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OUTLOOK Economic Data and Commentary

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The Economic and Political Outlook for the Middle East and North Africa

About this article

Isobel Coleman is a senior fellow at the Council on Foreign Relations in New York City and director of the Council's Civil Society, Markets and Democracy Initiative. She is the author and co-author of numerous publications, including *Restoring the Balance: A Middle East Strategy for the Next President*, which was published in 2008.

Recent events in Tunisia and Egypt represent a potentially seismic shift in the Middle East, with thousands of protesters taking to the streets to oppose autocratic regimes that had been in power for decades.The tumult may represent a new wave of democracy in the region.

At the same time, however, the protests may augur an era of instability in a key, strategically important part of the world where many of the people hold less-than-benign views of the United States and global capitalism. A new wave of anti-American sentiment could spread in the region even as democracy takes root.

To get a sense of both the risks and the opportunities, OUTLOOK spoke with Isobel Coleman, a senior fellow at the Council on Foreign Relations in New York City. She is director of the Council's Civil Society, Markets and Democracy Initiative. She is the author and co-author of numerous publications, including *Restoring the Balance: A Middle East Strategy for the Next President*, which was published in 2008.

OUTLOOK: Characterize the importance of the Middle East and North Africa from an economic and international trade standpoint.

Isobel Coleman: The Arab world – which stretches from North African countries like Morocco west to the Arabian Peninsula – is a large region of about 350 million people. The broader Middle East also includes the large economies of Turkey in the north and Iran in the east, which are not Arab. The people of Turkey are Turkish – they speak a different language and ethnically are related to China's Uighurs. Iranians are Persians and speak Farsi. When you include Iran and Turkey, it brings the population of the overall Middle East region to nearly half a billion people.

The region has one of the youngest demographics in the world, a very, very high percentage of young people, which is important in economic terms because young people are workers – or should be workers. North Africa is literally on the back doorstep of Europe, which is rapidly aging. So

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you have had a fair amount of migration from North Africa to Europe. There are a lot of Turks living in Germany, and lots of North Africans from Tunisia, Algeria and Morocco living in France. So you have a lot of demographic integration between Europe and this part of the world.

Of course this is also a part of the world that has oil. The Arabian Peninsula is home to Saudi Arabia, which has the largest known reserves of oil in the world, and more importantly, reserves that are the easiest to access. Iraq also has very large oil reserves, as does Iran. And some of the other Gulf countries, Qatar in particular, have large natural gas reserves. Lastly, it's a very economically important transit route through the Suez Canal.

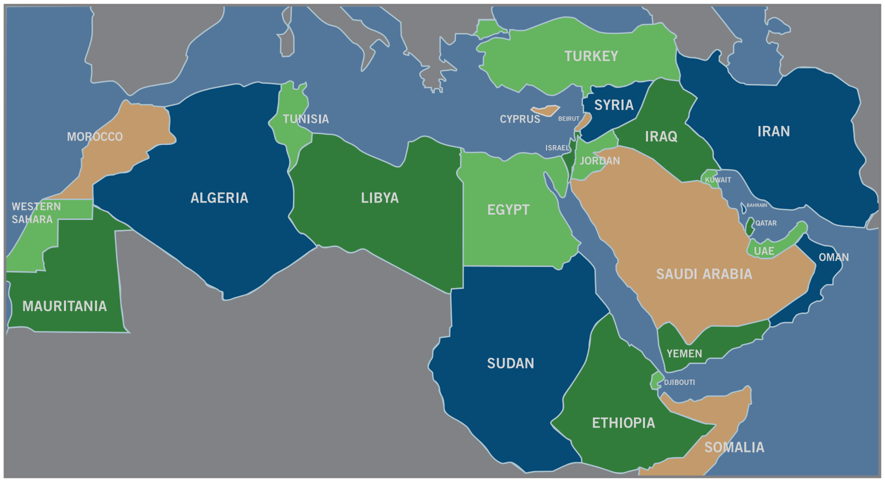
OUTLOOK: What is the range of economic development in this region?

