

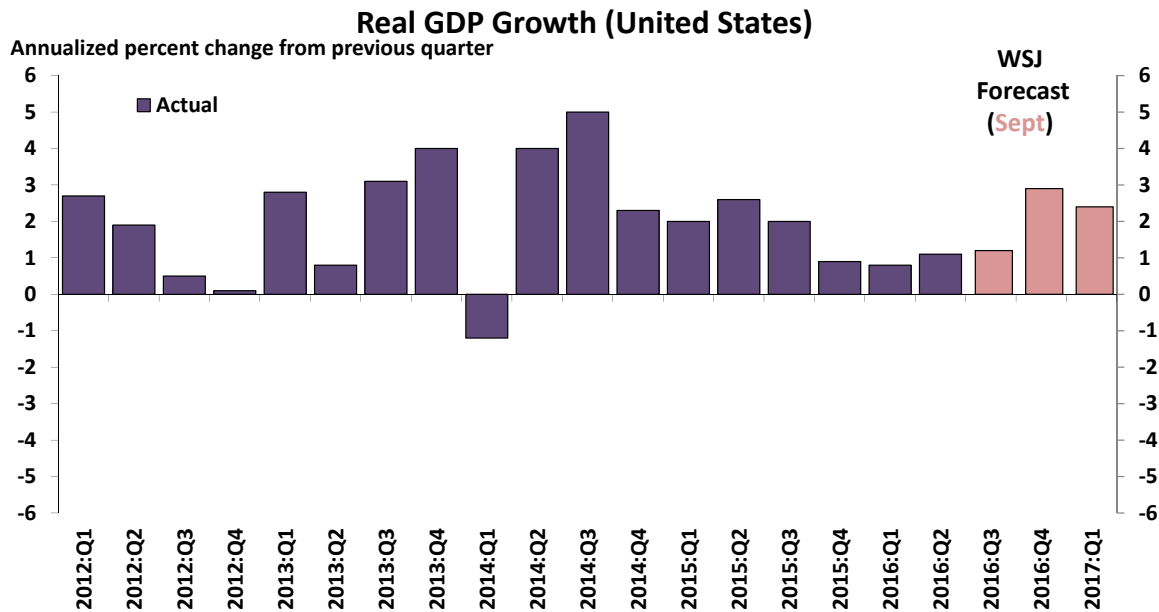
Macroeconomic and Interest Rate Outlook

2016 Ag Lenders Conference

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The economic recovery continues to struggle to find its footing.



Source: Bureau of Economic Analysis and Wall Street Journal (WSJ) September 2016 Forecast Survey (Average)

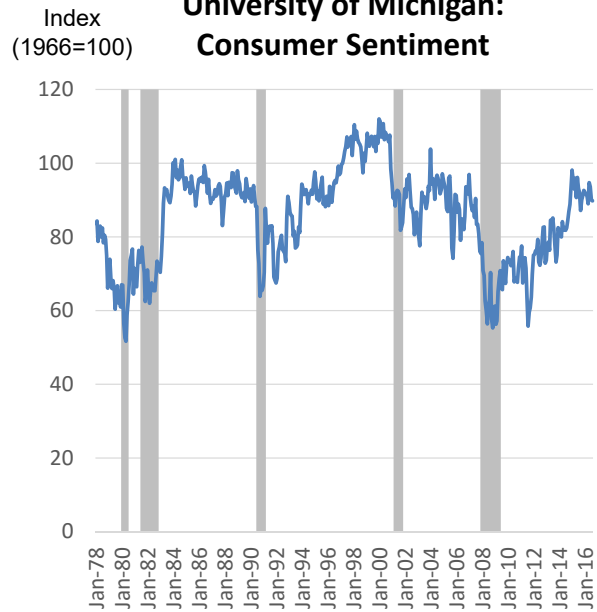
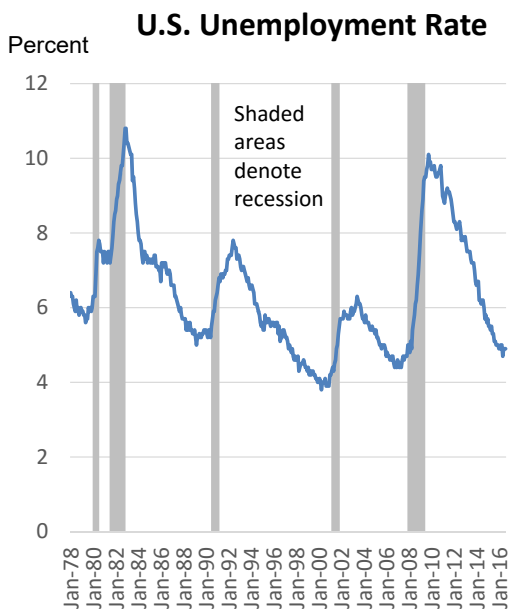
Today's exceptional accommodative monetary policy has created quite the dialogue within the Fed.

