Macro Economics and Its Impact on Commercial Agriculture
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
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
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

The Fed
- Sell Securities
- Raises Fed Funds Rate
- Receives Money

Treasury Market

Economy

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Monetary Policy Mechanism: Fed Funds Rate

Stimulate the Economy: Place Money in the Economy

The Fed

Buy Securities

Lowers Fed Funds Rate

Gives Money

Treasury Market

Economy
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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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Y = C + I + G + NX

- Y is GDP
- C is Consumption (presently ≈ 70% of Y)
- I is Investment (presently ≈ 15% of Y)
- G is Government Spending (presently ≈ 20% of Y)
- NX is Net Exports (presently ≈ -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.
Meat and milk spending tends to decline in jobless recoveries.

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

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.

Change in Employment
Oct 07 to Oct 09 (3 month moving average)

- Pacific: Metro -5.5%, Rural -4.8%
- Mountain: Metro -4.1%, Rural -2.3%
- Western North Central: Metro -2.8%, Rural -1.8%
- East North Central: Metro -7.2%, Rural -8.2%
- South Atlantic: Metro -5.6%, Rural -6.8%
- New England and Middle Atlantic: Metro -3.9%, Rural -3.3%
- West South Central: Metro -2.8%, Rural -1.8%
- East South Central: Metro -7.1%, Rural -7.4%
- West South Central: Metro -0.2%, Rural 1.7%

Calculations based on Bureau of Labor Statistics, LAUS data
Deleveraging should contribute to a slow recovery...returning to saving habits.
The trade balance has improved.
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.

Source: Bureau of Labor Statistics
Monetary Policy Transmission Mechanisms

To combat the financial crisis and recession, the Federal Reserve has expanded its balance sheet.
Despite a surging monetary base, inflation has been subdued.

Growth in Monetary Aggregates

Index (Jan 1930 = 100)

Index (Jan 2007 = 100)

Monetary Base

M2

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.
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In general, farmers are financially sound.

Source: USDA
Collateral requirements have tightened and loan maturities have fallen.

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

Diffusion Index

Average Maturity of Non-Real Estate Farm Loans – U.S. (Right Axis)

Collateral Required Tenth Federal Reserve District (Left Axis)

Source: Federal Reserve Bank of Kansas City and Agricultural Finance Databook
Historically, agricultural land values were related to much stress for agricultural lenders.
Questions?

Federal Reserve Bank of Kansas City – Omaha Branch

www.kansascityfed.org/omaha