COBANK

OUTLOOK Economic Data and Commentary

April 2013 Volume 10 Number 4

Growth Prospects For The U.S. Economy

On Friday, April 26, the government released the latest official growth statistics for the American economy. Gross Domestic Product for the United States expanded at an annualized rate of 2.5 percent in the first quarter of 2013, compared to 0.4 percent in the fourth quarter of last year and 2.2 percent for all of 2012. Despite the improvement, the number disappointed many economists and others who'd been hoping for a first-quarter growth rate closer to 3 percent. And more recent signs of deceleration – a so-called "spring swoon" – have dampened hopes that U.S. growth will significantly exceed 2 percent this year.

What about the longer term? Economist Donald Marron says the current rate of economic expansion is likely to remain typical for the foreseeable future. Marron, who served on the President's Council of Economic Advisers under George W. Bush, believes it will be difficult for the U.S. to sustain GDP growth of more than about 2.5 percent going forward, given an aging population and slow growth in the labor force. That said, Marron believes the economy has indeed turned a corner and is in far better shape than it was a few years ago.

Today Marron serves as director of the Urban-Brookings Tax Policy Center, a think-tank in Washington, D.C., that provides data and analysis on tax policy to policymakers, journalists, citizens and researchers. He has also served as acting director of the Congressional Budget Office and as executive director of Congress's Joint Economic Committee. Previously, he taught economics at the Georgetown Public Policy Institute and the University of Chicago School of Business. He holds a bachelor's degree in mathematics from Harvard University and a doctorate in economics from the Massachusetts Institute of Technology.

OUTLOOK: Characterize the current state of the U.S. economy.

DM: It depends on the time horizon you choose. If you look at what the U.S. economy is producing today and you compare it to what would have been a reasonable aspiration in the years leading up to the Great Recession, there's still about $1 trillion dollars per year that's "missing" in terms of GDP. U.S. GDP is roughly $16 trillion today, and a few years ago it would have been perfectly reasonable to expect us to be running at $17 trillion.

About this article

Donald Marron is an economist who formerly served as a member of the President's Council of Economic Advisers under President George W. Bush. He is now director of the Urban-Brookings Tax Policy Center, a think-tank in Washington, D.C. that provides data and analysis on tax policy to policymakers, journalists, citizens and researchers. Previously he served as acting director of the Congressional Budget Office and as executive director of Congress's Joint Economic Committee. He has also taught economics at the Georgetown Public Policy Institute and the University of Chicago School of Business. He holds a bachelor's degree in mathematics from Harvard University and a doctorate in economics from the Massachusetts Institute of Technology.

Where did that $1 trillion go? One of the biggest factors is that we've had a remarkable loss in jobs. Unemployment is still significantly higher today than where we'd ever want it to be. We've also seen a lot of folks drop out of the labor force, either through retirement or moving onto disability programs. Others have become discouraged with the job market and given up looking for work altogether. You have to go all the way back to the mid-1980s to find a time when the percentage of employed Americans was as low as it is today. So if you look at this from a couple decades' point of view, we have reason to be quite concerned. The economy's not in a good place.

On the other hand, we are beginning to see signs that we're making progress recovering from the malaise of the past few years. We've seen job growth in the private sector. Consumers are feeling better than they did a couple years ago. In fact, real consumer spending grew at a healthy 3.2 percent in the first quarter. It suggests things are heading in a better direction.

OUTLOOK: What kind of growth do you expect over the balance of the year?

DM: I don't do forecasts myself, but if you look at surveys of what forecasters have in mind, people are expecting a slowdown in the second quarter – something like 1.5 percent annualized growth – followed by strengthening again later in the year. It's reasonable to assume we'll see growth of something like 2.0 to 2.5 percent for the year as a whole. Not a gangbuster recovery, but a return to "new normal" levels of growth.

OUTLOOK: What are some of the bright spots in the economy right now?