IC: The Arab world – excluding Turkey and Iran – has 350 million people but has an economy only the size of Spain and Portugal, which have a combined population under 60 million. The economy of the Arab world has operated way below its potential. In spite of, or maybe because of all the oil, it has a relatively small economy as a region.

This is also a region with enormous disparities in terms of wealth, in terms of Gross Domestic Product (GDP) per capita and in terms of overall development. The poorest country in the region is Yemen, which has a GDP per capita of about $2,600, similar to sub-Saharan African countries. Then you've got countries like Qatar, which as of 2010 has the world's highest GDP per capita of $145,000. There are huge, huge differences. Countries like the United Arab Emirates and Saudi Arabia to some extent have rapidly modernized and their cities have all the trappings of the most modern cities – flashy new skyscrapers, fancy restaurants, Rolls-Royce dealerships. And then you have countries like Yemen, where outside of Sanaa, the main capital, it's pretty barren. In a country like Egypt, with more than 80 million people, somewhere around 20 percent of the population, according to the World Bank, lives below the poverty line and 40 percent of the population lives on less than $2 per day.

Even within the developed countries, there's a lot of economic inequality. In a country like Saudi Arabia, you have such enormous wealth concentrated among the elite, the royal family broadly defined. We're talking über wealthy – private planes, mansions, incredible control over resources. The

THE MIDDLE EASTERN AND NORTH AFRICAN REGION



average Saudi isn't poor by African standards or by Yemeni standards. Yet GDP per capita is around $24,000. On the surface, that appears to be catching up with Western standards, but it is more a testament to the extreme wealth of elites than to high living standards of the general populace.

OUTLOOK: What are the main exports, aside from the energy sector, from this region?

IC: The region's biggest export, frankly, is labor. Over recent decades, you've seen Egyptians and Yemenis export their labor to the booming countries of the Gulf, where they've built much of the infrastructure, educated much of the next generation, and treated their sick as doctors.

Some countries have built up textiles as part of their economy. Tunisia has a relatively strong textile sector. Egypt grows cotton and also has textile exports. And tourism is one of the biggest parts of Egypt's economy. It's also true in Morocco, Tunisia, Jordan and Turkey to some extent.

Turkey is the most diversified and advanced economy in the region. It's got a very active manufacturing sector, a strong service sector and is increasingly exporting around the world, not only to Europe but also to Africa and increasingly to emerging markets in Central Asia. Historically, Iran has had a much more robust and diversified economy than other countries in the region, but economic sanctions imposed in recent years have really taken a toll on that country and its economy.

OUTLOOK: How market-oriented are Middle Eastern and North African economies?

IC: You can characterize them as having been state-controlled for the most part, but they have also gone through a period of economic liberalization in the past 10 to 15 years, a trend that really accelerated in the last 5 to 10 years. A country like Saudi Arabia, which is very state-oriented, joined the World Trade Organization in 2005. It had to meet certain criteria as part of that process to open up its economy, to become more transparent, to reduce bureaucracy and to implement more rule-of-law standards. Egypt has also been going through a period of economic liberalization, deregulating its economy, reducing tariffs, cutting back on bureaucracy, creating incubators for startup companies and really trying to be more entrepreneurial. Morocco has been doing more of the same. Tunisia has been more of a business-friendly environment than some of these countries. It's a small country with just over 10 million people, and on a per-capita basis, it's been one of the highest recipients of direct foreign investment, a reflection of its more business-friendly environment. Part of the problem across many of these countries has been endemic corruption.

OUTLOOK: Tell us about the recent turmoil we've seen in Egypt and Tunisia and what's driving that.