- In the Fed, it is a debate between:
 - Doves: Benefits of continued accommodative monetary policy to the economy outweigh the risk (international turmoil and deflation)
 - Hawks: The economy continues to improve and extraordinary accommodative policies may be promoting excessive risk taking behavior
- The market was ready for a Fed Funds rate increase back in June 2015...now what?

Diverse voting on FOMC at Sept. 2016 meeting

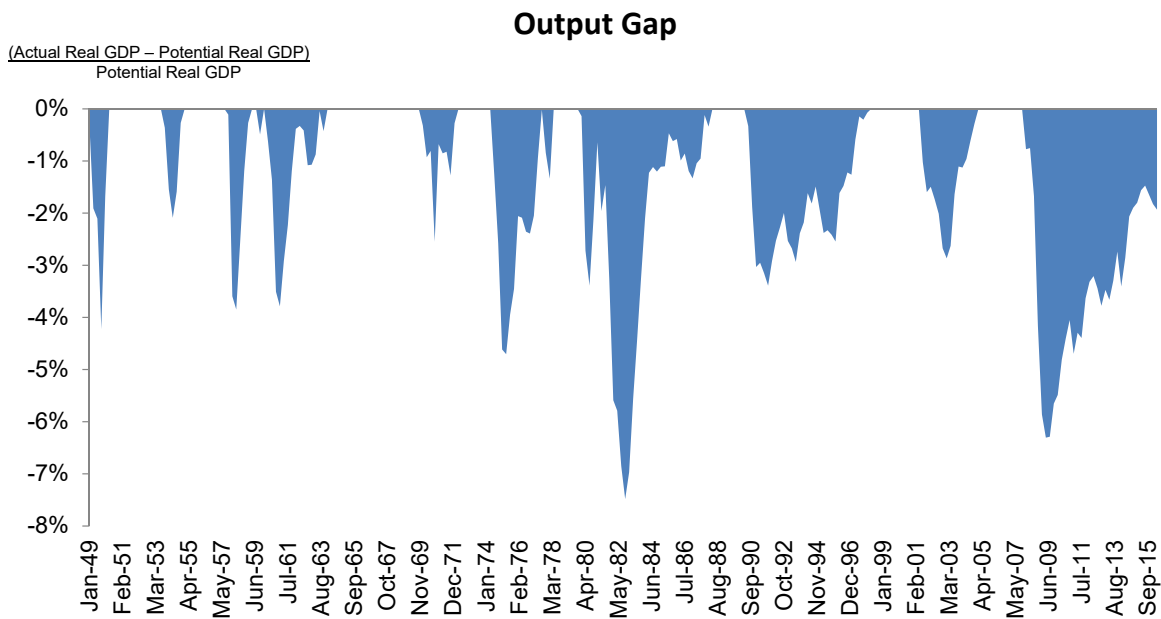
- “The Committee judges that the case for an increase in the federal funds rate has strengthened but decided, for the time being, to wait for further evidence of continued progress toward its objective”
 - FOMC Statement from September 2016 meeting
- Seven voted to maintain $\frac{1}{4}$ to $\frac{1}{2}$ Fed Funds Rate and four voted to raise to $\frac{1}{2}$ to $\frac{3}{4}$ Fed Funds Rate (Esther George, Loretta Mester, and Eric Rosengren)

The labor market has improved.



