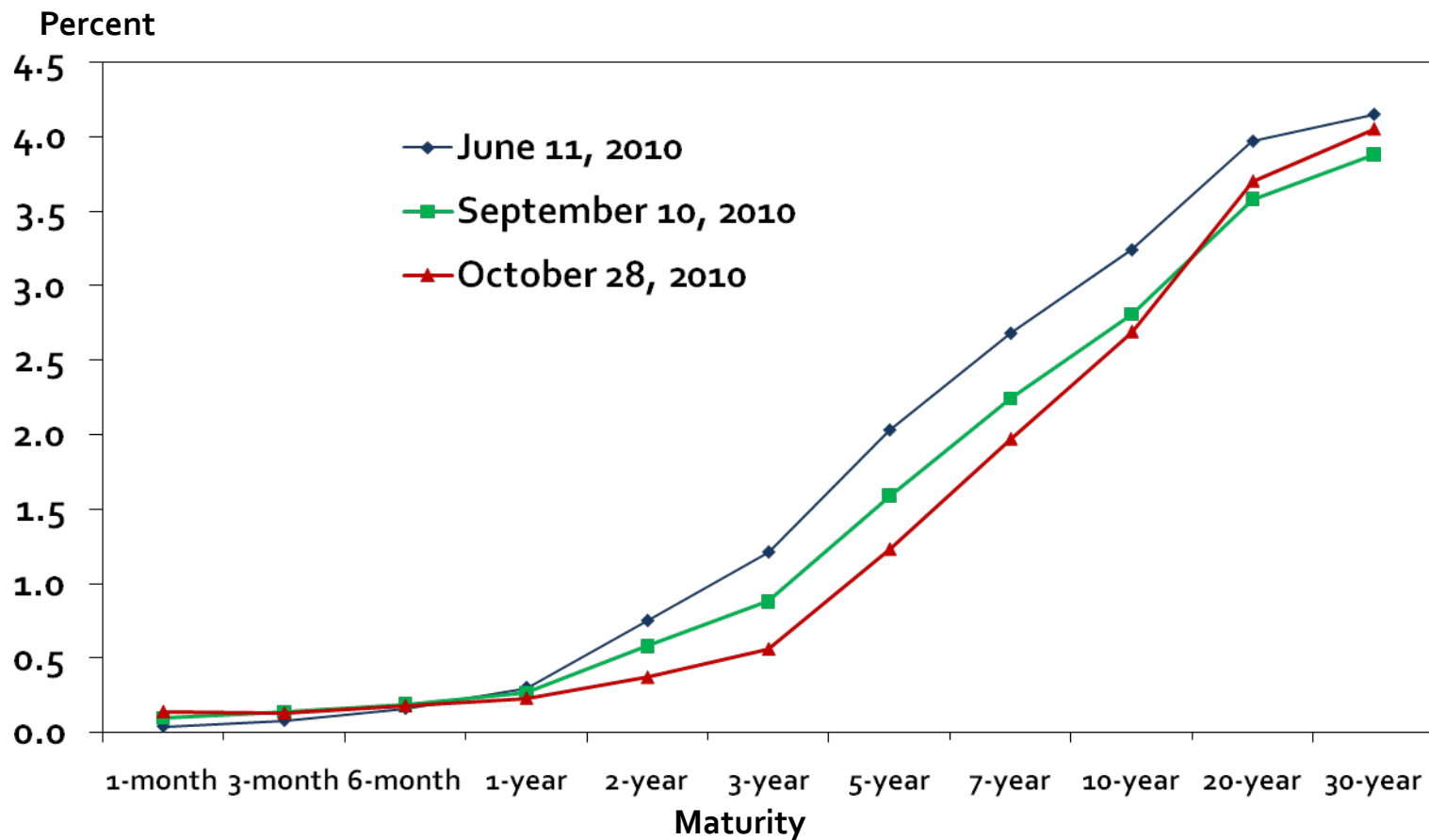


Source: Federal Reserve Board of Governors



The yield curve recently steepened.