IC: I think this was unrest that was building for a very long time. Why did it happen right now? We can retrospectively point to a number of factors. In Tunisia you had Mohamed Bouazizi, the street vendor who had his cart taken away, and in an act of desperation set himself on fire back in December. Social media kept that story alive – there was video of him and there was a Facebook page of him. Al Jazeera covered his death and the subsequent protests. That kept the spotlight on it, and it just built and built and built. I'm not saying social media caused it – it just played a role in sparking civil unrest over bigger long-standing issues such as unemployment, food inflation, corruption, freedom of speech and poor living conditions. The ensuing riots and demonstrations led to the very abrupt, and in many ways completely unforeseen, demise of one of the most hard-fisted, autocratic regimes in the region, of Tunisia's Ben Ali. Revolutions are not created out of despair, they're created out of hope. And it gave hope to people throughout the region – "Hey, they did it in Tunisia, we can do it here." You saw pressures begin building around the region, particularly in Egypt.

The Egyptian population has been fuming for many years under Hosni Mubarak's very autocratic, oppressive regime, which has denied people their basic freedoms. The people of Egypt are just sick of it, and there's a longing for something better. Tunisia gave people hope, and Facebook and Twitter gave people means to organize. It's not like this is new; tension has been bubbling in Egypt for years. For instance, what's going on today is an outgrowth of civil unrest that started three years ago, where you had rising commodity prices and rising food prices across the board, and people out demonstrating in the streets. But it didn't catch hold then. In November of last year, though, you had a parliamentary election in Egypt where there was no pretense by the government to even give a nod to political reform, openness and democracy.

MIDDLE EAST AND NORTH AFRICA ECONOMIC REPORT

GDP GROWTH

Country	2008	2009e	2010e	Country	2008	2009e	2010e
Algeria	3.0%	2.1%	3.7%	Oman	7.8%	4.1%	3.8%
Bahrian	6.3%	3.0%	3.7%	Palestine	2.3%	5.5%	6.5%
Egypt	7.2%	4.7%	4.5%	Qatar	16.4%	11.5%	18.5%
Iraq	9.8%	4.3%	5.8%	Saudi Arabia	4.4%	0.2%	3.0%
Jordan	7.9%	3.0%	4.0%	Sudan	6.8%	4.0%	5.5%
Kuwait	4.4%	-1.5%	3.3%	Syria	5.2%	3.0%	4.2%
Lebanon	8.5%	7.0%	4.0%	Tunisia	4.6%	3.0%	4.0%
Libya	6.1%	1.8%	5.2%	UAE	7.4%	-0.2%	2.4%
Morocco	5.6%	5.0%	3.2%	Yemen	4.7%	4.2%	7.3%

Source: IMF

"This is a part of the world that's very dependent on other parts of the world for its food.

You had such narrowly defined terms to allow who could run, a very, very low voter turnout – by some measures just 5 percent – and you had the ruling party win in excess of 90 percent of the vote. And I think people were just so fed up and so demoralized. They'd had Mubarak in power for 30 years, and it looked like they'd be steamrolled into another election where Mubarak would be president for five more years, or somehow, his son would be positioned to be president. People spoke with despair of "60 years of Mubarak."

OUTLOOK: You mentioned food and commodity prices as a problem for Egypt. Please talk about their role in this current crisis and whether commodity prices could play an impact in other nations if they continue to rise.

IC: This is a part of the world that has enormous trouble feeding itself. If you look at the Arabian Peninsula, Saudi Arabia is a country of about 28 million people and it's mostly desert. It really doesn't have much in the way of agriculture. Now, the Saudis are very rich, so they've gone down the path of attempting to achieve more food security through desalinization plants that pipe water in for desert agriculture. None of it's really worked – they've been huge white elephant projects that produced $600 lettuce. Those efforts have largely been abandoned.

Yemen is a country of 25 million people on the Arabian Peninsula and they're rapidly running out of water. One of the few things they do produce is qat, the chewing stick that's a natural narcotic. They used to grow various other agricultural products, but unfortunately much of that has given way to the growing of qat, which is highly water-intensive. That exacerbates the water shortage.