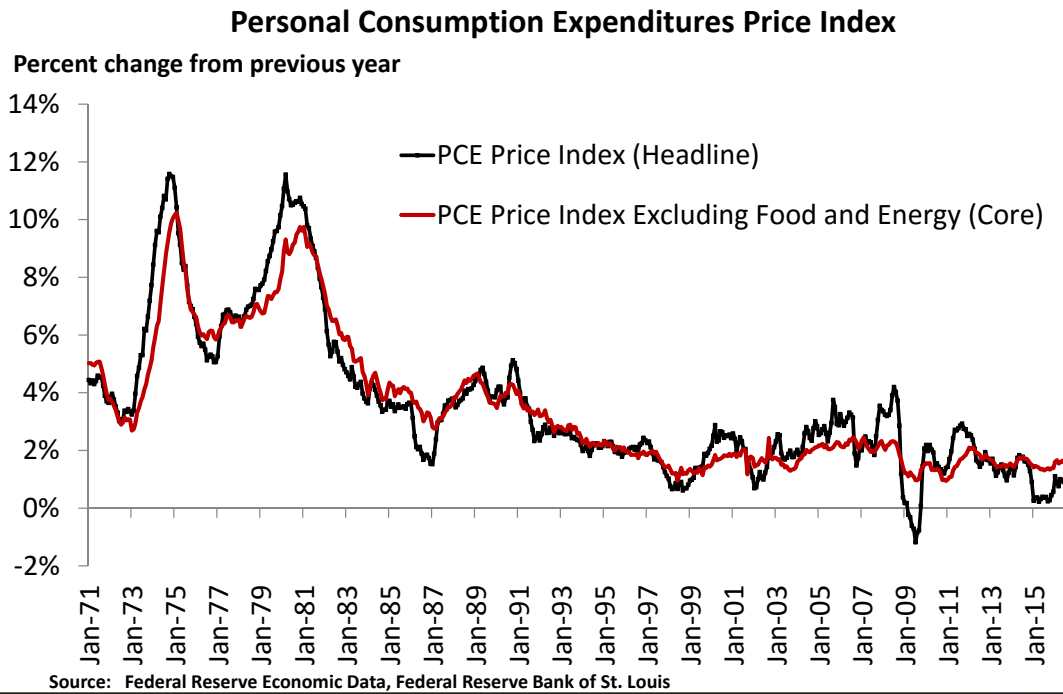
Source: Bureau of Labor Statistics

Improvements in the overall U.S. economy are finally reducing a historically deep and wide output gap.



Source: Congressional Budget Office

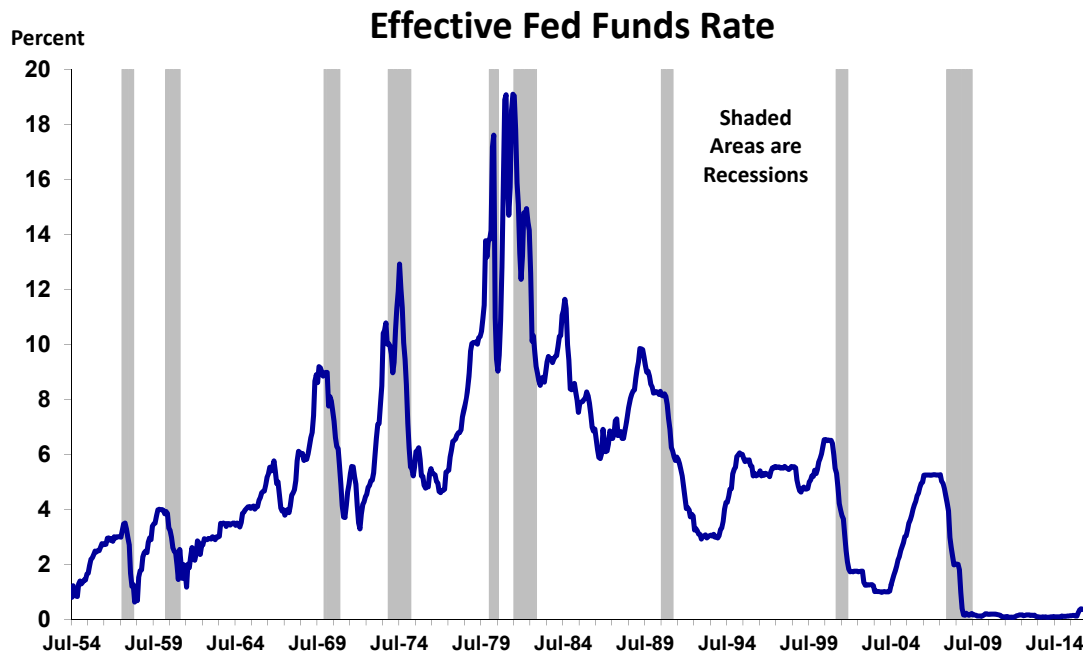
Today's inflation is well below 1970s levels...