U.S. Treasury Yield Curve Rates



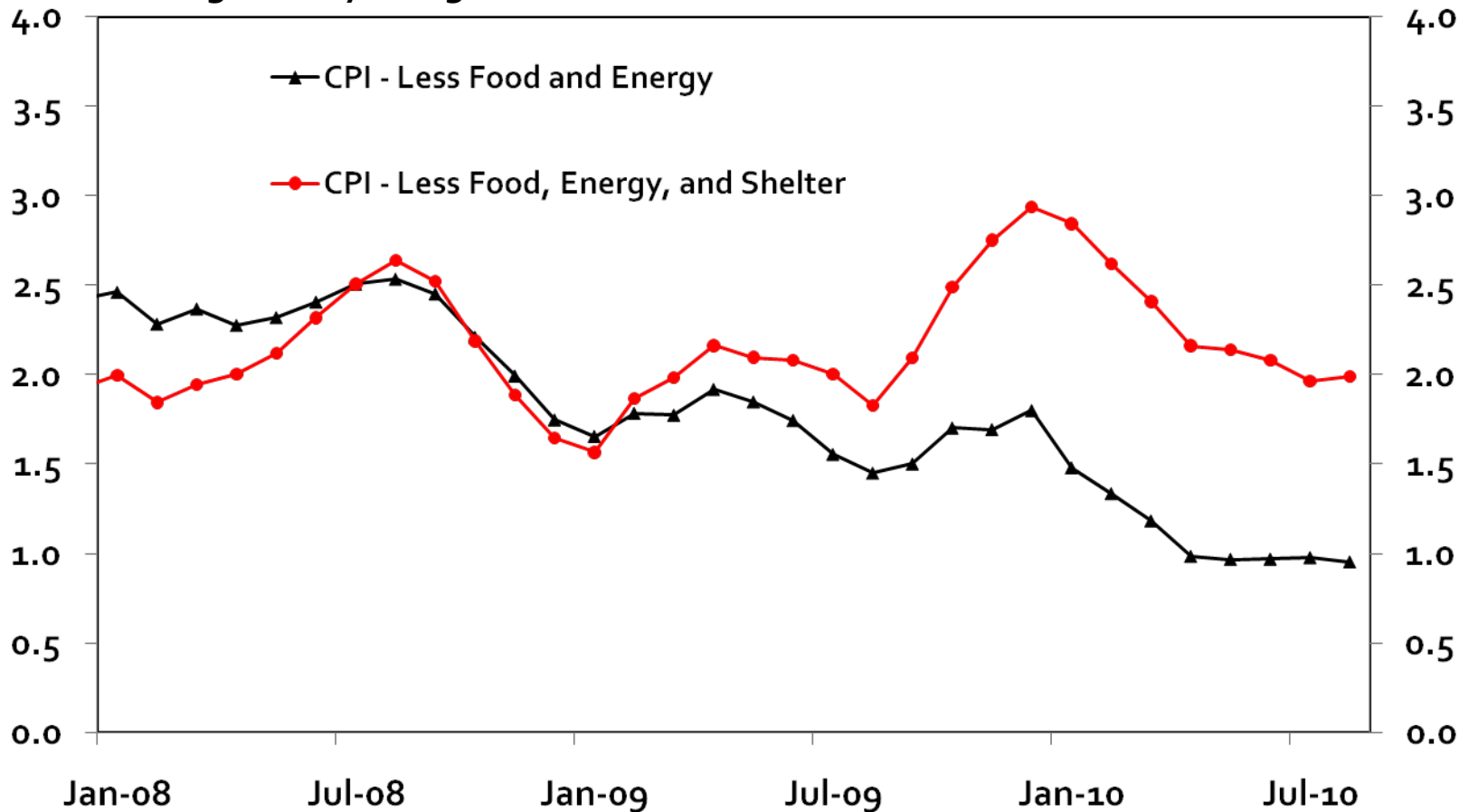
Source: Federal Reserve Board of Governors



How low is inflation if you exclude housing?

Consumer Price Inflation

Percent change from year ago



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



What are some of the key issues?