And Egypt is a desert country. If you fly over the country, it's just endless desert, with a green strip of the Nile down the middle. Egypt is the largest wheat importer in the world – a population of 80 million people, and it has to import most of its grain. In fact, six of the world's 10 top wheat importers are Middle Eastern countries, so this is a part of the world that's very dependent on other parts of the world for its food. In 2008, you had rapidly rising food prices for a variety of reasons – drought in Australia, increased demand in Asia, and a reduced harvest in Russia – and poor populations in the Middle East are very vulnerable to rising commodity prices. We're seeing some of the same dynamics today as commodity prices are rising again. Additionally, you've had rapid urbanization in that part of the world – a quarter of Egypt's population lives in greater Cairo.

> I think what's happened in Tunisia and Egypt is the beginning of a complete reworking of the political landscape of the Middle East.

These have become very urbanized countries, and they need to import a lot of food. And outside of the Gulf countries, they have to import all of their oil, too – the oil is concentrated in a few countries. Egypt has a little bit of oil, but it needs to import.

OUTLOOK: What has happened to oil prices due to the unrest in the Middle East?

IC: You did see an uptick in oil prices around the instability in Egypt, but they didn't go up that much, and I think the concern was more related to fears of the Suez Canal being closed. About 5 percent of the world's oil goes through the Suez Canal, and if that were closed, oil being shipped to Europe and the United States would have to go around the tip of Africa, adding time and cost to oil deliveries. But I think the markets seemed to be taking it a little more in stride. But if we see unrest spreading to Yemen, because it's on the Arabian Peninsula, it would make people very nervous – if Yemen, then possibly Saudi Arabia, then what's next? So I think there's potential volatility there if people think it's going to spread.

OUTLOOK: What's the potential economic impact on the United States of what has been going on in Egypt and Tunisia?

IC: Clearly, the biggest issue would be instability that has an impact on the price of oil. A spike in oil prices could lead to inflationary pressure and become an obstacle to broader economic recovery. But, again, we haven't seen that so far. In terms of the overall U.S. economy, we export far, far more to our largest trading partners – Canada, Mexico, Latin America, Europe and Asia – than we do to the Middle East. One place that's not true is that the Middle East is a huge military market for the U.S. The largest arms deal in American history is being concluded now with the Saudis, $70 billion over some years. We've been giving Egypt about $1 billion in military aid every year, and they turn around and buy a lot of military hardware from us with that.

We also sell a lot of wheat to Egypt and Saudi. In general, the Gulf countries are export markets for us in terms of agricultural commodities and manufactured goods. But the region is not a huge trading partner, accounting for barely over 5 percent of U.S. exports. Tunisia is not even within the top five export markets for the U.S. within the Middle East. Before all this instability happened, the Middle East was looked at as a promising emerging market, Egypt in particular.

> Democracy would produce governments that by definition are more responsive to their people. But that may not be a benefit for the United State's strategic interests in the region.

Not in the first tier of emerging markets, but clawing its way into the second tier, on par with Colombia, Indonesia and Vietnam in terms of potential – with a lot of caveats. The instability throws that in to doubt. But Egypt has got to import wheat.

OUTLOOK: Things are moving very fast right now and instability has spread to other countries in the region. Do you expect that to continue and what is the potential impact?

IC: This has been a humbling couple of weeks because so many people have been wrong about what is going on and what is going to happen. It's hard to predict, but I think what's happened in Tunisia and Egypt is the beginning of a complete reworking of the political landscape in the Middle East. I think we're at the very beginning of that transformation. It's unclear even what's going to emerge in Tunisia. There's going to be a new government, but what it's going to look like and how well it will be able to meet the aspirations of its people remains to be seen.

