OUTLOOK Economic Data and Commentary

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Outlook for the U.S. Dollar

Is the world really ready to abandon the U.S. dollar as the staple of the global economy?

The short answer is no. But the recession that began in the United States and spread globally has prompted several nations to openly question whether the dollar – or any one nation's unit of currency – should play such a prominent role. Central banks around the world hold more U.S. dollars in reserve than any other foreign currency, with euros a distant second.

The debate gained renewed attention in March, when the Chinese government released an essay written by the head of the nation's central bank, Zhou Xiaochuan. He called for eventually phasing out the dollar as the dominant reserve currency. Russia backs this view, and in August, French President Nicolas Sarkozy said: "What was true in 1945 can no longer be true today. The dollar cannot claim to be the only currency in the world."

Some of those who call for moving away from the dollar as the global benchmark currency favor replacing it with a global unit of currency used by the International Monetary Fund. The unit, known as the SDR, or Special Drawing Right, is a "basket" of four currencies, with the U.S. dollar having the heaviest weight. The others are the yen, the euro and the pound.

A shift away from the dollar could have important implications for the American economy – especially for businesses involved in the import and export of commodities or manufactured goods.

OUTLOOK talked recently with Lex Rieffel, a Senior Fellow in the Global Economy and Development program with the Brookings Institution, about this issue. Rieffel, a former Treasury official, is an expert on international economic institutions and teaches a graduate course in emerging markets at George Washington University's Elliott School of International Affairs in Washington, D.C.

OUTLOOK: What does it mean from a practical standpoint to say that the dollar is the only "global" currency?

LR: For Americans, it means that our businesses can work in their own currency when conducting international transactions. There's a step in the process – the step of converting from one currency to another – that

American's don't have to deal with. For instance, when we buy oil, being able to do that in dollars means we don't have to pay fees required to convert currencies. We also don't have exchange-rate risk. If we had to pay for our oil in euros, then we would have to worry about what the dollar-to-euro rate would be in a month or six months, and it would raise the cost of purchasing oil.

OUTLOOK: When did the dollar ascend as the dominant currency in the world? Why?

LR: The starting point was really the period between World War I and World War II, when the U.S. became the world's dominant economy. It took off, though, after World War II, when the United States was spending money all over the world as part of the reconstruction and development effort. In 1945, for instance, the World Bank was created to assist in that process and to ensure that poorer countries have access to a reliable source of debt capital. Member countries were required to make their capital deposits in dollars. At the time, there was more purchasing power in the U.S. dollar than any other currency.

The other thing that happened after World War II is that we developed the world's deepest and broadest capital market. If any country in the world wants to borrow or lend in foreign currency, they have a choice between the best, second best or third best. Most choose to transact in dollars, because for historical reasons rooted in the size and dynamism of our economy, the dollar has been the first choice.

OUTLOOK: How does the supremacy of the dollar impact the world of commodities, including agricultural commodities and agricultural exporters?

LR: Agricultural commodities are like all other commodities, and there is an advantage to our exporters to price in dollars. If they were selling corn to China and had to price in euros or yen, then they would have to convert to dollars when they got paid. They would have to pay a fee for that conversion, which means they would lose money every time. With their corn priced in euros or yen, there would also be a lot of uncertainty about what the exchange rate would be every time they made an export sale.

There is conceivably a better alternative. It would be better for everybody, including Americans, if there were a single currency for the whole world.

OUTLOOK: What did Governor Zhou propose in his essay back in March and the following month at the G20 summit in London?

LR: He expressed concern that a world economy that is as dollar-based as it is today is not in China's interest and might not be in the interest of the world more generally. Although he didn't spell out specifically what the alternative

About this interview

Lex Rieffel is a senior fellow at the Brookings Institution, specializing in the global economy and development. He is a former U.S. Treasury official and teaches a graduate course at George Washington University.

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would be, you could read between the lines that he was thinking about something like the SDR. Subsequent statements made by China's officials have also pointed in that direction.

OUTLOOK: What is an SDR? Why was it created and how is it used?

LR: First of all, the SDR is simply a unit of value, an accounting unit, used by the IMF to value transactions. This unit of value is composed of a basket of four currencies. At the end of every day, the IMF looks at the market exchange rates for these currencies and announces the value of the SDR for the next day.

One example of how the SDR is used can be seen in the capital contribution each country makes when it joins the IMF. Those capital contributions are denominated in SDRs. Twenty-five percent of each country's capital contribution must be paid in some combination of the four basket currencies. The remaining 75 percent is paid in each country's own currency. The IMF uses the currencies to make loans to member countries in need of balance-of-payments financing. If Turkey, let's say, needs a loan from the IMF, it will be denominated in SDRs. But Turkey will actually receive the specific currencies it chooses equivalent to the SDR value of its loan.