- Is high unemployment cyclical or structural?
 - Structural: for current job openings, people are in the wrong place with the wrong skills
 - Cyclical: stronger economic conditions will lead to job gains
- What is the natural rate of unemployment?
- What is the long-term rate of economic growth?
- Should monetary policy have a short-term or long-term focus?



Today's Roadmap

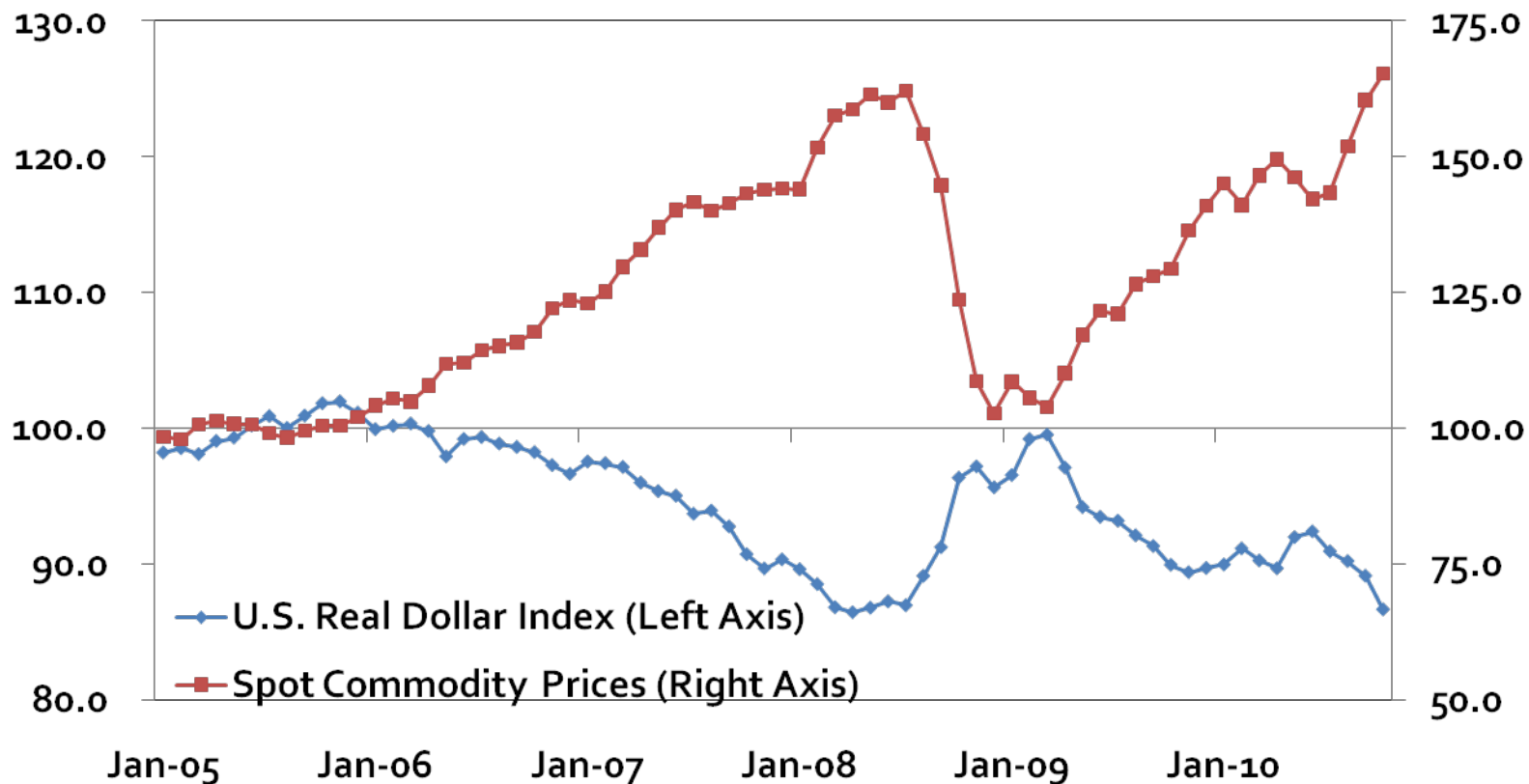
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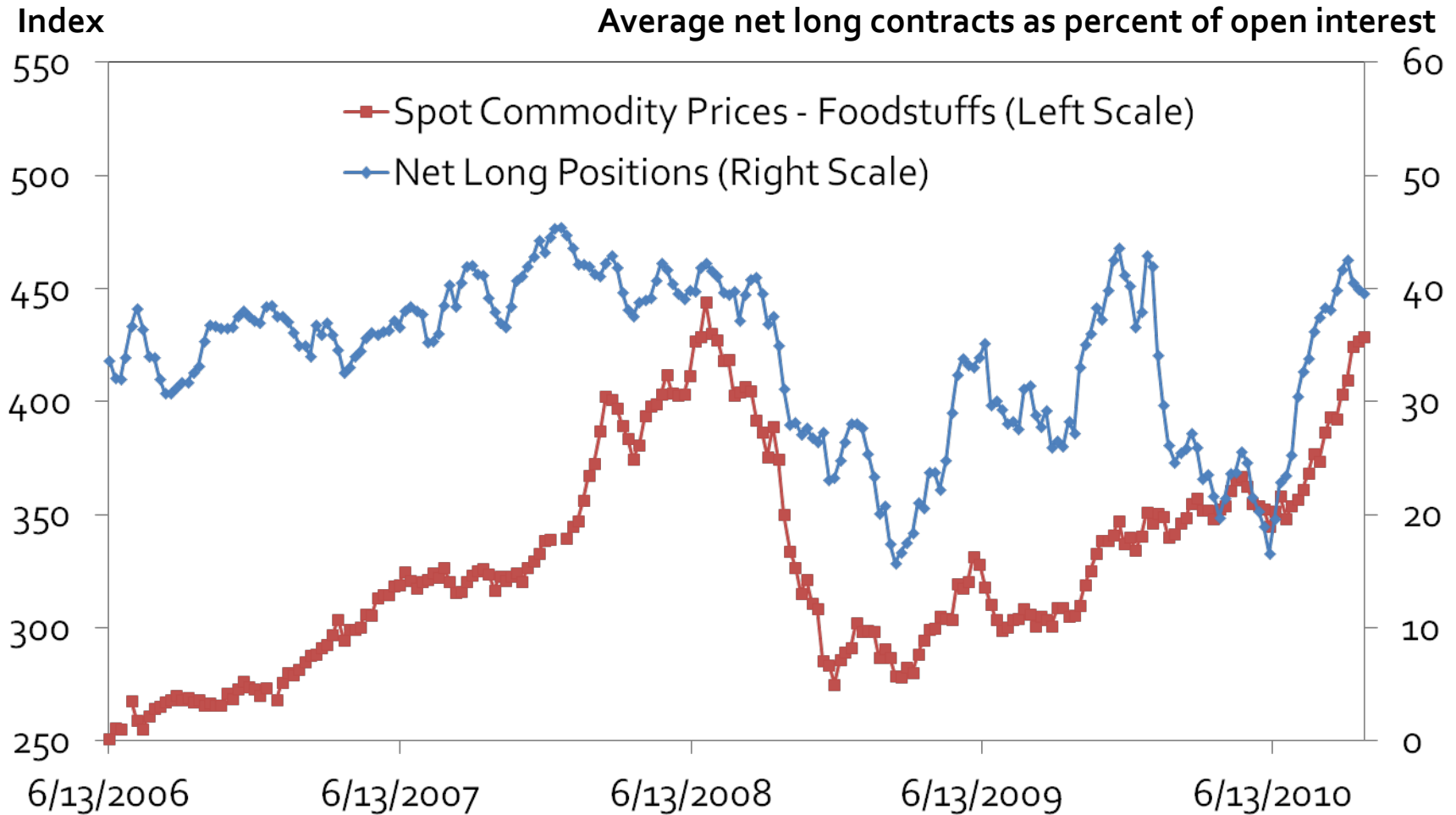
The side effect of QE is a weaker dollar which tends to boost commodity prices and asset values.

