Macroeconomic Outlook: Ag Lending
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- Founder of *The Policy*, a public policy forum with a digital audience of over 30,000 people
A Brief History of the Federal Reserve

- 1913: Congress delegated its authority to the Federal Reserve (Federal Reserve Act)

- “Dual Mandate”
  - Must maintain price stability and maximum employment

- Operationally Independent
  - Conducts monetary policy without interference from the other branches of government
Federal Reserve Policy Tools

• Open market operations
  – the buying and selling of bonds and similar assets to increase the monetary base and influence the federal funds rate

• Changing the reserve requirement
  – the percent of money banks are allowed to loan out

• Changing discount or interest rates
  – the rate the federal reserve charges member banks for borrowing
The Federal Open Market Committee

- Buys and sells financial assets in the open market

- Assesses realized and expected economic conditions relative to its objectives
  - Maximum employment and 2 percent inflation

- Expects economic conditions to evolve in a manner that warrants *gradual increases* in the federal funds rate
  - The federal funds rate is likely to remain below levels that are expected to prevail in the longer run
Quantitative Easing

- Engaged in massive open market operations to stimulate the economy
  - 3 rounds of Quantitative Easing known as QE1, QE2, QE3

- Bought a large number of bonds and mortgage-backed securities to increase the supply of money
Post - Quantitative Easing

- Buying assets via QE1-3 created a bloated balance sheet

Source: Board of Governors of the Federal Reserve System (US)
fred.stlouisfed.org
Current Policy Goals

• The Federal Reserve wants to improve its ability to respond to an economic downturn and maintain current growth.

• Actions:
  – Raise interests rates slow enough to preserve current economic expansion
  – Raise interests rates fast enough to be able to cut them in the event of an unexpected economic downturn
  – Slowly sell off balance sheet while preserving economic expansion
Managing Expectations

• Forward Guidance

• The Federal Reserve communicates its policy objectives to the market

• Forward guidance relies on credibility
Expected Inflation

- Relatively low expected inflation
- Funds from QE are sterilized
  - Fed pays interest on excess reserves
  - Regulation discourages risky/high yield investment
Inflation and Asset Values

- Asset values are tightly correlated with inflation
  \[ \Delta P \rightarrow \Delta \rho_i \]
Exchange Rates - Yuan and Yen

- Moderate dollar weakness since early 2017
  - Good for exports, including countries that trade with ND
Re-Load & Repeat:
The Fed has history of cutting rates when responding to recessions. Real and nominal interest rates also tend fall to during recessions.
The Re-Load:
The Fed is looking to gradually raise rates.

Source: Board of Governors of the Federal Reserve System (US)
fred.stlouisfed.org

myf.red/g/fcUZ
Notable Metrics:
Historically Low Growth
Policy Issues

• Declining labor force participation and low productivity
  – Could depress long-term, effective interest rates

• Changes in worldwide demographics and the supply/demand of savings
  – Could keep interests rates low

• Regulation that discourages investment risk
  – Could lead to overinvestment in “safe” assets that are less conducive to growth
Trump & Ag Policy

- Trump Budget includes changes to the Farm Bill:
  - Caps the federal crop insurance premium subsidies program at $40,000/year
    - Saves $16.2 billion over 10 years
  - Eliminates insurance policy that guarantees revenue based on harvest prices instead of the projected price before planting
    - Saves $11.9 billion over 10 years
- Farmers could experience more financial stress
Negative-Interest Rates

- Denmark, Sweden, Switzerland and Japan currently have rates set below the zero-bound
- This turned 10-year bond yields negative in some countries
- Unclear if current central bank policy will stimulate growth
## Regulatory Risk - Basel III

### Basel III phase-in arrangements

(All dates are as of 1 January)