Much of the confusion about the SDR arises because the IMF has also – separately from using the SDR as a unit of value – created a stock of synthetic currency, labeled it the SDR and distributed these SDRs to its members. These allocated SDRs can only used by the IMF, the central banks of countries that belong to the IMF and a small number of international organizations. These SDRs do not circulate in the global economy. They are figures in a ledger. There are no SDR bills, notes or coins.

OUTLOOK: The Chinese essay sparked debate over the past few months about whether the dollar should have such a prominent role in the global economy. Why? What are the reverberations?

LR: This debate did not start a few months ago with the Chinese governor's comments. People have been talking about it for years, especially the possibility that the euro might replace the dollar. We are just seeing the latest phase of an old discussion.

FOREIGN RESERVES IN U.S. DOLLARS

Rank	Country	Billion USD
1	China	$ 1,968.4
2	Japan	$ 1,011.0
3	Russia	$ 427.1
4	Taiwan	$ 296.4
5	India	$ 256.4
6	South Korea	$ 201.2
7	Brazil	$ 193.8
8	Hong Kong	$ 182.5
9	Singapore	$ 174.2
10	Algeria	$ 143.5

Data as of December 31, 2008

Source: CIA World Factbook

Back in the 1970s, the United States had a serious inflation problem and a long-standing policy of valuing the dollar based on the gold standard. We chose to abandon the gold standard and to move to a floating exchange-rate system. Because of the size of the U.S. economy and the role of the dollar, when we moved the rest of the world had to move with us. Back then, experts were seriously considering creating a substitution account, where dollars could be converted into a more broadly based substitute, making international reserves and international transactions less dependent on a single currency. But the U.S. eventually got inflation under control, and over the next 30 years we were able maintain confidence in the strength and purchasing power of the dollar.

As this issue has resurfaced recently, the response of the U.S. government – and the rest of world – has been all over the map. One group of experts argues that it is totally unrealistic for any currency or currency basket to replace the U.S. dollar in the near term, which we might say is three to five years. Another group of equally reputable experts argue that it would not be all that difficult to move toward an international monetary system based on a currency basket like the SDR.

OUTLOOK: In your opinion, is it realistic to think the SDR or another currency could replace the dollar at some point in the future?

LR: I cannot imagine that the global economy 100 years from now will be based on the U.S. dollar. I would hope that, before then, the nations of the world will figure out how to operate with a single currency, because that has some huge advantages. But how do we get there from where we are now, and if it's not based on the U.S. dollar, what will it be based on?

In my mind, there are two possible paths: One is the evolutionary path and the other is the crisis path. If an evolutionary path is followed, my best guess is that a global currency will materialize in closer to 50 years than 100 years. But if there's some kind of global breakdown – bigger than the global financial crisis we are having now – then it could happen sooner.

There was a moment a year or so ago when the world economy was in free fall, and people were talking about a Depression-like situation. It looks like we avoided that fate. But if we were still in that kind of free fall today, then I believe we would be a step closer to talking about replacing the dollar. In effect, the United States would have to mis-manage its economy so badly that everybody, even Americans, would lose faith in the dollar and prefer to hold euros, yen or even Chinese renminbi. It's really a question of having an attractive alternative. Right now, even given the recent turmoil in the international economy, there is no great alternative, and it is hard to imagine one emerging any time soon.

OUTLOOK: What are the advantages of this kind of global currency?

LR: The huge advantage is certainty. You remove exchange-rate risk when exporting or importing goods and services or when investing in other countries. As long as the new currency is not inflating, it would provide a wonderful incentive to save and invest more wisely and efficiently.

Just imagine choosing between investing in Brazil or Nigeria. If your investment was going to be repaid in Brazilian real or Nigerian naira, the company would have to guess how the exchange rates for these currencies will evolve over the lifetime of the investment. If both countries were using a single currency, like the SDR, then the company wouldn't have to guess about future exchange rates; it could calculate more easily which investment option would be best.

The other big difference is inflation. One thing we know about all currencies is that they tend to inflate. If we had a global currency, it would have to be designed to be inflation proof. If businesses and households don't have to worry about inflation, then a major source of pressure to spend any money earned disappears. They can be confident that the value of the money they earn will be the same 10 years from now. As a result, they will save and invest more, do it more efficiently and incomes will rise more quickly.

OUTLOOK: How would the U.S. economy be affected under this kind of system?