...and inflation expectations are low and continue to remain below the “2% target.”



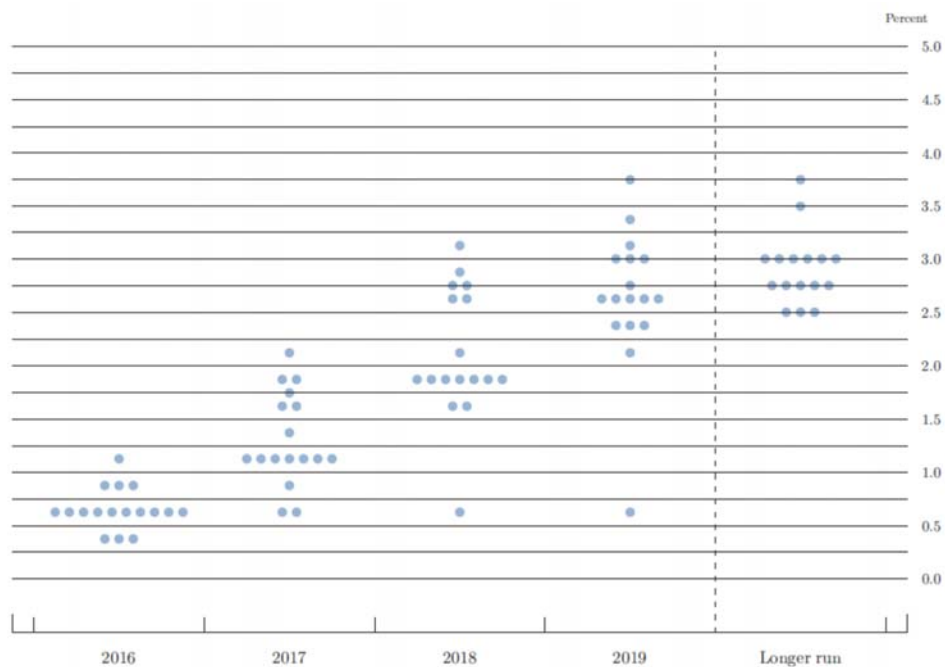
With an improving economy, the FOMC did raise rates in December 2015.



Source: Federal Reserve Board of Governors

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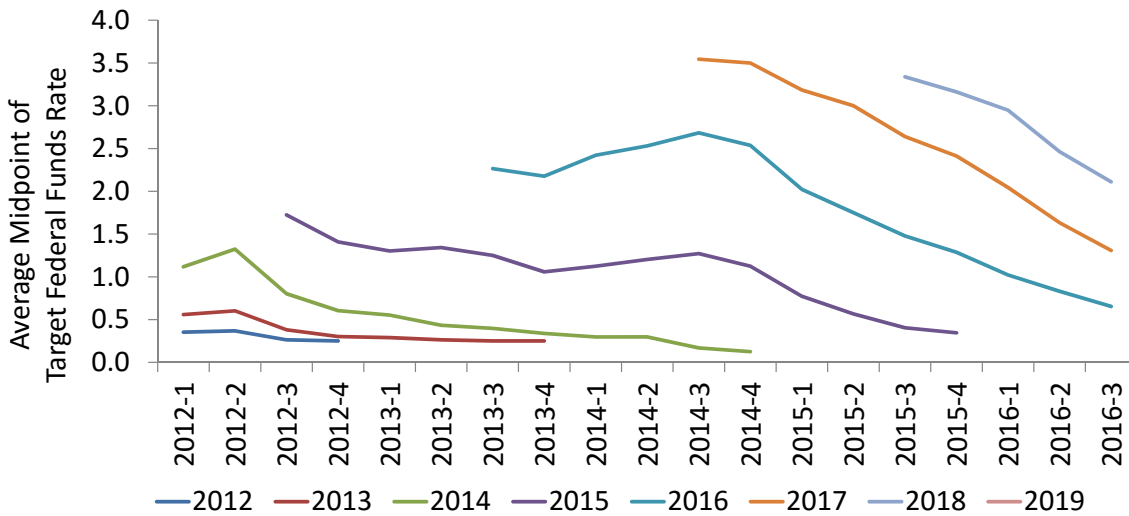
The September 2016 FOMC dot plot shows future interest rates rising significantly...but will they?