In Egypt, we could end up with an even more repressive version of the Mubarak government, with cronies of his who perpetuate the existing system. Or not. I think it's clear the military is not going to roll over and the outcome is much more unclear. Is there the possibility for instability to spread? I think there is. This part of the world is a powder keg, whether it's Egypt, Tunisia or Iran. Remember, it was a year and a half ago that there were millions of people on the streets in Iran's major cities demonstrating against the government. Iran's government used enormous repression to put that down, but those people are still there and those aspirations are still there. What could set that off again? I don't know, but it's possible.

OUTLOOK: Even if you do see these autocratic countries become more democratic, will it produce leadership that is friendly to the United States?

IC: Democracy would produce governments that by definition are more responsive to their people. But that may not be a benefit for the United State's strategic interests in the region. Throughout the Middle East, most of the people don't like American foreign policies and they will make that quite clear. This isn't unique to the Middle East. We've had strong dictators in power who have been closely allied with the United States before, and when they have left office and a more representative government has come in, "I think the best outcome for the people is to have a transition to a more representative government, but one with enough maturity in the system to protect minority rights.

you've seen pushback on U.S. policies. In recent years that can be seen in Korea, where a more democratic system there has distanced itself from the U.S. because they've got people with deep anti-American feelings; or in the Philippines, where there was a demand for U.S. military bases to be renegotiated; or in Turkey. Many countries in the Middle East look to Turkey as a model. In that country, you've seen a close, strategic U.S. ally become much more democratic and be forced by its people to stand up to the U.S. During the run-up to the invasion of Iraq for instance, the Turkish government said, 'We're not going to allow you to position your troops here, and we're not going to allow transit through our territory for the invasion of Iraq.' They said no because they knew how deeply unpopular it was with their people. So it's easy to see that more democracy will lead to more policies that are less acquiescent to the United States.

OUTLOOK: What's the best outcome for the people of these countries?

IC: I think the best outcome for the people is to have a transition to a more representative government, but one with enough maturity in the system to protect minority rights. I think that's what the main issue is – the fear in these countries always is 'one man, one vote, one time.' The fear is that some group is going to use the democratic process to come to power and throw democracy back in the basement and pull up the drawbridge. You need the building blocks of democracy and civil society to ensure that doesn't happen. Does Egypt have those building blocks? In some respects it does and in others it doesn't.

So I think the best thing that can happen is a strong, fair guiding hand that can take the country through a process of constitutional reform and amendment that creates a better framework for true, representative government. You need to have increasing civilian control over the military and some of the other building blocks: freedom of the press, rule of law, transparency. But whoever is in charge in any of these countries needs to have sound economic policies. The people of Egypt desperately need jobs and economic growth, and in a young, immature democracy, you run the risk of very self-destructive, populist economic policies. That would be very devastating for a country like Egypt.

OUTLOOK: What does all this mean for Israel, our closest ally in the region?

IC: It's hard to say. The regime in Egypt goes back prior to Anwar Sadat, who forged peace with Israel. It was a very brave and courageous thing he did, but he lost his life for it because it's never been popular with people in Egypt.

"The United States has less influence on the course of events than most people in America might imagine.

It's been a cold peace, not a warm peace by any means. Will a new more representative, democratic government come under pressure to renege that agreement? Undoubtedly. Will it actually do it? It could if there's an extended period of turmoil in Egypt with moderates pushed to the sidelines and more radical voices taking center stage, really appealing to populist tendencies on the political and economic extremes. That could mean ripping up the peace treaties with Israel. I can certainly imagine a young democratic government responding to populist pressures to have a lot of fiery rhetoric on that topic. People in the street might cheer that. I'm hoping more practical, pragmatic voices will prevail. I don't see Egypt gaining any benefit from going to war with Israel or abrogating the peace treaty, and right now that seems to be the prevailing sentiment in Egypt too.

OUTLOOK: What do you think of the United States' response?

