CoBANK

OUTLOOK Economic Data and Commentary

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Outlook for U.S. Agribusiness

Interview with Economist Terry Barr

A year ago, the U.S. agricultural complex was dealing with record commodity prices and unprecedented market volatility. Despite the challenge of high agricultural input costs, much of rural America was reaping the benefits of soaring farmland values and robust profits.

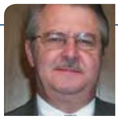
Now, 12 months later, the view from the farm gate has changed dramatically. The nation and the world economy are in the grips of a severe recession. Worldwide demand for U.S. agricultural products has softened, and commodity prices have retreated from the highs reached during the first eight months of 2008. Though many within the agricultural industry entered the recession with strong balance sheets, the worldwide economic downturn creates an unsettling degree of uncertainty for the entire sector.

CoBank recently asked nationally recognized agricultural economist Terry Barr to talk about the state of U.S. agriculture in the context of the global recession. Barr has more than 30 years of experience as an agricultural economist, including lengthy terms as chief economist for the National Council of Farmer Cooperatives and the U.S. Department of Agriculture. In May, Barr joined CoBank as the senior director of industry research.

OUTLOOK: The U.S. and global economy are in recession. In a general sense, how has the downturn impacted agriculture and agribusiness? What are the prospects for the year ahead?

Terry Barr: One has to remember that agriculture is very export-dependent, not just for the grains complex but the meat side, too. In fact, we export about 15 percent of the meat we produce in this country; for pork and poultry, it is well over 20 percent. A global recession hurts these exports markets as well as the domestic markets.

Agriculture has probably weathered this a bit better than other sectors, simply because we don't have to undertake the de-leveraging that is occurring in other sectors. But certainly from the demand side, you can feel those pressures. It is showing up in virtually all the commodities, which have seen prices soften significantly from the past few years. Some of that softness in the global marketplace is because the dollar obviously has gotten a little bit



CoBank Senior Director Terry Barr

"We will see even more volatility as we re-enter the resource-challenged environment we had before the recession.

stronger and due to a general flight from risk. But that could change fairly quickly. We are seeing some signs that China has been a bit more aggressive in some markets as they begin to stockpile resources. That has been helpful, particularly on the soybean side. A lot of this is about crop output, too. For instance, South America is having weather problems and that uncertainty is inducing a few buyers in the soybean complex to build a little bit of inventory. It is not an explosion of demand out there, but I don't think demand is going to soften further. If crop conditions improve, then demand will probably remain soft. If crop conditions weaken or worsen, we could see some more aggressive buyers who want to begin to take care of next year's needs prior to getting into a new harvest.

Domestically, you've got a lot of stimulus money out there and a lot of Federal Reserve action putting liquidity into the marketplace. That's going to have an impact in the next nine months in terms of beginning to boost demand. I think one has to anticipate – when we start coming out of recession and finish the down phase of the business cycle – that we will see growth, but it will be tempered growth.

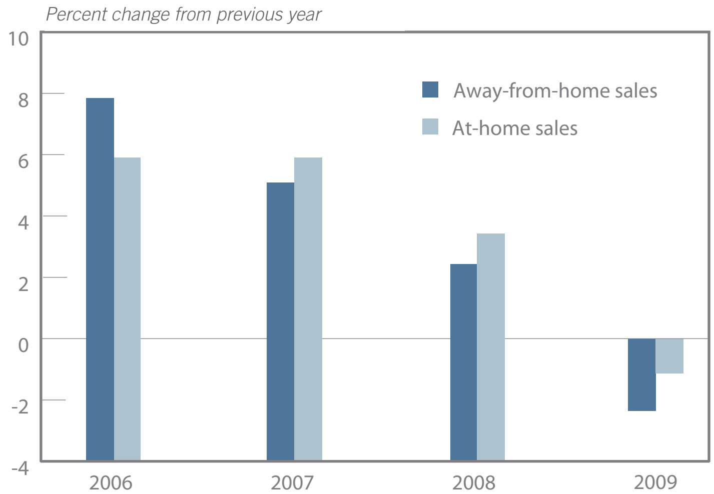
OUTLOOK: Volatility was the story in 2008. What can we expect for 2009 in terms of volatility?