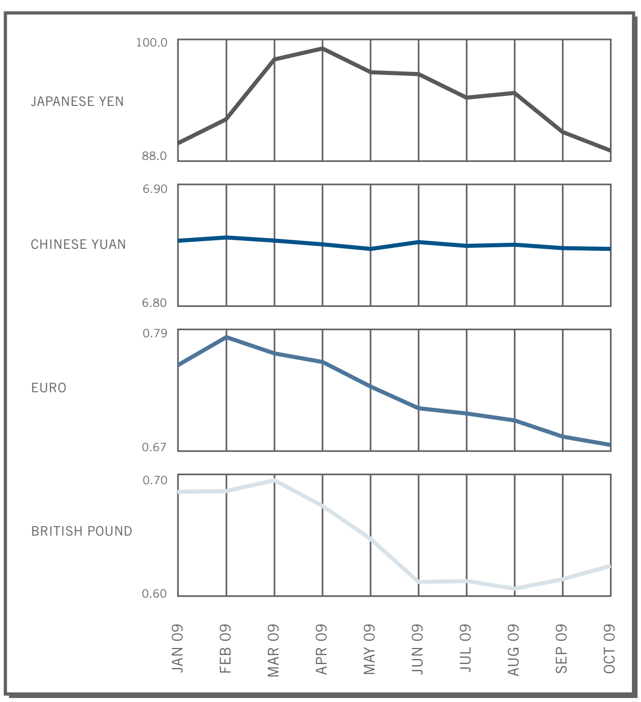
LR: It seems clear that one of the sources of instability in the global economy is payment imbalances that are related to incompatible exchange-rate policies among countries. Since a global currency would be a stabilizing force, then it should be in the U.S. national interest to have one. In a world with a single currency, it is not possible to have the kind of global payment imbalances we have now.

The negative side of this policy choice is losing an instrument of policy. The exchange rate is an instrument often used to manage economic growth. If a country's economy is contracting or not growing as rapidly as desired, allowing the currency to depreciate can boost employment and growth. However, if every country tries to do this at the same time, nobody wins and everybody loses.

OUTLOOK: What would be the impact of a global currency on the commodity industries?

LR: The fundamental drivers for commodity industries are supply, demand, processing costs and transportation. I don't see a big difference between having commodities priced in dollars, SDRs or some other currency in the future. Perhaps it would elevate the importance of transportation costs.

FLUCTUATION IN VALUE PER 1 USD, 2009



Source: www.xrates.com

OUTLOOK: U.S. monetary and fiscal policy has been a significant factor in the global economic downturn. Has that eroded international confidence in the dollar and sparked the increased discussion about moving to a different global currency?

LR: This crisis has done something that's irreversible: It's made the entire world less confident in the ability of the United States to manage its own economy. The only way to correct that impression and increase our political capital is to pull up our socks and show that we can manage our affairs. We will have to prove that we can reduce our fiscal deficit and deal with other serious problems, such as having more than 40 million citizens without health insurance. We will have to make our economy look strong again to the rest of the world. Many Americans do not understand how much the rest of the world has improved relative to the United States. Thirty years ago, only a few countries did not view the United States as a model. That's changed. Now many are questioning the U.S. system.

OUTLOOK: Is this the right time politically and economically to be discussing or pushing for a global currency?

LR: I see a lot of merit in starting to discuss the issue, but it would be unwise to try to move to an SDR-based system in the next three to five years. Consider the euro. It took 10 years for the Europeans to move from entirely separate currencies to the euro. To be done well, it would take at least that long, if not twice that long, for the world to move step by step, carefully, toward an SDR-based system.

Right now, the euro is the only serious multi-country currency in the world. One step toward getting people comfortable with a new global currency could be to develop other regional currencies – an Asian currency or a Western Hemisphere currency. That would make it easier to then take the next step and transition to a global currency. **OL**

Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 9/30/09. 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

Source: Insight Economics, LLC & Blue Chip Economic Indicators

				US Treasury Securities	
2009	**GDP**	**CPI**	**Fed Funds**	**2-year**	**10-year**
Q2	-1.00%	1.30%	0.18%	2.20%	3.30%
Q3	3.00%	2.70%	0.16%	2.50%	3.60%
Q4	2.40%	1.80%	0.19%	2.50%	3.70%
2010	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q1	2.50%	1.60%	0.23%	2.50%	3.80%
Q2	2.70%	1.60%	0.25%	2.70%	4.00%
Q3	2.70%	1.90%	0.62%	3.10%	4.20%