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How accurate has the FOMC been in predicting the effective fed funds rate?

FOMC "Dot Plot" Average Annual Federal Funds Rates



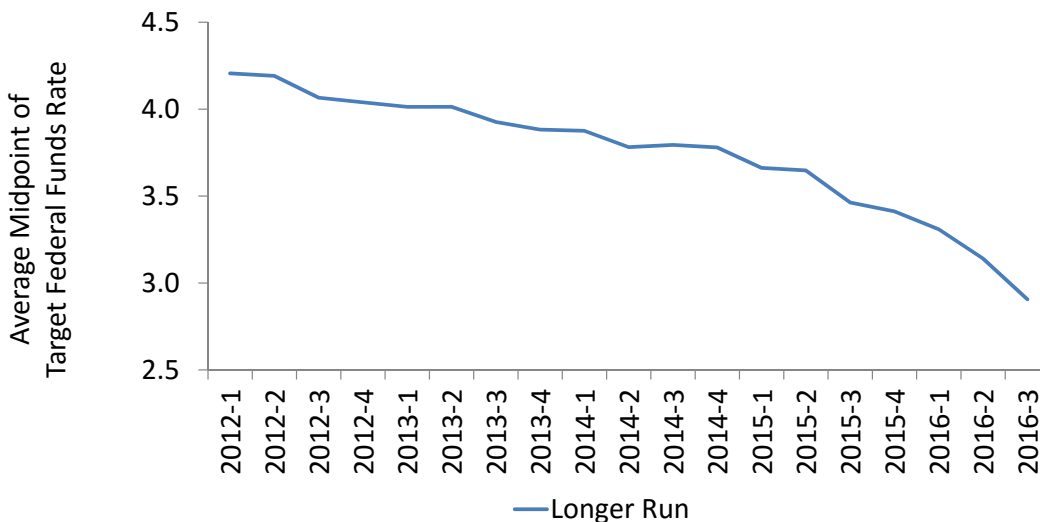
Release Date for FOMC Projection of Federal Funds Rate

Source: Federal Reserve Board of Governors



Projected longer run Federal Funds Rate has steadily declined.