DM: Housing appears to have bottomed, and we're starting to see new housing starts rising instead of falling and house prices going up. We're to the point where housing is no longer a drag on the economy; it's a contributor. Auto sales have done remarkably well in the last year or so. Health care and education continue to percolate along, and we've seen relatively strong growth in business services.

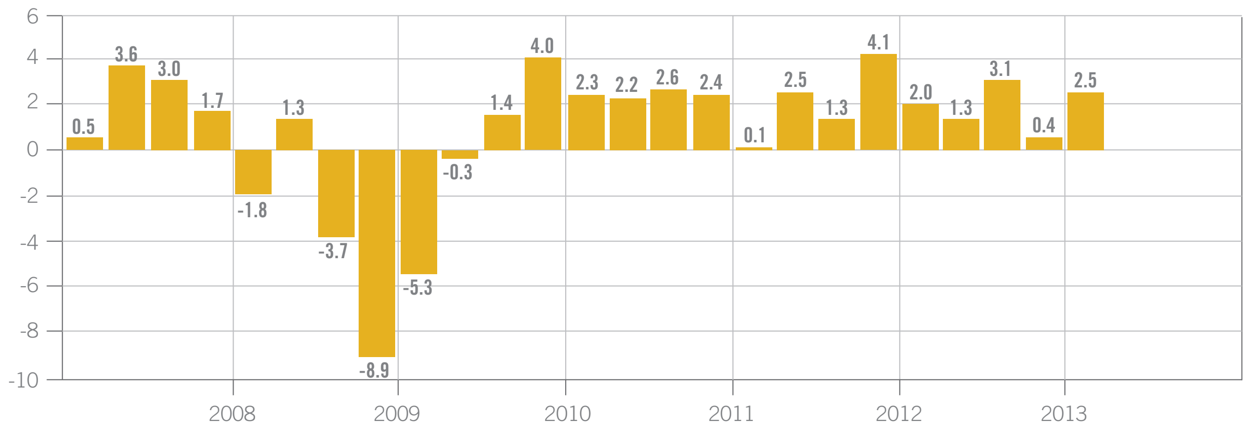
OUTLOOK: What areas continue to struggle?

DM: Manufacturing has been adding some jobs, but there's still a long-run trend towards lower manufacturing employment due to productivity gains, changing demand, and, to a somewhat lesser extent, trade and offshoring.

Another negative that impacts many sectors of the economy is economic conditions in other parts of the world, particularly Europe. When you have a severe economic downturn, you want the rest of the world to be strong so that they can buy more of your products and help lift you out. Unfortunately, the rest of the world has not been fully cooperating on that front (although agricultural exports have recently been strong).