U.S. Exchange Rates and Commodity Prices

Index (2005 average = 100)

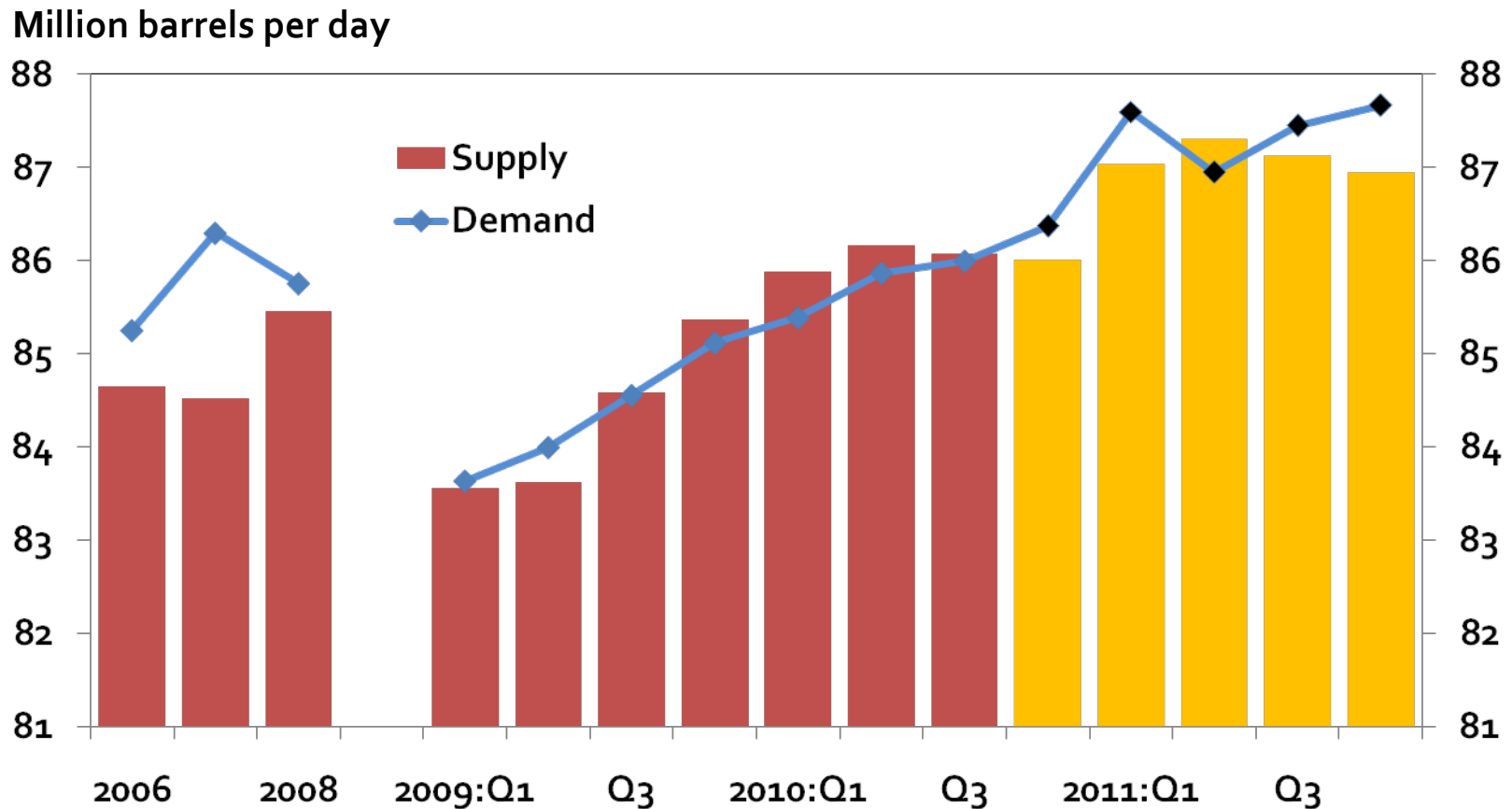


Swap Dealers and Managed Money Net Long Positions in Corn, Soybeans, Wheat, Oats, and Rice Markets and Food Commodity Prices



What happens to prices if crude oil demand outpaces supply?