TB: Going into a planting season where it's been wet and the crops have been delayed, we are already beginning to see some volatility, mostly in the grains complex. Oil obviously is beginning to ratchet up, too. As we begin to see some signs that this global recession is coming to an end, we will see even more volatility as we re-enter the resource-challenged environment we had before the recession. Perhaps we won't have as much liquidity driving prices up, but there is always going to be a speculative component that is going to interject. There is also uncertainty about acreage and uncertainty about adjustments going on in the livestock sector. If it gets too wet, too dry or whatever, there is the potential for volatility. But I don't think the swings are going to be as big as what we saw last year.

About this interview

Terry Barr is the senior director for industry research at CoBank. Previously, he was the chief economist for the National Council of Farmer Cooperatives, and prior to that he held several positions during a 14-year tenure at the U.S. Department of Agriculture. Barr is also a founding member of the National Business Economic Issues Council and has served as chairman of the World Agricultural Outlook Board. He holds a doctorate in economics from Washington State University.

U.S. FOOD EXPENDITURES



Source: USDA
2009 data are year-to-date through February

OUTLOOK: Why won't there be as much liquidity in the commodities market?

TB: There is a great deal more risk aversion than there was in the past year, and we've had a significant erosion in capital, too. I also think regulators are going to put more restrictions on margin calls and how they view speculators versus legitimate hedgers. All those things are going to work, I think, to temper the volatility and keep it from being as extreme as it was in 2008.

OUTLOOK: Can country grain elevators, which bore the brunt of much of that volatility, breathe a sigh of relief? Or do they still have to carefully watch their capital and balance sheets?

TB: They still have to be concerned about their balance sheets. One of the things that is coming out of this recession – in commodities, housing or whatever – is that the degree of leverage that's permitted going forward is not going to be as large as it was a year ago. Every business is going to have to rebuild their balance sheet and be prepared for volatility. Country elevators are going to have to have more working capital simply because prices are higher and volatility is higher.

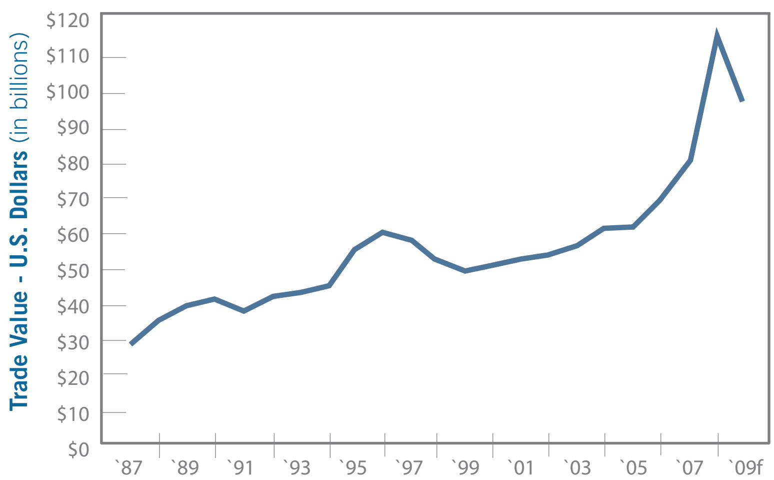
OUTLOOK: What about the long-term prospects for global markets? Will the dynamic of increasing demand from emerging markets resurface once we are out of this downturn?

TB: We came into this recession as a resource-challenged world, whether you are talking about cement, iron ore, copper or agriculture products. Everything was running with the trend of fulfilling the needs of new, emerging markets and their rising middle classes. We are now in a transition phase, where we are realigning economies and expectations. Coming out the other side, however, the fundamentals are still there. As these economies begin to improve, they will bid more aggressively for commodities.

OUTLOOK: A weak dollar benefits ag exporters. Where do you see the dollar headed in the short, medium and long term?