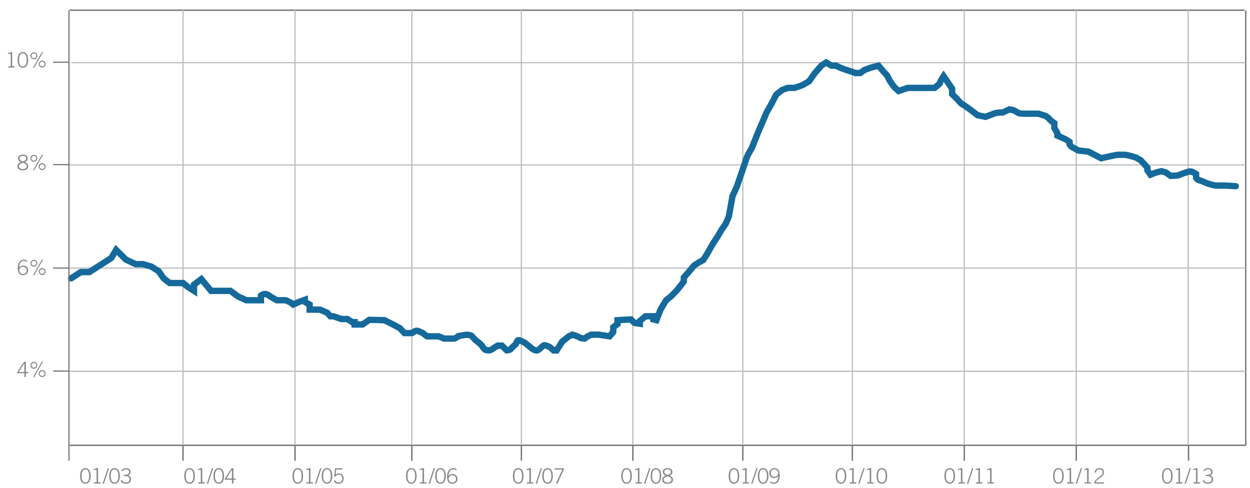
U.S. GDP GROWTH RATE

Percent Change in Gross Domestic Product



Source: U.S. Bureau of Economic Analysis

U.S. UNEMPLOYMENT RATE



Source: Bureau of Labor Statistics

OUTLOOK: What is the overall level of confidence among consumers?

DM: There are well-known measures of consumer sentiment and consumer confidence, and to be honest it's not always obvious how closely those correlate with real economic activity. But if you look at those, clearly we are up from the dreadful levels we were at in 2008, 2009 and early 2010. You can also look beyond sentiment to actual behavior. Auto purchases have picked up nicely, and that's one of those classic durable goods that consumers put off during the worst of the economic crisis.

OUTLOOK: What about business confidence?

DM: One of the most well-known gauges of business confidence is a monthly survey of manufacturing purchasing managers. On a scale of 1 to 100 that survey has recently been in the low 50s, indicating moderate growth.

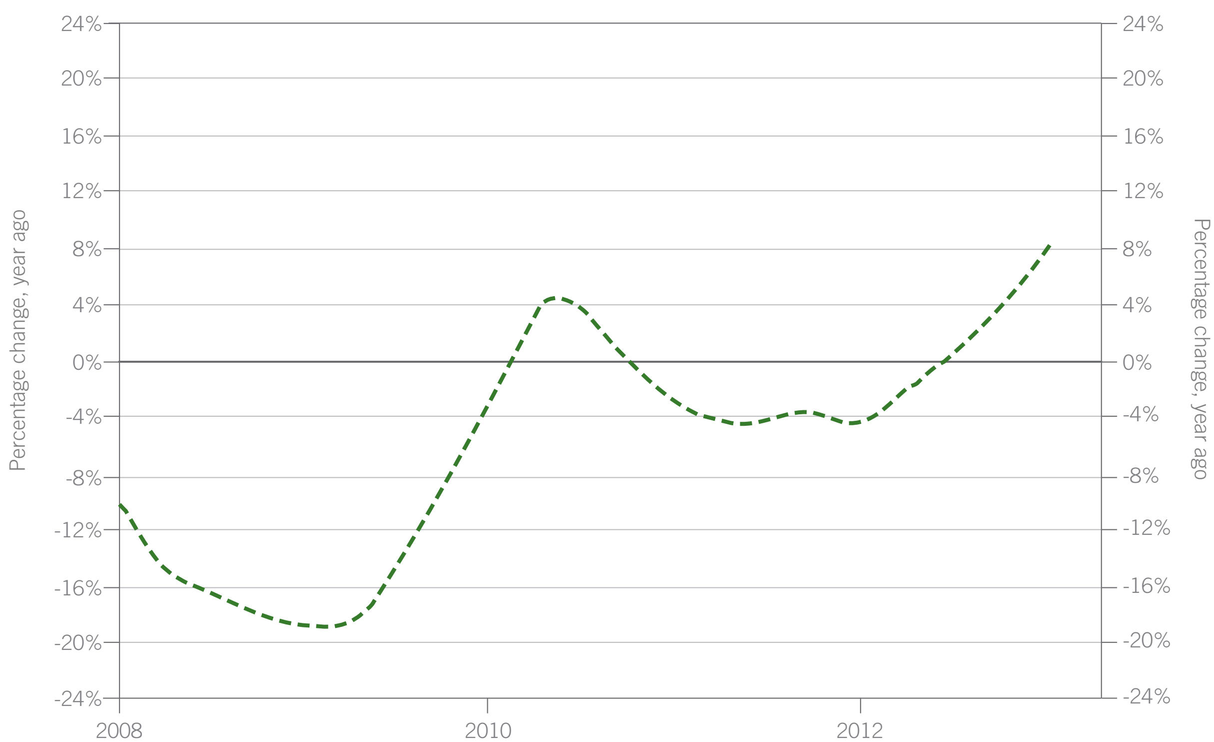
OUTLOOK: Some of the best-known U.S. stock indexes have risen to all-time highs in recent months. How important is that?