FOMC Longer Run Average Annual Federal Funds Rate

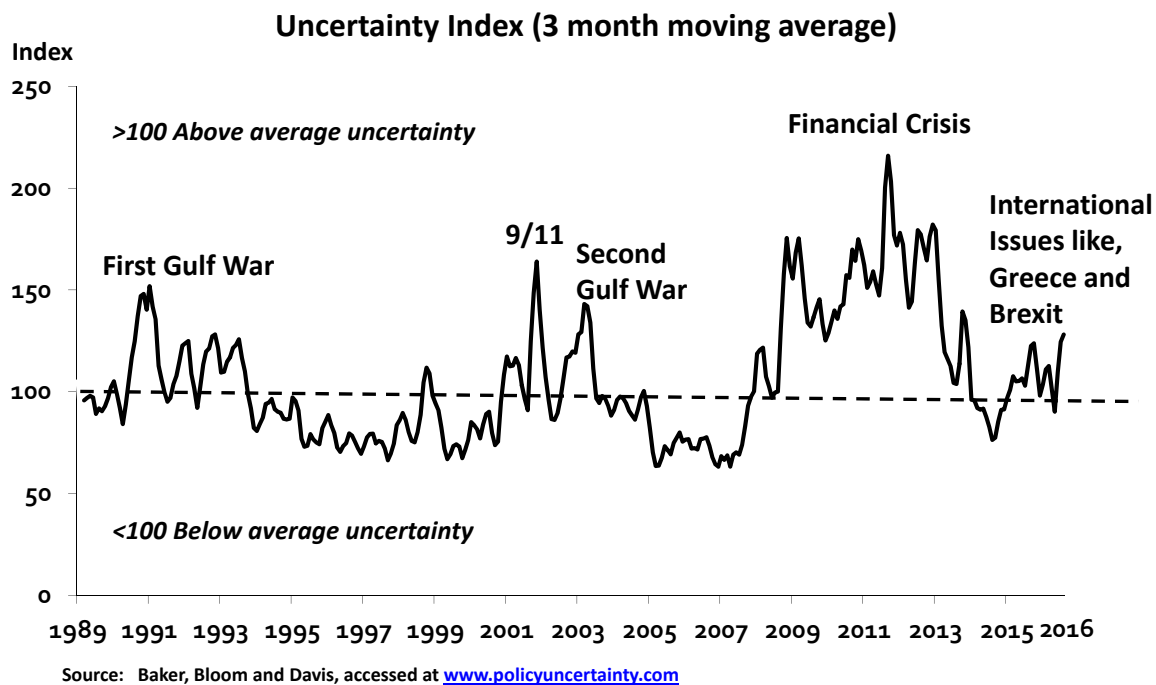


Release Date for FOMC Projection of Federal Funds Rate

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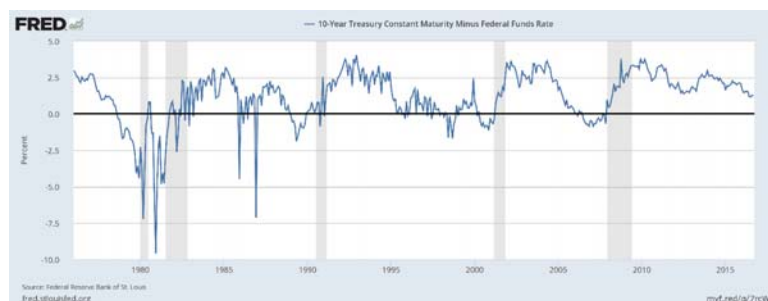
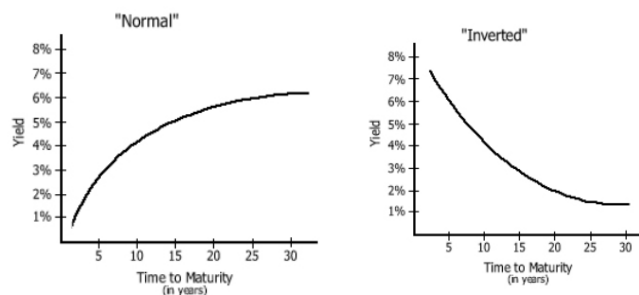


Uncertainty is likely weighing on the decision to raise interest rates.



What are the implications of a “Fed created” positive spread?

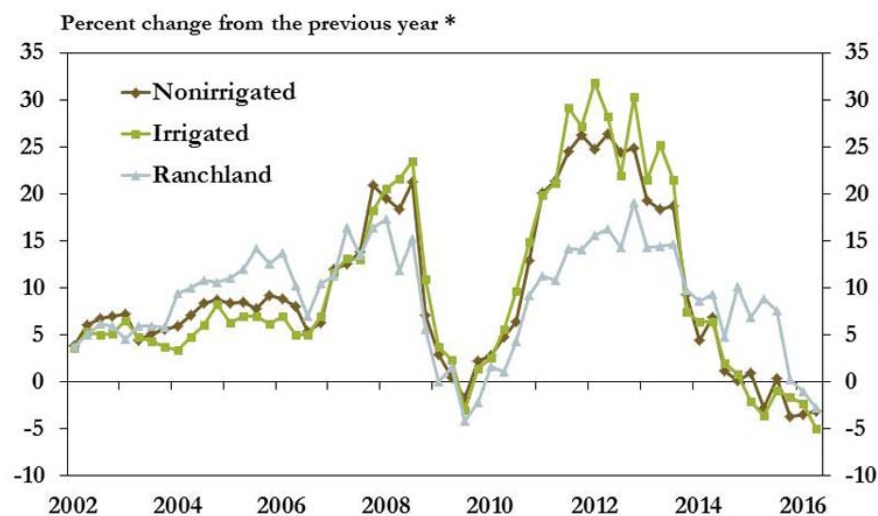
- Shorter end of the yield curve is being held down by accommodative policy...so:
 - Why not reach for yield?
 - Why not use cheap short term funds to lower longer term loan rates?
 - Why lock in longer-term rates?
 - Why should I miss out on the party?