World Crude Oil and Liquid Fuels Balance



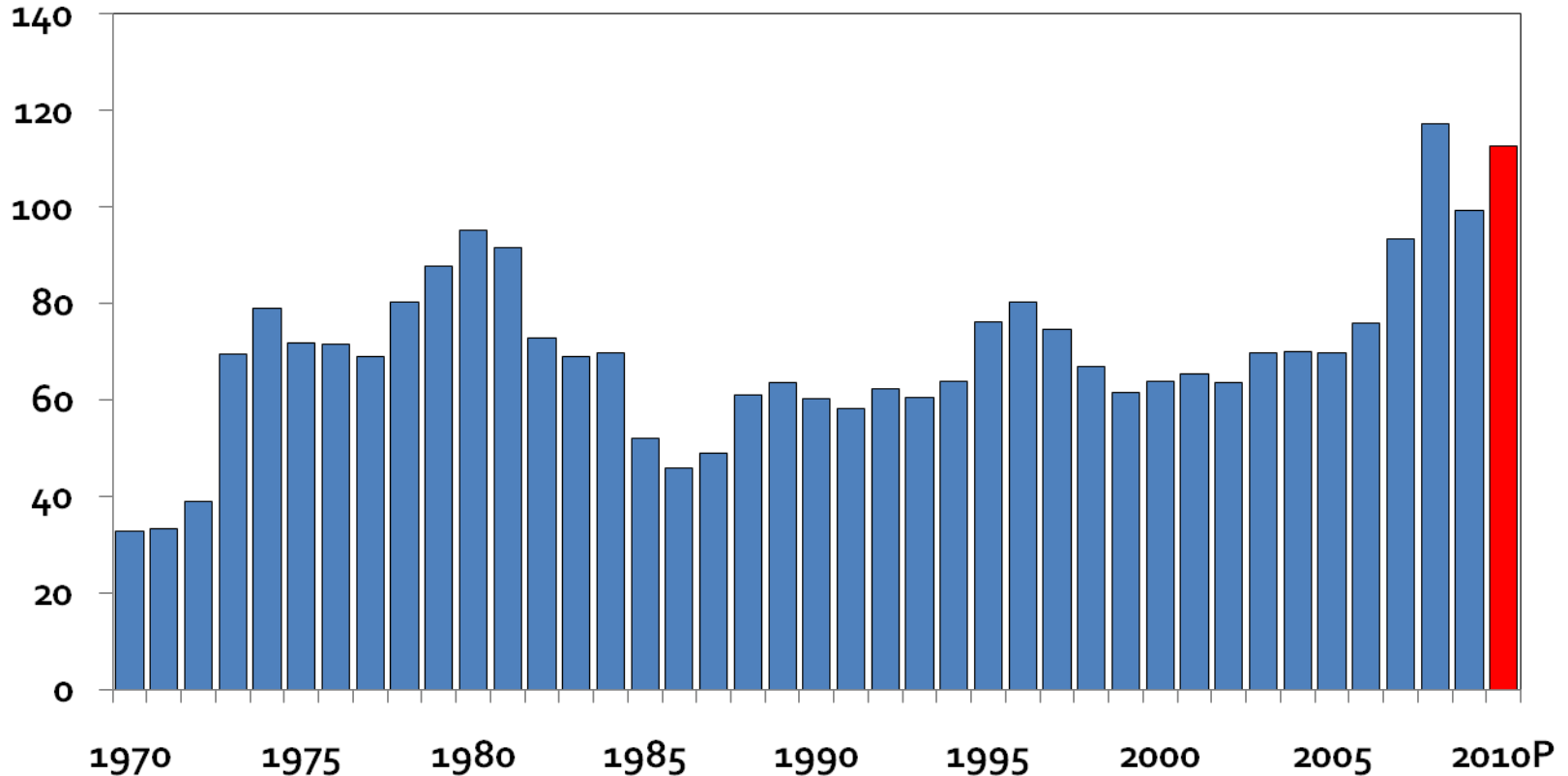
Source: Energy Information Administration



U.S. agricultural exports have rebounded.