DM: The Federal Reserve has been doing its best to support the economy in part by boosting asset prices. They're very clear that by investing in Treasuries and mortgage-backed securities they're hoping to induce people to invest in other, more risky assets and the productive side of the economy. The stock market is clearly one reflection of that.

Presumably we're also seeing a higher overall level of confidence about the future from investors. We've gone through a period in which the memory of the crisis of 2008 and early 2009 was sharply written in people's minds, and

U.S. HOME PRICES

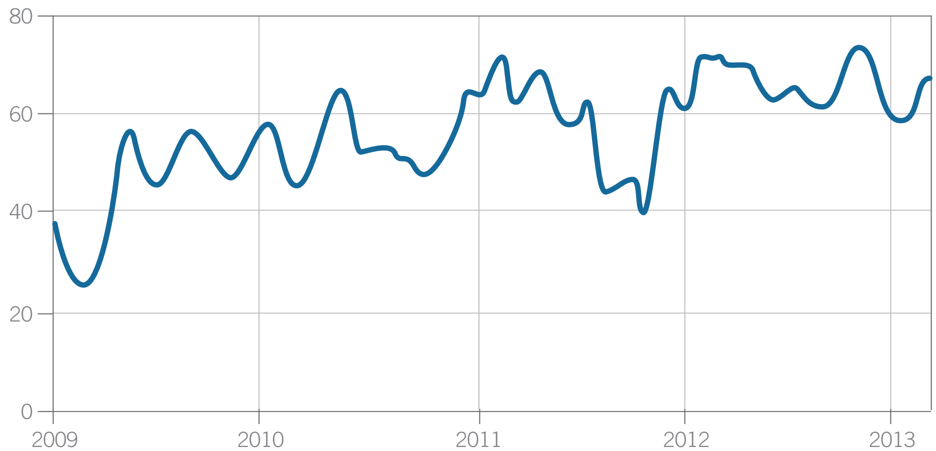
Annual returns for the Case-Shiller 20-city composite home price index.



Source: S&P/Case-Shiller

CONSUMER SENTIMENT

Conference Board Consumer Confidence Index; 1985 = 100



Source: Conference Board

there was always this lingering concern that we might fall off again. We've also had the debt limit debate and the fiscal cliff in Washington. But we've now moved, at least for the moment, into a world where those kinds of policy-driven crises seem to be receding.

OUTLOOK: If the economy has truly begun to rebound, what is a realistic optimal growth rate that the U.S. should aspire to for the long term?