WHAT DO LOW, LONG TERM INTEREST RATES MEAN FOR U.S. AGRICULTURE?

The decline in farmland values is slow and measured.

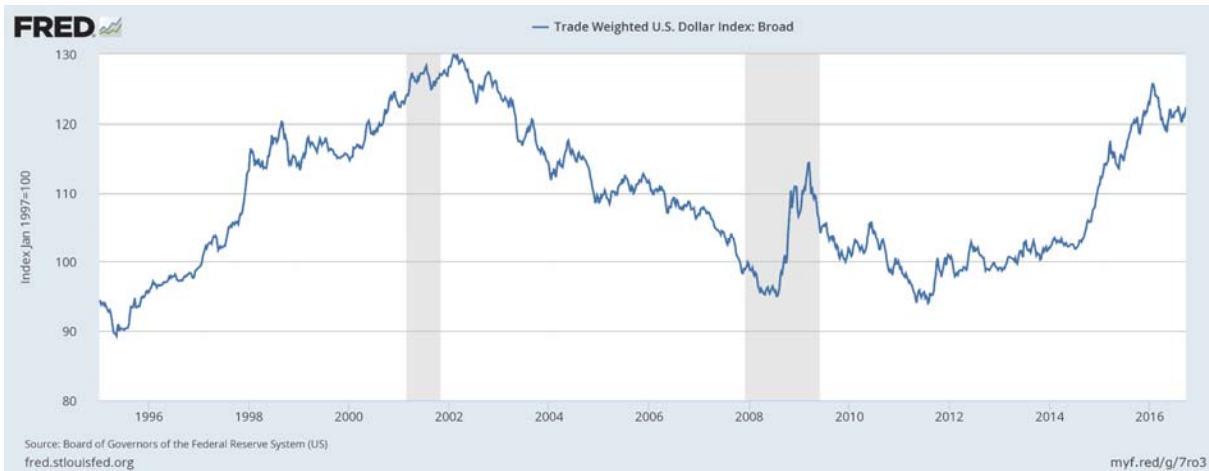
Chart 9: Tenth District Farmland Values



*Percent changes are calculated using responses only from those banks reporting in both the past and the current quarters.