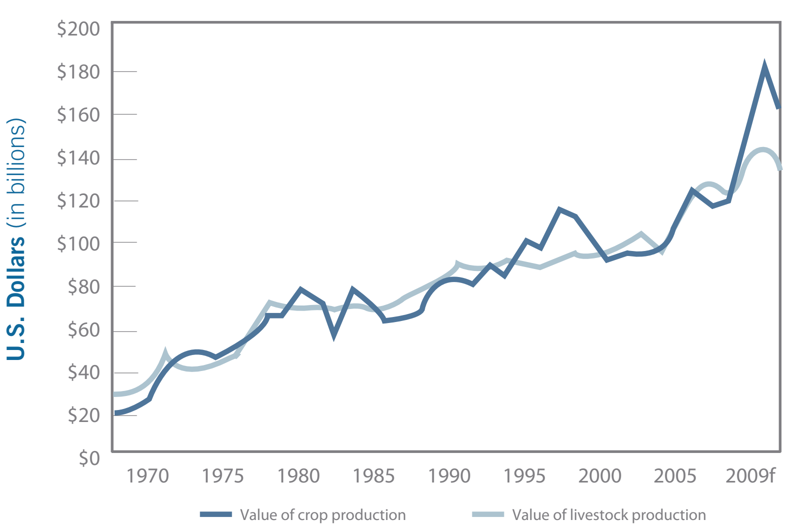
TB: The strengthening of the dollar has been driven by risk aversion and the fact that the U.S. economy, despite being in recession, is still doing better than the economies of most other major currencies. Additionally the U.S. economy, along with China, is likely to recover faster and lead any global re-

U.S. AGRICULTURAL TRADE



Source: USDA

VALUE OF CROP AND LIVESTOCK PRODUCTION



Source: Economic Research Service, USDA

covery. Issues related to Iran and North Korea only serve to increase the risk aversion appetite. For the short-to-medium term these factors will support the dollar.

As we begin to develop more clarity regarding the pattern of recovery in the global economy, I expect the U.S. dollar to come under increasing downward pressure, particularly if no clear cut deficit reduction strategies are forthcoming from the administration or the Congress. Federal Reserve policy changes regarding interest rates will also be a factor in terms of the risk-reward of holding dollar-denominated assets and financial instruments.

OUTLOOK: What do you expect the impact of the federal economic stimulus package will be on rural America?

TB: We really haven't tapped into it yet. Last time I looked, we'd only spent about $132 billion of the $787 billion authorized by Congress. We have a lot of that stimulus in the pipeline. For rural America, I think we are going to begin to see the fruits of that in the near future, whether it is in construction in individual states or in the purchase of agricultural commodities. It makes me feel positive that this economy is probably going to turn later this year, and we will carry into 2010 with a fair amount of momentum from the stimulus package.

OUTLOOK: The livestock, dairy and poultry industries have experienced a lot of stress lately. What do you foresee for those industries going forward?

TB: Obviously, adjustments were already underway for the hog side, but the H1N1 flu virus really extended their adjustment process by hitting export markets in conjunction with a weak domestic demand. They've got much more of a production adjustment to carry out than they thought before, but I think you will see some turn, even for them, in the second half of the year.

On the dairy side, their markets held up very well until about November, when the world market just gave way. U.S. dairy producers were exporting

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about 10 percent of their product in some form or another. That market has simply gone away because of weaker demand and the re-emergence of milk production in New Zealand. Dairy producers understand they have to make adjustments on the production side. Those adjustment processes are well under way, but it is probably going to take well through this year before you begin to see a real turn for dairy and we get production more in line with consumption expectations.

For others in the livestock and poultry industries, I think it will be a difficult time, particularly for those areas where you have significant leverage. That is really one of the big keys in all of this – those highly leveraged entities will have the most problems trying to adjust and acquire the working capital to sustain their operations in this economic environment. If you are looking for how you determine what areas are going to be most severely impacted, the degree of leverage is probably the biggest indicator.

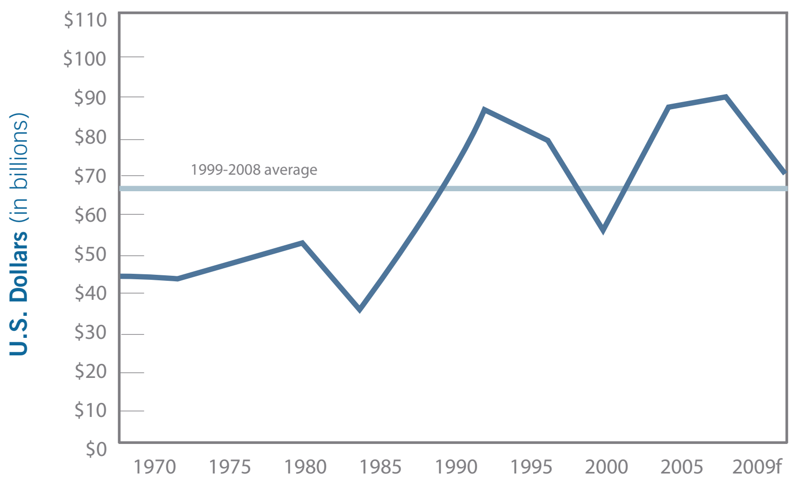
OUTLOOK: We often hear that agriculture went into this recession in pretty good shape after several strong years and therefore did not suffer as much as other industries. Will agriculture bounce back with the rest of the economy or will there be a lag for the agricultural industry?