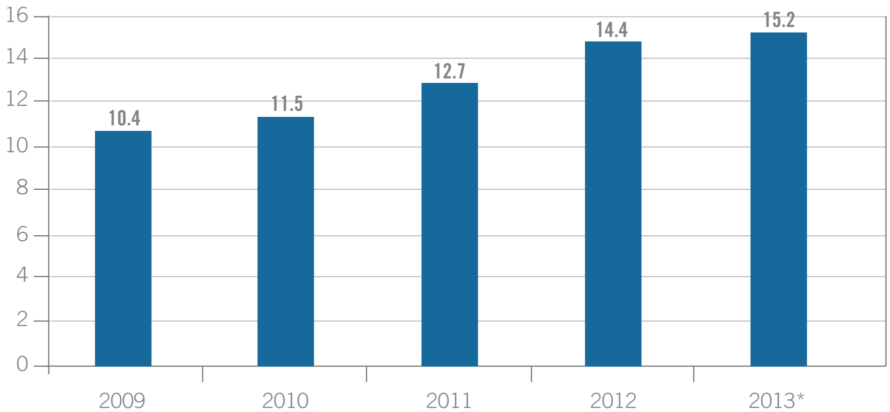
DM: In the long run, persistent GDP growth above 2.5 percent per year is going to be hard because of demographics. As the population ages, the labor force isn't going to increase that rapidly and so future growth rates will be lower than what we experienced in the 1980s and 1990s, when the labor force expanded more rapidly. Over the next few years, however, there is a chance of faster growth if the unemployment rate falls and discouraged workers rejoin the labor force. With luck, we could see a couple years of 3-plus percent growth.

OUTLOOK: Even with forced spending cuts from the sequester, the federal government is still running a fiscal deficit that will exceed $800 billion this year. How important is it in your view that the federal government addresses the deficit problem in the near term?

DM: This is not a moment where we should look for the government to cut its deficit even more rapidly than we are by further raising taxes or cutting spending. We've got plenty of deficit reduction underway right now. Unemployment remains very high, particularly when you use broader measures that account for people who are discouraged or working part-time. While in the long run I think we have significant fiscal concerns, in the short run the government should not do anything more that would slow the economy down.

NEW LIGHT VEHICLE SALES

In Millions



Sources: National Auto Dealers Association, Global Insight
**Projected*

That said, now would be a fine time for policymakers to make progress on longer-term budget challenges. Social Security, for example, is not sustainable in its current form. There won't be a crisis any time soon – except, potentially, in its disability program – but it would make sense to institute gradual changes today to avoid the need for more dramatic changes down the road.

OUTLOOK: How much do you worry about the Fed's ability to unwind from the extremely loose monetary policy it has adopted over the past couple of years without triggering inflation?

DM: I approach that question with humble optimism. It's true that the Fed has dramatically expanded its balance sheet in ways that we haven't seen before, and whenever you have a big change in behavior you always have to be a little bit humble about unforeseen challenges.

On the other hand, I'm encouraged that the Fed has the tools to combat inflation if that ever becomes a concern. During the financial crisis the Fed got one new power which is sometimes overlooked, which is the ability to pay interest on the reserves it holds for banks. It used to be that when banks had money on deposit with the Fed, they didn't get interest. Now the Fed has the ability to pay them interest. That's a very powerful inflation-fighting weapon down the road if the Fed needs it. If it becomes worried that the expansion of its balance sheet is going to create excess money sloshing around the economy, it can do more than just raise the Federal Funds Rate, which is the traditional policy. It also now has the ability to raise the interest rate it pays on reserves and attract excess cash into its coffers and out of the system.

Policymakers should focus on doing no harm. They should no longer make fiscal policy by crisis.

And keep in mind that in the standard data we look at about inflation, there aren't any signs of it out there. The standard inflation measures are all running at 2 percent or lower, even as unemployment is running at north of 7.5 percent. And so I think one would have to say that if the Fed has erred in any direction it's that it has not brought down unemployment fast enough, rather than having kindled inflation.

OUTLOOK: If there was one thing that federal policymakers could do to keep the economy on an upward trajectory, what would that be?