IC: I certainly wouldn't give the Unites States an "A" on this. The U.S. government apparently was really surprised by what happened and had not done scenario planning on this particular turn of events. That is surprising to me, because many people have been warning that Egypt is a powder keg. The U.S. also seemed to vacillate at times, giving mixed messages from 'the transition needs to start immediately' to 'well, Mubarak sticking around can assure stability and can be part of that transition.' So it wasn't clear to the American people, it wasn't clear to Egyptians, and I'm not sure how clear it was to Mubarak himself. That said, I think the United States also had limited influence. The U.S. was not in a position to support Mubarak such that he could stay, since there millions of people in the street, and it was not in a position to kick him out either.

The United States was trying to juggle various interests here, from Obama's interest 'to be on the right side of history' and yet not abandon a stalwart ally. So it came across as giving mixed messages. It makes one wonder how much we really knew about what was going on in Cairo, or who we were getting our signals from. It was clearly a very fluid situation, and the United States seemed very often to be reacting, and behind the eight ball, as opposed to understanding what was going on so it could be out in front. It shows the limits of U.S. power.

Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 1/31/11. 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	
2010	**GDP**	**CPI**	**Fed Funds**	**2-year**	**10-year**
Q4	3.20%	2.20%	0.19%	0.50%	2.90%
2011	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q1	3.20%	2.00%	0.20%	0.70%	3.40%
Q2	3.30%	1.50%	0.20%	0.80%	3.50%
Q3	3.30%	1.80%	0.25%	0.80%	3.70%
Q4	3.50%	1.80%	0.25%	1.00%	3.80%

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	0.30%	0.44%	1.26%	2.18%	2.86%	3.46%
0.25	0.38%	0.54%	1.46%	2.36%	3.00%	3.57%
0.50	0.46%	0.69%	1.68%	2.58%	3.16%	3.71%
0.75	0.58%	0.89%	1.94%	2.80%	3.36%	3.84%
1.00	0.73%	1.14%	2.17%	3.01%	3.51%	3.95%
1.50	1.27%	1.68%	2.69%	3.40%	3.84%	4.22%
2.00	1.81%	2.20%	3.14%	3.77%	4.11%	4.44%
2.50	2.31%	2.72%	3.55%	4.06%	4.34%	4.60%
3.00	2.82%	3.23%	3.96%	4.34%	4.58%	4.76%
4.00	3.67%	4.06%	4.52%	4.75%	4.89%	4.99%
5.00	4.28%	4.64%	4.87%	5.02%	5.12%	5.19%

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

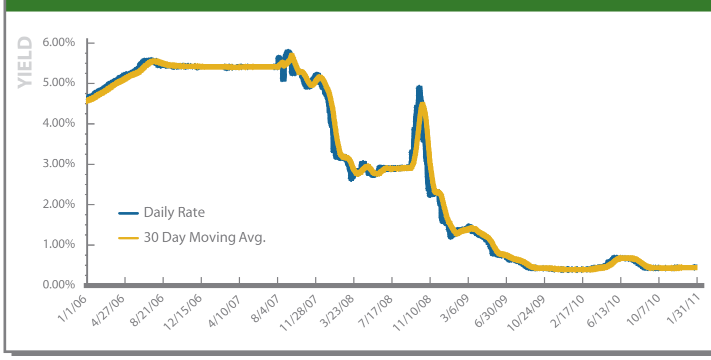
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	8	9	9	7
90	20	24	25	17
180	37	46	48	32
365	38	101	97	63

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.

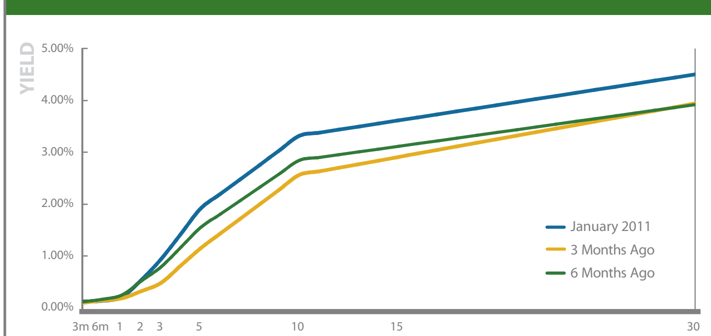
3-MONTH LIBOR



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 Reports Full-Year Financial Results for 2010