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<tbody>
<tr>
<td>Leverage Ratio</td>
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<tr>
<td>Minimum Common Equity Capital Ratio</td>
<td>3.5%</td>
<td>4.0%</td>
<td>4.5%</td>
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<tr>
<td>Capital Conservation Buffer</td>
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<td>0.625%</td>
<td>1.25%</td>
<td>1.875%</td>
<td>2.5%</td>
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<tr>
<td>Minimum common equity plus capital conservation buffer</td>
<td>3.5%</td>
<td>4.0%</td>
<td>4.5%</td>
<td>5.125%</td>
<td>5.75%</td>
<td>6.375%</td>
<td>7.0%</td>
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<td>Capital</td>
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<td>Phase-in of deductions from CET1*</td>
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<td>20%</td>
<td>40%</td>
<td>60%</td>
<td>80%</td>
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<td>Minimum Tier 1 Capital</td>
<td>4.5%</td>
<td>5.5%</td>
<td>6.0%</td>
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<td>Minimum Total Capital</td>
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<tr>
<td>Minimum Total Capital plus conservation buffer</td>
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<td>8.0%</td>
<td>8.625%</td>
<td>9.25%</td>
<td>10.5%</td>
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<tr>
<td>Capital instruments that no longer qualify as non-core Tier 1 capital or Tier 2 capital</td>
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<td>8.0%</td>
<td>10.5%</td>
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<td>Liquidity</td>
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<td>Liquidity coverage ratio – minimum requirement</td>
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<td>Net stable funding ratio</td>
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* Including amounts exceeding the limit for deferred tax assets (DTAs), mortgage servicing rights (MSRs) and financials.
** transition periods

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**Basel Committee on Banking Supervision**

**Bank for International Settlements**

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**NDSU Public Choice Private Enterprise**
Regulatory Risk - Basel III

• Banks to hold 4.5% value of common equity of risk-weighted assets
  - Capital requirements are higher for riskier assets
  - Incentivizes investment in low and “zero” risk assets
  - May be responsible for relatively low growth rates
Regulatory Risk – Policy

• “Systemic Risk Designation Improvement Act”
  – Allows the Fed to exempt small and regional banks & non-bank lenders from reporting requirements and merger and acquisition limitations imposed by Dodd-Frank

• Policies may change under a new Fed Chair
  – Janet Yellen no longer favored to be re-appointed

• Tax reform could be a boost, but details matter
FOMC: Summary of Economic Projections

<table>
<thead>
<tr>
<th>FOMC Summary of Economic Projections</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fed Funds Rate, Median</td>
<td>1.4%</td>
<td>2.1%</td>
<td>2.7%</td>
<td>2.9%</td>
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<tr>
<td>Personal Consumption Exp. Inflation Rate, Central Tendency, Midpoint</td>
<td>1.6%</td>
<td>1.9%</td>
<td>2.0%</td>
<td>2.1%</td>
</tr>
<tr>
<td>Growth Rate of Real Gross Domestic Product</td>
<td>2.4%</td>
<td>2.1%</td>
<td>2.0%</td>
<td>1.8%</td>
</tr>
<tr>
<td>Civilian Unemployment Rate, Range, Midpoint</td>
<td>4.4%</td>
<td>4.2%</td>
<td>4.2%</td>
<td>4.3%</td>
</tr>
</tbody>
</table>

- Federal funds rates projected to slowly rise over the next 3 years
- Personal consumption expenditures projected to rise above 2% in 2020
- GDP growth projected to slow over the next 3 years
- Civilian unemployment rate projected to fall further until 2020
Notable Metrics:
Labor Force & Wages

Source: U.S. Bureau of Labor Statistics
fred.stlouisfed.org

myf.red/g/fjnE

Source: U.S. Bureau of Labor Statistics
fred.stlouisfed.org
Notable Metrics:

Unemployment

Source: U.S. Bureau of Labor Statistics
fred.stlouisfed.org
Possible Fed Shake Up

• The White House is seeking to appoint people to the Fed willing to roll back financial regulations.

• People rumored to be considered for Fed Chair:
  – Kevin Warsh, former fed governor
  – John Taylor, Stanford University economist
  – Jerome Powell, current fed governor
  – Gary Cohn, National Economic Council director
  – Janet Yellen, current fed chair
Take Away

• Interest rates will remain relatively low for the foreseeable future
• Aging populations = lower growth prospects
• Policies direction may change with new appointment
• Tax reform has potential to help small business owners
• Regulatory reform may help small banks and non-bank lenders through reduced reporting standards