TB: Agriculture was better positioned simply because the industry wasn't as leveraged as the other sectors of the economy. That has allowed the agricultural industry to weather through the early phase of the recession without as much impact. But now the recessionary forces have shifted from the U.S. and into the rest of the global market, and agriculture is beginning to feel the effect. Now the question is how do we make the adjustments? In my view, the brunt of the impact will be felt over the next six months or so, until we begin to see some resiliency on the export side.

OUTLOOK: Are their any other major economic challenges for agriculture this year unrelated to the economy? We've heard about potential regulatory changes involving everything from environmental regulations to price supports.

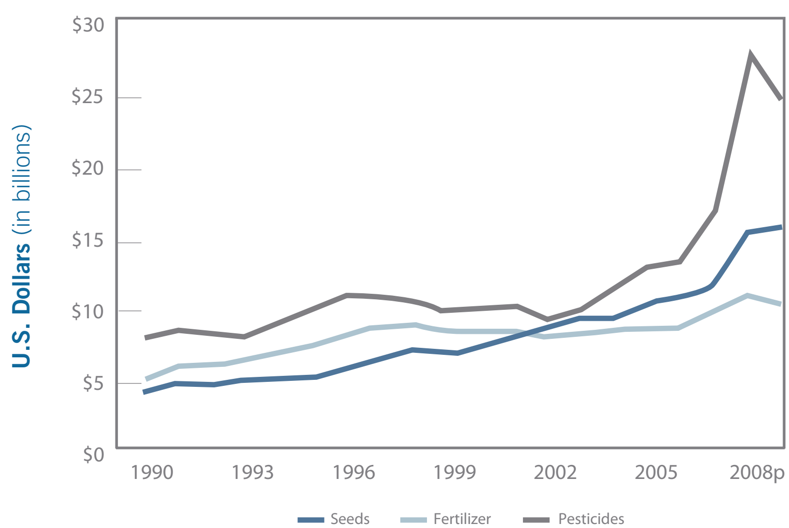
TB: There are a broad range of challenges on the horizon. Policymakers are proposing major reforms to the financial sector, the development of new en-

NET FARM INCOME



Source: Economic Research Service, USDA

SEED, FERTILIZER AND PESTICIDE EXPENSES



Source: Economic Research Service, USDA

ergy and climate-change policies that move away from fossil fuels, major health care reform and a broad range of regulatory changes, including food safety and the environment. These will provide unique challenges and opportunities for all sectors of the economy. Obviously, the Obama administration is much more proactive in terms of environmental regulation and oversight, and that will require active engagement from the impacted sectors. I don't think we are going to see a lot in terms of farm policy changes. If Congress and the president begin to start talking about deficit reduction in a meaningful way next year, then that could have some impact on some of the farm programs.

The other challenge out there is related to the cost of agricultural inputs. The cost side of the equation is always one that is hard for producers to get their arms around. We've seen some easing in prices on the nutrient side, but by and large agricultural input costs are still fairly high relative to the price adjustments we have seen in the commodity marketplace. That is a real challenge for cooperatives as well as producers since there are few strategies for managing risk on the inputs side.

One of the reasons that input prices have not declined as rapidly is that firms in some input industries, which have consolidated rapidly over the past decade, have decided to try to limit price declines by reducing supply capacity. Closing production lines and mines will bring supply more in line with demand and permit industries to hold a larger portion of the recent price increases. Since there are fewer competitors in each of these industries, the supply side adjustments are not likely to seriously erode the market share among competitors in the short run.

OUTLOOK: Will the recession prompt structural changes to the U.S. agricultural industry?

TB: I don't think a lot will change due to the recession, but that's because the U.S. agricultural complex had really gone through major changes in the years leading up to the recession. Obviously, we are a much more consolidated industry at all phases, whether you are talking about the retail side, the processing side or the farm side.

"In today's marketplace the firm with excess working capital and little leverage is king.