DM: That's a good question. It's difficult to imagine either Congress or the Federal Reserve undertaking major new efforts to boost the economy. So policymakers should focus on doing no harm. In particular, they should no longer make fiscal policy by crisis. We did a round of that in 2011 with the debt limit showdown, and we did another round in the fourth quarter of 2012 with the fiscal cliff. There's no way such policy brinksmanship helps the economy. It doesn't inspire confidence in our system of government, and it doesn't inspire confidence in people who have to make investment

U.S. MANUFACTURING PMI

Seasonally Adjusted

Source: Markit

U.S. INFLATION RATE

Annual Change on Consumer Price Index

Source: www.tradingeconomics.com, Bureau of Labor Statistics

and spending decisions. I'd like to go back to a world in which, yes there are disagreements between the members of Congress and the president and the parties, but where we don't have extreme brinksmanship. That would be is a good trajectory to be on. We shouldn't be legislating by scaring Americans.

OUTLOOK: If you look forward a couple of years from today, how do you think the U.S. economy will be performing? Are you optimistic or pessimistic?

DM: Over the next couple of years I think we'll continue to percolate along at a moderate growth rate. With luck, we will have couple strong years that put more Americans back to work and then return to trend growth rates. I'm not sure I have the right term to describe it. "Muddling through" is slightly too negative. We'll be growing somewhere in the mid-2 percent range, and we'll have made a little bit of progress of in reducing the lost potential from the Great Recession but by no means all of it.

Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 3/31/13. 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 and Blue Chip Economic Indicators

				US Treasury Securities	
2013	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q1	2.10%	1.50%	0.15%	0.27%	1.87%
Q2	2.00%	1.90%	0.14%	0.29%	1.98%
Q3	2.50%	2.10%	0.14%	0.37%	2.14%
Q4	2.70%	2.00%	0.15%	0.46%	2.31%
2014	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q1	2.60%	2.10%	0.17%	0.54%	2.48%

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 SWAP RATES

Years Forward	3-month LIBOR	1-year Swap	3-year Swap	5-year Swap	7-year Swap	10-year Swap
Today	0.29%	0.35%	0.54%	0.95%	1.44%	2.01%
0.25	0.35%	0.39%	0.60%	1.06%	1.55%	2.09%
0.50	0.38%	0.42%	0.67%	1.16%	1.65%	2.18%
0.75	0.40%	0.45%	0.75%	1.27%	1.75%	2.27%
1.00	0.42%	0.48%	0.83%	1.38%	1.85%	2.35%
1.50	0.50%	0.59%	1.06%	1.62%	2.06%	2.53%
2.00	0.62%	0.76%	1.32%	1.88%	2.28%	2.72%
2.50	0.84%	1.01%	1.61%	2.13%	2.49%	2.88%
3.00	1.06%	1.26%	1.91%	2.38%	2.70%	3.03%
4.00	1.77%	1.95%	2.48%	2.83%	3.09%	3.33%
5.00	2.32%	2.50%	2.92%	3.18%	3.38%	3.56%

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

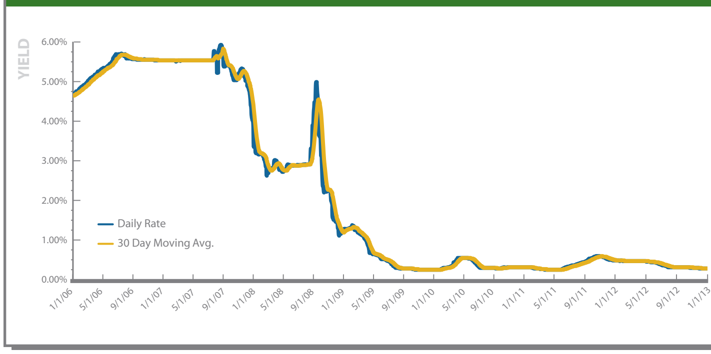
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	5	5	6	5
90	5	10	13	12
180	7	17	23	21
365	19	36	48	40

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.