Net Earnings Increase 8.6 Percent to $613.8 Million; Capital and Liquidity Levels Remain Strong

2010 Patronage Payments To Customers Will Total $284.6 Million

CoBank recently announced fourth-quarter and full-year financial results for 2010. Full-year earnings and net interest income reached record highs, and loan quality continued to improve throughout the year. CoBank's overall levels of capital and liquidity remained strong.

"We're exceptionally pleased with CoBank's business performance throughout 2010," said Robert B. Engel, president and chief executive officer. "Despite an economic environment that remains challenging and highly volatile, the bank continued to serve as a dependable source of credit for vital industries across rural America. In addition, our proposed merger with U.S. AgBank positions the bank as an even stronger financial institution for the long term. We remain focused on delivering on our value proposition for customer-owners, and on ensuring the bank can fulfill its mission for future generations."

2010 Financial Results

CoBank's full-year net income was a record $613.8 million, up 8.6 percent from $565.4 million in 2009. Net income for the fourth quarter of 2010 was $162.8 million, compared with $132.6 million in the same period in the prior year. Full-year net income reflected the benefit of refunds of Farm Credit insurance premiums paid in prior years, a lower premium in the current year, a lower provision for loan losses, and greater fee income. Those positive earnings drivers were partially offset by impairment losses in the bank's investment portfolio and other factors.

Average loan volume during 2010 was $45.5 billion, up 2.3 percent from the prior year. A key driver was higher seasonal financing requirements from agribusiness customers due to the sharp increase in prices for grains and other agricultural commodities that occurred in the latter part of 2010. The bank also increased its lending to rural electric distribution cooperatives around the country. Those increases were partially offset by lower levels of borrowing from customers in the rural communications industry, where

About CoBank

CoBank is a $66 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.

overall demand for debt capital remained weak. Average loans to other banks and associations in the Farm Credit System were essentially unchanged, reflecting relatively flat loan demand at the producer level of the U.S. farm economy. Total loan volume for the bank at December 31, 2010, was $50.0 billion, compared with $44.2 billion at the end of 2009.

“The recent spike in commodity prices has once again underscored the volatile nature of the global economy and the direct impact it can have on our agribusiness customers and our results,” Engel said. “We’re fortunate to have the capacity necessary to stand by our customers and to meet their borrowing needs in all kinds of market conditions.”

Full-year net interest income for CoBank rose 0.5 percent to $950.8 million, from $946.0 million in 2009. In the fourth quarter, net interest income increased 20 percent to $275.9 million, compared to $229.9 million the prior year, largely due to the increase in agribusiness loan volume cited above.

In March, the bank will pay $284.6 million in total patronage distributions, including $194.1 million in cash and $90.5 million in common stock. For most customers, that represents 100 basis points of average loan volume, lowering their overall net cost of debt capital from CoBank.

Engel noted that, over the past five years, CoBank has returned more than $1.3 billion in patronage to customer-owners around the country. “Strong, dependable patronage is an important component of the CoBank value proposition,” Engel said. “As a cooperatively organized bank, we’re delighted in the patronage payout authorized by our board this year and in delivering this benefit to eligible customers who choose CoBank as their financial partner.”

Credit quality in CoBank’s loan portfolio has improved as reflected in a number of credit quality indicators. At year-end, 1.71 percent of the bank’s loans were classified as adverse assets, compared to 1.88 percent at the end of the third quarter of 2010 and 2.17 percent at December 31, 2009. Nonaccrual loans and leases decreased in the fourth quarter to $167.0 million from $240.4 million at the end of the third quarter and $307.6 million at the end of 2009. For the year, the bank’s provision for loan losses totaled $60.0 million, compared with $80.0 million in 2009.