We've seen significant consolidation throughout the industry as part of the drive to realize economies of scale. We've seen lots of changes in the structure of the industry, too, with the focus on delivering what customers want through the food chain. All of those things have come along over the last five or six years.

The one place where we do have a different agriculture coming out the other side, again, deals with leverage. Folks are simply not going to be able to carry the degree of leverage they've been carrying over the last three or four years.

OUTLOOK: What advice would you give to grain cooperatives moving forward?

TB: It's still going to return to the issue of capital, maintaining your working capital capacity to be able to handle the volatility that is out there. One has to deal with how you manage input risk and how you share that risk with the producer. The cooperatives cannot continue to take all that risk on the input side. They are going to have to figure out a way to share that risk in a manner that is consistent with the kind of capital base that they have to work with. Also, don't get so focused on where we are now, but be more focused on deploying capital for the opportunities that are coming. It's kind of a two-fold job – make sure you are prepared for what you see right now but don't miss on some opportunities that may be coming down the road as we re-enter this resource challenged period. There are going to be some great opportunities.

In today's marketplace the firm with excess working capital and little leverage is king. We are going to see acceleration in consolidation across the agriculture, energy and communication sectors. Firms will attempt to reduce per-unit costs and consolidate their market positions by acquiring competitors who have insufficient capital to succeed in the new market environment. New marketing and supply chain arrangements will be forged to share market risk and ensure supplies of strategic resources throughout the food, energy and agriculture system. This will occur domestically and internationally.

Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 06/30/09. They are intended to provide rate or cost indications only and are for notional amounts in excess of $5 million except for forward fixed rates.

KEY ECONOMIC INDICATORS

Gross Domestic Product (GDP) measures the change in total output of the U.S. economy. The Consumer Price Index (CPI) is a measure of consumer inflation. The federal funds rate is the rate charged by banks to one another on overnight funds. The target federal funds rate is set by the Federal Reserve as one of the tools of monetary policy. The interest rate on the 10-year U.S. Treasury Note is considered a reflection of the market's view of longer-term macroeconomic performance; the 2-year projection provides a view of more near-term economic performance.

ECONOMIC AND INTEREST RATE PROJECTIONS

Forecasts courtesy of Insight Economics, LLC

				US Treasury Securities	
2009	**GDP**	**CPI**	**Fed Funds**	**2-year**	**10-year**
Q1	-5.70%	-2.40%	0.18%	0.90%	2.70%
Q2	**-2.50%**	**0.20%**	**0.18%**	**1.00%**	**3.30%**
Q3	-2.50%	2.50%	0.20%	1.30%	3.60%
Q4	-1.00%	1.00%	0.20%	1.20%	3.60%
2010	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q1	0.00%	2.00%	0.23%	1.00%	3.70%

PROJECTIONS OF FUTURE INTEREST RATES

The table below reflects current market expectations about interest rates at given points in the future. Implied forward rates are the most commonly used measure of the outlook for interest rates. The forward rates listed are derived from the current interest rate curve using a mathematical formula to project future interest rate levels.

IMPLIED FORWARD RATES

Years Forward	3-month LIBOR	1-year Swap	3-year Swap	5-year Swap	7-year Swap	10-year Swap
Today	0.60%	1.61%	2.15%	2.96%	3.40%	3.75%
0.25	1.59%	1.83%	2.41%	3.15%	3.55%	3.86%
0.50	1.87%	1.80%	2.60%	3.30%	3.69%	3.94%
0.75	2.31%	1.68%	2.79%	3.44%	3.76%	4.03%
1.00	1.51%	1.44%	2.95%	3.55%	3.85%	4.09%
1.50	1.41%	2.23%	3.42%	3.88%	4.10%	4.28%
2.00	2.84%	3.37%	3.96%	4.23%	4.36%	4.48%
2.50	3.50%	3.78%	4.22%	4.40%	4.49%	4.58%
3.00	3.71%	4.09%	4.39%	4.51%	4.58%	4.65%
4.00	4.63%	4.44%	4.60%	4.65%	4.70%	4.73%
5.00	4.41%	4.64%	4.69%	4.72%	4.76%	4.77%

HEDGING THE COST OF FUTURE LOANS

A forward fixed rate is a fixed loan rate on a specified balance that can be drawn on or before a predetermined future date. The table below lists the additional cost incurred today to fix a loan at a future date.

