Today’s Roadmap

- Who is the Fed?
- Financial crisis update
- Economic update
- Agriculture and rural update
Missions of the Federal Reserve

- 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
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

- Two primary objectives
- Price stability
- Sustainable economic growth
Today’s Roadmap

- What is the Fed?
- Financial crisis update
The financial market crisis has eased.

Source: Federal Reserve Board of Governors
While the financial crisis has eased, risks still exist in the economy.

- Probably the one risk most talked about today is commercial real estate (CRE).
- Most banks are exposed to CRE and/or have exposures to commercial mortgage backed securities (CMBS).
- Eventually, CRE will need to be refinanced...who will do this in today’s market?
U.S. commercial vacancy rates are rising.

U.S. Commercial Real Estate Vacancy Rates

Source: Torto-Wheaton Research
The share of CRE loans past due are rising.
While commercial banks’ profitability has fallen, capital levels have risen.
The U.S. is going through a de-leveraging process.

Domestic Debt Outstanding

Percent of GDP

Source: Federal Reserve Board of Governors
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Forecasts expect we have hit bottom and should return to growth.

Real GDP Growth
Annualized percent change from previous quarter

Source: Bureau of Economic Analysis and Blue Chip Economic Indicators
Since 2008, retail sales have fallen. Recent boost from cash-for-clunkers, but is it sustainable?

U.S. Monthly Retail and Food Sales

Source: U.S. Census Bureau
The unemployment rate continues to rise.

U.S. Unemployment Rate

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td></td>
</tr>
<tr>
<td>1973</td>
<td></td>
</tr>
<tr>
<td>1977</td>
<td></td>
</tr>
<tr>
<td>1981</td>
<td></td>
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<td>1985</td>
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<tr>
<td>2001</td>
<td></td>
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<tr>
<td>2005</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td></td>
</tr>
</tbody>
</table>

Source: Bureau of Economic Analysis
Improvements in the U.S. trade balance continue.

Real Net Exports of Goods and Services

Source: Bureau of Economic Analysis
Will emerging countries lead the recovery?

GDP Growth

Annual percent change, constant dollars

Source: International Monetary Fund, April 2009
The bulk of the stimulus package comes in 2010.

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

Billion Dollars

Source: Congressional Budget Office, February 13, 2009
Deflation, Disinflation, Inflation: What is the difference?

- Deflation: a *fall* in the general level of prices of goods and services in an economy over a period of time.
  
  *For example, CPI < 0*

- Inflation: a *rise* in the general level of prices of goods and services in an economy over a period of time.
  
  *For example, CPI > 0*

- Disinflation: *a decrease in the rate of inflation* – a slowdown in the increase of the general price level of goods and services over time.
  
  *For example, CPI > 0, but falling from 2.5 to 1.5%*
The U.S. is experiencing disinflation.

Source: Bureau of Labor Statistics
Monetary Policy Transmission Mechanisms

The Fed has expanded its balance sheet to extend credit to banks.

Prior to September 2008, the Fed was sterilizing liquidity injections to capital markets.

- Expansion of short-term lending through Term Auction Facility (TAF) - Green
- Offset by lower treasury portfolio - Blue

After September 2008, Fed unable to sterilize liquidity injections through the discount window and various lending facilities.

- The creation of the Term Asset-backed Securities Loan Facility (TALF) to acquire consumer loans could expand the balance sheet even further.

Federal Reserve Balance Sheet

**Billions of Dollars**

<table>
<thead>
<tr>
<th>Jan-07</th>
<th>Jul-07</th>
<th>Jan-08</th>
<th>Jul-08</th>
<th>Jan-09</th>
<th>Jul-09</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>400</td>
<td>800</td>
<td>1,200</td>
<td>1,600</td>
<td>2,000</td>
</tr>
</tbody>
</table>

Source: Federal Reserve Board of Governors
Unlike the Great Depression, money stock (M2) has edged up with a surge in the monetary base.
The velocity of money has plummeted.
What is the future path of interest rates?

Fed Funds Rate

- Fed Funds Effective
- Fed Funds Intended
- Fed Funds Futures (Aug. 7, 2009)
- Fed Funds Futures (Oct. 19, 2009)

Source: Federal Reserve Board of Governors and CME Group
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What does all of this mean for U.S. agriculture?

- USDA projects net farm incomes will fall by 38 percent this year
  - But remember, this fall is from a very high level (2008 net farm income levels)
- Depressed demand has severely hurt the U.S. livestock sector
- What does this mean for agricultural credit conditions?
In 2009, the farm boom is projected to end.

Source: USDA
Meat and milk spending tends to decline in jobless recoveries.