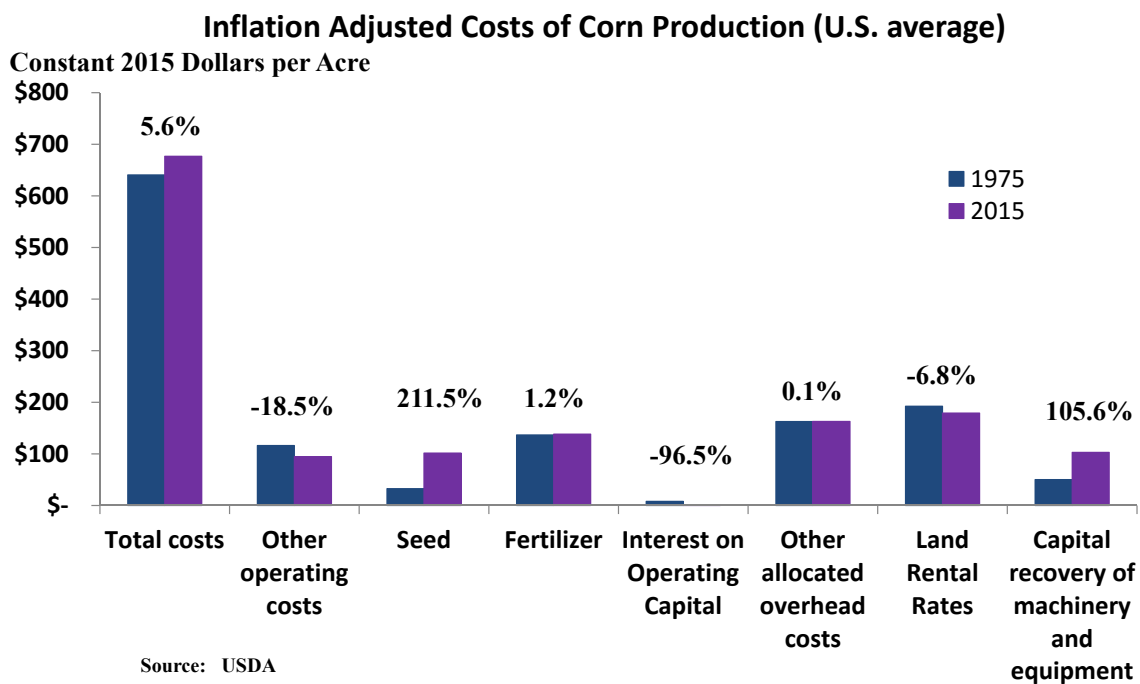
Source: Federal Reserve Bank of Kansas City's Agricultural Credit Survey:
<https://www.kansascityfed.org/research/indicatorsdata/agcreditsurvey>

Will lower interest rates equate to a lower value of the dollar?



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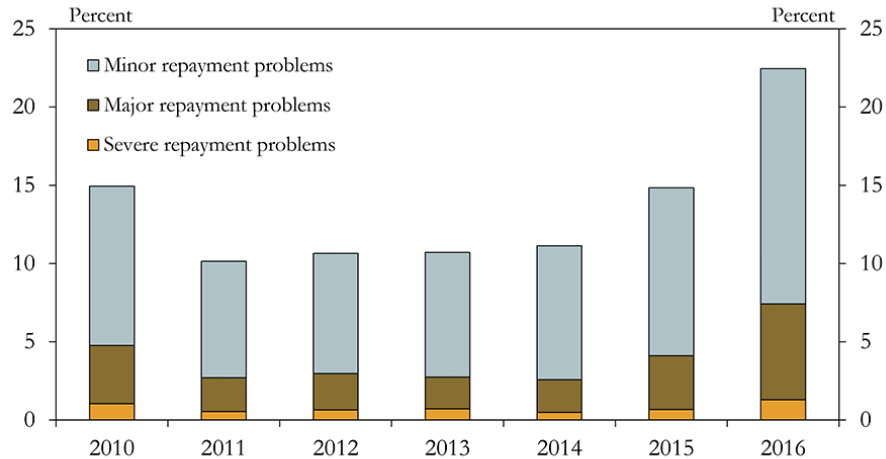
Compared to 1975, today's total costs of production are higher, but interest costs are very low.



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Lower interest rates will likely not help current or future loan repayment issues.

Chart 6: Tenth District Loan Repayment Problems



Sources: Federal Reserve Bank of Kansas City: Survey of Agricultural Credit Conditions.

Concluding thoughts

- Monetary policy remains extremely accommodative
 - Dove versus Hawk debate within the Fed
- The impact of ultra-low interest rates and massive amounts of liquidity have had a large impact on the U.S. economy, global economy and agriculture
 - Agriculture as an investment: commodities and farmland values
 - Lots of liquidity sitting on the sideline...inflation?
- The Fed's exit strategy is very important, and the million dollar question, when will interest rates rise?

Future key areas for agricultural bankers

- Provide education for your customers
 - Risk management (crop insurance), grain marketing, latest agronomic news, technology adoption, etc.
- Stress test loan portfolio
 - How sensitive is your portfolio to a net farm income and/or land value drop?
- Do not be an asset based lender, tried and true practice
- Liquidity, liquidity, liquidity
 - If crop prices drop and loan payments stop, how long can you weather the storm?
- Regulation, regulation, regulation
 - What is next?

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Thank you. Questions?

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