FORWARD FIXED RATES

Cost of Forward Funds

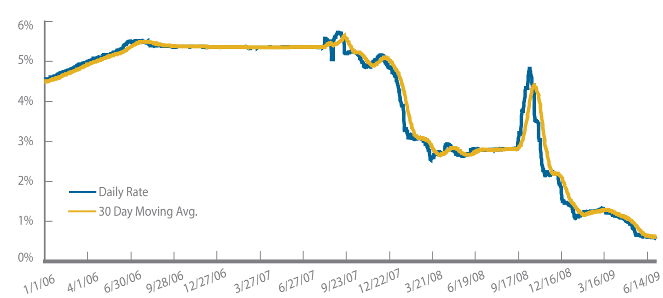
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	13	14	11	7
90	31	36	29	17
180	46	60	50	29
365	96	107	91	53

Costs are stated in basis points per year.

SHORT-TERM INTEREST RATES

This graph depicts the recent history of the cost to fund floating rate loans. Three-month LIBOR is the most commonly used index for short-term financing.

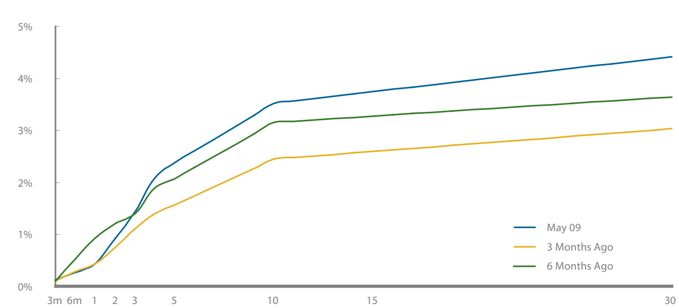
3-MONTH LIBOR



RELATION OF INTEREST RATE TO MATURITY

The yield curve is the relation between the cost of borrowing and the time to maturity of debt for a given borrower in a given currency. Typically, interest rates on long-term securities are higher than rates on short-term securities. Long-term securities generally require a risk premium for inflation uncertainty, for liquidity, and for potential default risk.

TREASURY YIELD CURVE



Cash Manager Helps CoBank Customers Control Assets

CoBank Cash Manager services are an increasingly important tool for many customers as they negotiate these uncertain economic times.

The Cash Manager customer base has increased about 20 percent in the last year, expanding into 44 states. Approximately 25 percent of all CoBank customers use the Cash Manager suite of tools to easily and efficiently manage their cash.

"Our strong growth over the last year speaks to the fact that CoBank Cash Manager gives businesses more control over their funds as well as saving them time and trouble," said Jim Fannan, CoBank's vice president of cash management and e-commerce. "During these trying economic times, controlling your cash is more important than ever."

CoBank Cash Manager services include the ability to deposit checks without leaving the office, which can improve funds availability by a day or more. It also gives users full access to ACH templates, making it easy, inexpensive and secure to schedule direct deposit payroll or collect monthly payments. Cash Manager integrates all collection and disbursement activity and automatically settles each day against other CoBank loans or investments. This saves time and ensures that funds are being used efficiently.

For more information about CoBank Cash Manager, contact your relationship manager or call 800-542-8072 x 45857.

CoBank Products and Services

- Tailored loan programs with short-, intermediate- and long-term maturities
- Cash management services
- Leasing through Farm Credit Leasing
- International banking services
- Loan participations and syndications
- Letters of credit
- Interest rate risk management services
- CoLink® online financial solutions
- Equity partnerships
- Private placements
- Tax-exempt bonds

A New "Outlook"

CoBank is pleased to introduce a new and improved Outlook publication for our customers, redesigned for electronic distribution. Each month, Outlook will continue to provide valuable data on interest rates and economic indicators, along with commentary from leading economics and public policy experts around the world. If you or others at your organization would like to be added to our distribution list, please contact your CoBank relationship manager.

About CoBank

CoBank is a $63 billion cooperative bank serving vital industries across rural America. The bank provides loans, leases, export financing and other financial services to agribusinesses and rural power, water and communications providers in all 50 states.

CoBank is a member of the Farm Credit System, a nationwide network of banks and retail lending associations chartered to support the borrowing needs of U.S. agriculture and the nation's rural economy. Headquartered outside Denver, Colorado, CoBank serves customers from regional banking centers across the U.S. and also maintains an international representative office in Singapore. For more information about CoBank, visit the bank's web site at www.cobank.com.