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

<table>
<thead>
<tr>
<th></th>
<th>One Year Prior to Recession</th>
<th>During Recession</th>
<th>One Year After Recession</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average in 5 Recessions Since 1980</td>
<td>6.0%</td>
<td>-1.0%</td>
<td>-4.0%</td>
</tr>
<tr>
<td>1981 Recession</td>
<td>7.0%</td>
<td>-2.0%</td>
<td>-3.0%</td>
</tr>
<tr>
<td>1982 Recession</td>
<td>6.0%</td>
<td>-1.0%</td>
<td>-4.0%</td>
</tr>
<tr>
<td>1990 Recession</td>
<td>8.0%</td>
<td>-2.0%</td>
<td>-5.0%</td>
</tr>
<tr>
<td>2001 Recession</td>
<td>10.0%</td>
<td>-3.0%</td>
<td>-6.0%</td>
</tr>
<tr>
<td>2007 to 2009* Recession</td>
<td>8.0%</td>
<td>-2.0%</td>
<td>-5.0%</td>
</tr>
</tbody>
</table>

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.
What does 2010 hold for loan repayments and delinquent farm loan volume?

Source: 10th District Agricultural Credit Survey and Call Reports
The tightening in credit markets has slowed.
After “leveling off” in 2009, what direction will farmland values follow?

U.S. Farmland Values

<table>
<thead>
<tr>
<th>Year</th>
<th>Dollars per acre</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>1090</td>
</tr>
<tr>
<td>2001</td>
<td>1150</td>
</tr>
<tr>
<td>2002</td>
<td>1210</td>
</tr>
<tr>
<td>2003</td>
<td>1270</td>
</tr>
<tr>
<td>2004</td>
<td>1340</td>
</tr>
<tr>
<td>2005</td>
<td>1610</td>
</tr>
<tr>
<td>2006</td>
<td>1830</td>
</tr>
<tr>
<td>2007</td>
<td>2010</td>
</tr>
<tr>
<td>2008</td>
<td>2170</td>
</tr>
<tr>
<td>2009</td>
<td>2100</td>
</tr>
</tbody>
</table>

Source: USDA
Historically, agricultural land values were related to much stress for agricultural lenders.
What does all of this mean for rural America?

- Rural areas have not been hit as hard as metro areas
- Still, challenges exist. Where will growth come from?
  - The recovery hinges on demand.
- Continued focus on entrepreneurship, innovation, and amenities may be the best strategies for rural growth.
Strong commodity markets insulated rural communities from the early stages of the recession.

**Employment Growth**

<table>
<thead>
<tr>
<th>Year</th>
<th>Metro</th>
<th>Rural</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>2007</td>
<td>1%</td>
<td>0%</td>
</tr>
<tr>
<td>2008</td>
<td>-1%</td>
<td>-2%</td>
</tr>
<tr>
<td>2009 YTD</td>
<td>-4%</td>
<td>-4%</td>
</tr>
</tbody>
</table>

Source: Bureau of Labor Statistics

Year-to-date data through July 2009
Rural economies have held up better than metro economies in many parts of the country.

Calculations based on Bureau of Labor Statistics, LAUS data
Rural housing markets are performing better than metro markets.

Residential Housing Price Indices

Annual Percent Change

Source: FHFA and FRBKC calculations
Rural financial markets are strained.

- Rural banks are performing better than metro peers.
- But, to reduce risk, banks have . . .
  - Tightened credit standards on loans.
  - Raised collateral requirements.
  - Shortened loan maturities.
- Risks remain in commercial real estate.
Consumer spending in rural places has not fallen as dramatically as in metro areas.

Retail Sales Growth 2007 to 2009

Year-to-date retail sales obtained from various department of revenues
Will processed food products drive rural export activity?

U.S. Export Growth

Percent change from previous year

<table>
<thead>
<tr>
<th>Year</th>
<th>Food and Kindred Products Exports</th>
<th>All Other Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>20%</td>
<td>10%</td>
</tr>
<tr>
<td>2008</td>
<td>25%</td>
<td>15%</td>
</tr>
<tr>
<td>2009 YTD</td>
<td>20%</td>
<td>-20%</td>
</tr>
</tbody>
</table>

Source: WISERTrade
Will the return of middle-aged adults offer opportunities for rural communities?

Rural Baby Boomer and Gen X Population Cohorts in Kansas City Federal Reserve District

Population in Thousands

- Baby boomers born from 1960 to 1964
- Gen X born from 1965 to 1969

Calculations based on Census Bureau data. Rural areas are based on nonmetro county definitions. The Kansas City Federal Reserve District includes Colorado, Kansas, Nebraska, Oklahoma, Wyoming, and portions of Missouri and New Mexico.
Long-term structural challenges remain.

- Aging populations and migration challenge rural communities.
- Rising fixed production costs threaten to intensify consolidation trends.
- The financial crisis has raised deposits in rural commercial banks.
  - Will this continue?
  - Is this a permanent change or a short-term safe haven?
Conclusion

- The financial crisis and recession appear to be ending, but risks surround the recovery.
- The outlook hinges on consumer spending, both in the U.S. and globally.
- As the recovery strengthens, questions will switch from growth to inflation.
- When will consumers and investors start “chasing”? 
For More Information

Federal Reserve Bank of Kansas City – Omaha Branch

www.kansascityfed.org/omaha