At year-end, the bank’s reserve for credit exposure totaled $500.5 million or 1.6 percent of non-guaranteed loans and leases outstanding when loans to Farm Credit associations are excluded.

“We continue to maintain a conservative posture with regard to loan loss reserves,” said David P. Burlage, CoBank’s chief financial officer. “Throughout the economic turmoil of the past few years, the bank and its customers have been well-served by that prudent approach, which has kept CoBank well protected from loan losses that can be expected in any economic downturn.”

Capital and liquidity levels at the bank remain strong and well in excess of regulatory minimums. At year end, the bank held approximately $14.5 billion in cash and investments. The bank averaged 240 days of liquidity during 2010, compared with the 90-day minimum established by the Farm Credit Administration (FCA), the bank's regulator. "For several quarters following the onset of the credit crisis, CoBank deliberately maintained higher levels of liquidity in order to ensure our ability to meet the needs of our customers," Burlage said. "More recently, as conditions in the credit markets and overall funding flexibility have improved, we have returned our liquidity position closer to our management target of 180 days." CoBank had 198 days of liquidity as of December 31, 2010.

During the year, the bank recorded $44.0 million in impairment losses on investment securities compared to $15.0 million in 2009. These impairments relate to the 4 percent of the bank's investment portfolio that consists of non-agency mortgage-backed securities or asset-backed securities. The remainder of the portfolio – approximately 96 percent – consists of securities that carry an implied or explicit guarantee from the U.S. government.

U.S. AgBank Merger Update

In December 2010, the CoBank and U.S. AgBank boards of directors unanimously approved a letter of intent to pursue a merger during 2011. Based in Wichita, Kansas, U.S. AgBank is one of the four other funding banks in the Farm Credit System. The combined bank would continue to do business under the CoBank name and remain headquartered outside Denver, Colorado, but it would maintain U.S. AgBank's existing presence and operations in Wichita and Sacramento, California.

The combined bank would have approximately $90 billion in assets and serve as a wholesale provider of financing to Farm Credit associations that provide credit and financial services to more than 70,000 farmers, ranchers and other rural borrowers in 23 states. It would also serve as a direct lender to farmer-owned agricultural cooperatives, other agribusinesses and rural electric, water and communications service providers throughout the country.

The merger requires the approval of CoBank and U.S. AgBank shareholders as well as the Farm Credit Administration. Since announcing the merger proposal in December, the banks have been conducting formal due diligence and preparing a comprehensive merger disclosure document, which will be submitted to the FCA for its review prior to distribution to shareholders later this year. FCA submission is scheduled for the end of March, with stockholder votes expected to take place in the summer. If stockholders endorse the transaction, the merger is expected to close on October 1, 2011.

"The merger of CoBank and U.S. AgBank will result in a bank that is better positioned to support agriculture and rural communities through all kinds of economic cycles, and we are very pleased with the progress we are making on the proposed transaction," Engel said. "The boards and management teams of both organizations are working together extremely well and are excited about the value the merger will create for our customer-owners. We strongly believe the merger will benefit all of our customers and position the bank as a safe, sound, well-diversified provider of credit to rural America for the long term."

Customer Meetings and 2010 Earnings Webcast and Conference Call

CoBank will provide information about the merger and its 2010 financial results at its upcoming series of regional customer meetings, which will take place in nine cities around the country between February and July of 2011. Managers and directors of any CoBank borrower are invited to attend these meetings, as are representatives of all Farm Credit institutions. For complete details about the meeting program, please visit the bank's meetings page at www.cobank.com/meetings.

In addition, the bank will hold its annual conference call and webcast at 3 p.m. Eastern time on Tuesday, March 1. The 60-minute call will feature a presentation of 2010 financial highlights, a merger overview and Q&A with CoBank executives.

To join via phone, call 866-362-4820 and use passcode 16622859. To join via the Internet, visit www.cobank.com and click on the "2010 Earnings Webcast" link at the top of the page.