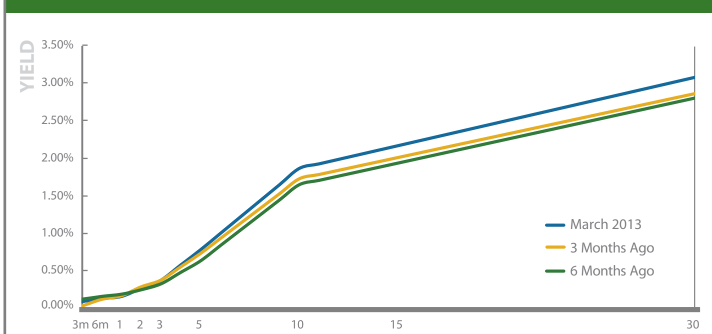
3-MONTH LIBOR



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 Executive Appointments

Chief Executive Officer Bob Engel Names Mary McBride As President; Thomas Halverson As Chief Banking Officer

CoBank recently announced that Chief Executive Officer Bob Engel has appointed Mary McBride as President of the bank and Thomas Halverson as Chief Banking Officer.

"Over the past few years, CoBank has become a larger and more complex business, particularly in the wake of our recent merger with U.S. AgBank," Engel said. "Given the increased breadth and scope of our operations, I am delighted to be announcing these new appointments, which will enhance the overall capacity of our executive team."

McBride has been with CoBank since 1993 and has served in a variety of executive positions during her 20-year tenure. She has managed the bank's capital markets, corporate finance and operations divisions and spent six years as Executive Vice President in charge of lending to rural infrastructure customers. She served as Chief Operating Officer of the bank in 2009 and 2010 before being named Chief Banking Officer. Prior to joining CoBank, McBride worked as a Senior Vice President at Wells Fargo/First Interstate Bank of Denver. Prior to that, she was with Bank of Boston. McBride holds a bachelor's degree from Wellesley College, a master's degree from the London School of Economics, and a master's of science degree from Sloan School of Management at the Massachusetts Institute of Technology.

In her new role as President, McBride will report to Engel and have responsibility for all of the bank's lending units as well as its Credit, Banking Services and Corporate Communications functions.

"I'm excited to be taking on this expanded role and look forward to working with Bob and the rest of executive leadership to continue meeting the needs of our customers and advancing CoBank's position in the market," McBride said.

Halverson comes to CoBank after more than 15 years at Goldman Sachs, one of the world's premier investment banking and securities firms. He most recently served as Managing Director and Chief of Staff for Goldman Sachs Bank USA, a $120 billion commercial bank subsidiary of the Goldman Sachs Group Inc. that extends credit and makes markets in derivatives and other financial services to institutional and individual clients. Previously he served in a variety of executive positions at the firm, including head of credit risk management for Goldman Sachs in Asia outside of Japan and Executive Director of credit risk management and advisory in London. Before joining Goldman Sachs he served as Principal Credit Officer for country risk at

About CoBank

CoBank is a $92 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. The bank also provides wholesale loans and other financial services to affiliated Farm Credit associations serving approximately 70,000 farmers, ranchers and other rural borrowers in 23 states around the country.

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.

Commentary in Outlook *is for general information only and does not necessarily reflect the opinion of CoBank. The information was obtained from sources that CoBank believes to be reliable but is not intended to provide specific advice.*

the European Bank for Reconstruction and Development, a multilateral development bank that extends credit and makes direct investments in projects across eastern and central Europe and the former Soviet Union to promote the development of open, democratic market economies.

In his new role as Chief Banking Officer, Halverson will report to McBride and have responsibility for the bank's portfolio of loans to customers in all 50 states, including corporate and regional agribusinesses, Farm Credit associations, rural electric cooperatives, rural water and wastewater companies, and rural communications service providers. He will also oversee the bank's agricultural export finance division.

"CoBank has an outstanding reputation as a provider of credit to the U.S. rural economy," Halverson said. "It's an honor to be joining such a great organization and a leadership team of such seasoned banking professionals."

McBride and Halverson's appointments are both effective as of July 1, 2013.