Real U.S. Agricultural Exports

Billion dollars (constant 2010=100 dollars)



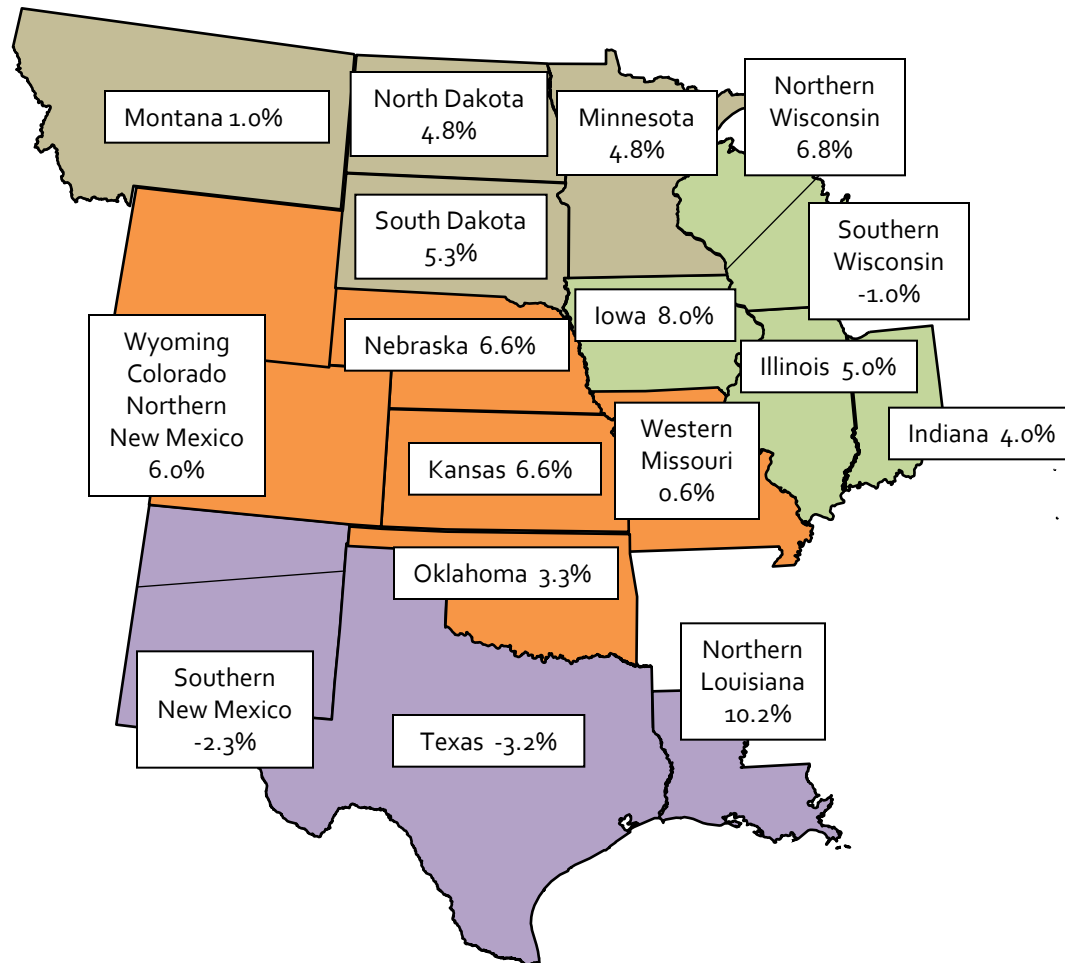
Source: USDA

* 2010 projection based on export growth through July 2010



Good Quality Farmland (Non-irrigated Cropland) Values

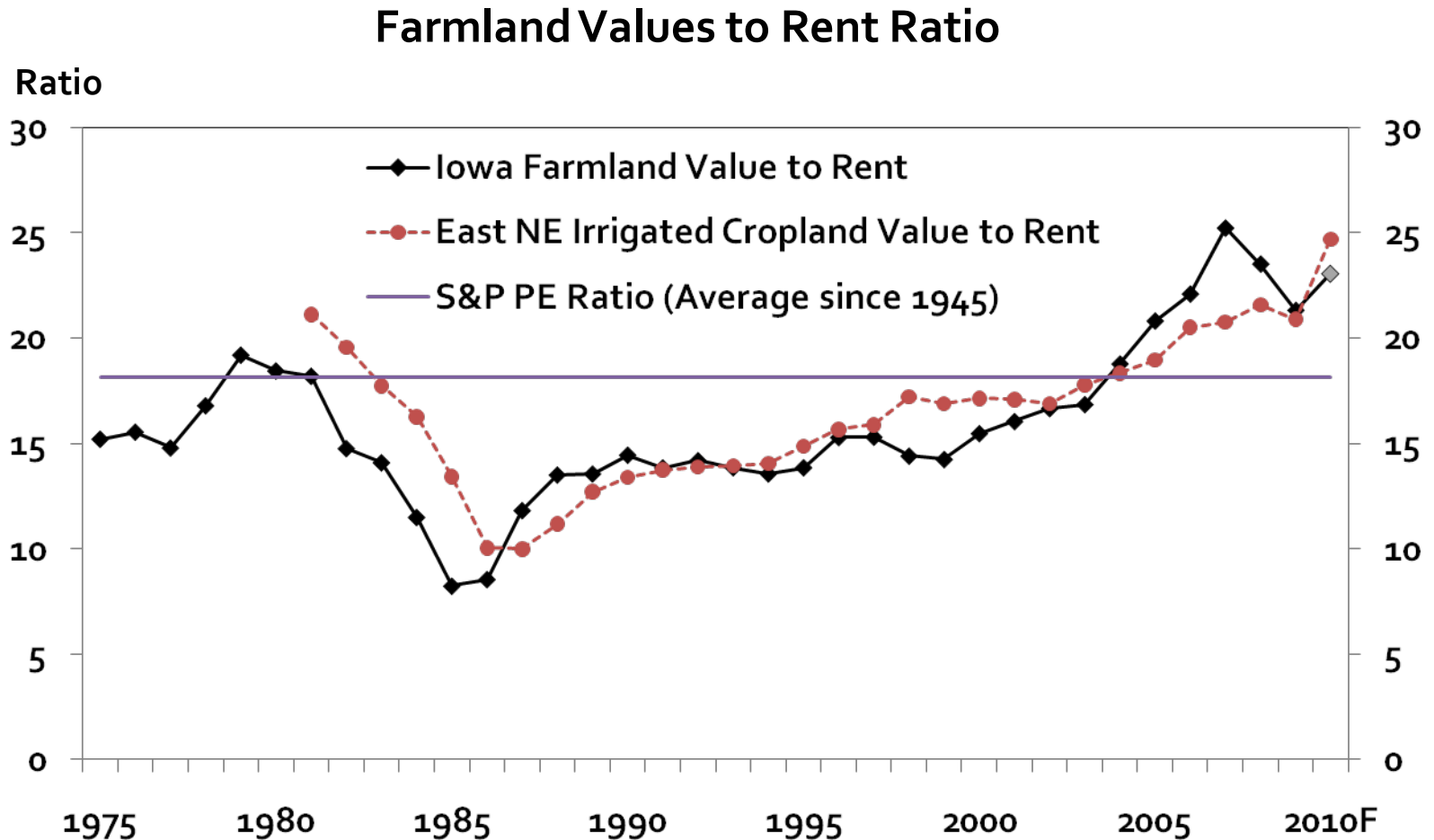
(Percent change Second Quarter 2009 to Second Quarter 2010)



Source: Federal Reserve District Surveys (Chicago, Minneapolis, Kansas City, Dallas)



Is a farmland bubble brewing? Are farmland values too high or rents too low?



Calculations based on Iowa State University and University of Nebraska data



Conclusions

- Despite a summer lull, the U.S. economy is expanding.
- With high unemployment rates and low inflation, the Federal Reserve is debating another round of monetary stimulus.
- Additional monetary stimulus could have the indirect effect of stimulating commodity markets.
- The agricultural boom is being capitalized into cash rents, how long will the boom last?



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