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	0.29%	1.26%	1.88%	2.65%	3.10%	3.45%
0.25	0.93%	1.51%	2.13%	2.84%	3.24%	3.56%
0.50	1.64%	1.60%	2.35%	3.01%	3.37%	3.66%
0.75	2.09%	1.51%	2.52%	3.14%	3.47%	3.73%
1.00	1.33%	1.31%	2.68%	3.26%	3.56%	3.80%
1.50	1.30%	2.03%	3.12%	3.56%	3.79%	3.99%
2.00	2.57%	3.05%	3.61%	3.90%	4.04%	4.18%
2.50	3.16%	3.42%	3.85%	4.07%	4.17%	4.28%
3.00	3.35%	3.70%	4.03%	4.18%	4.26%	4.35%
4.00	3.80%	4.08%	4.27%	4.34%	4.39%	4.45%
5.00	4.08%	4.30%	4.39%	4.43%	4.48%	4.51%

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

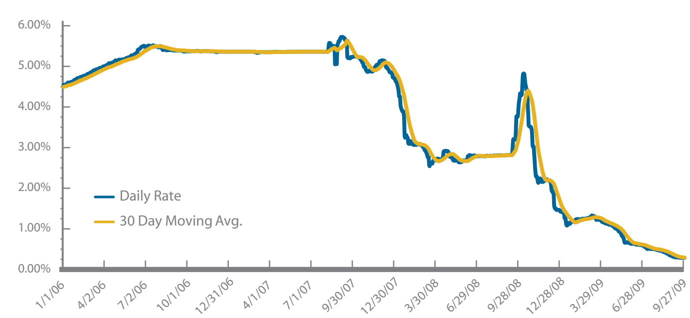
Forward Period (Days)	Average Life of Loan 2-yr	3-yr	5-yr	10-yr
30	11	12	10	7
90	30	32	28	16
180	49	57	50	29
365	89	97	88	50

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.

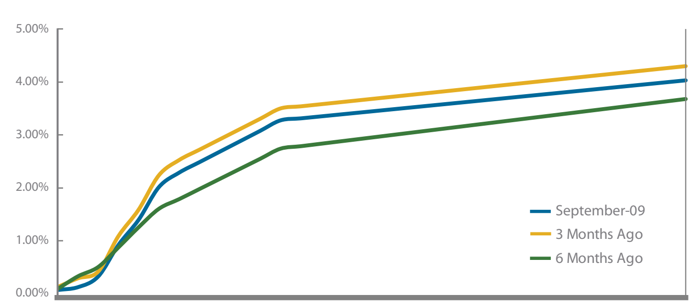
3-MONTH LIBOR



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



Cobank Announces Board Election Results

CoBank recently announced results of shareholder elections for the bank's 2010 Board of Directors.

Gene Batali was re-elected to the board in CoBank's Western Region. Batali, who has served on the board since 2007 and also served from 2003 to 2005, is the owner of Batali Ranch, a diversified mint farming operation in Yakima, Washington.

Shareholders in the bank's Central Region re-elected Daniel Kelley. Kelley has been a bank director since 2004 and also serves as the board's first vice chairman. He is the owner and operator of Kelley Farms, a 3,000-acre corn and soybean operation in Normal, Illinois. Kelley is also the chairman and president of GROWMARK Inc., an agricultural and energy cooperative that operates throughout the midwestern U.S. and parts of Canada.

Scott Markham was elected to the board from the bank's Eastern Region. Markham is the owner and operator of Markham Farms, a dairy farm in Constableville, New York. He succeeds Sheldon Brown, who is retiring from the board in December.

"Gene, Dan and Scott are all remarkably qualified, experienced and dedicated individuals with a deep understanding of the opportunities and challenges facing rural America today," said Everett Dobrinski, chairman of the CoBank board. "They are fully committed to CoBank's success and will make significant contributions to the board throughout their upcoming terms. I look forward to working with them, along with the rest of the board and CoBank's executive team, to continue fulfilling CoBank's mission of serving as a dependable source of credit for rural America's vital industries."

Dobrinski also praised Brown for his 11 years of service to CoBank. "Sheldon has been a tremendous asset to our board during a period of remarkable growth and change for the bank and its customer base," he said. "We are deeply grateful for Sheldon's many contributions and wish him continued success in the future."

Batali, Kelley and Markham will all serve four-year terms that begin in January 2010.

CoBank's 16-member board of directors reflects the bank's national scope and the diverse industries it serves. Members include agricultural producers, agribusiness leaders and representatives from the energy and communications sectors. Twelve directors are elected by shareholders from three geographic regions covering all 50 U.S. states. The remaining board members are appointed to their seats. All directors serve four-year terms.

The bank uses an independent nominating committee to develop a slate of qualified director candidates. No current board member may serve as a member of the nominating committee. No member of management sits on the CoBank board.

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. In addition to serving its direct borrowers, the bank also provides wholesale loans and other financial services to affiliated Farm Credit associations and other partners across the country.

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.