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## India: The Other Asian Giant

At first glance, India seems to have much in common with China, its neighbor to the east. China grabs most of the headlines, but both countries have populations of more than 1 billion people, enjoy fast-growing economies and control large land masses across Asia.

But there are key differences as well. China's growth model has depended on a blend of free-market reforms and top-down Communist government control. India, meanwhile, has remained democratic since the former British colony became an independent nation after World War II. And while China has leveraged its low cost of labor to become the world's dominant exporter of manufactured goods, India has been successful providing call center, IT and other outsourced services that leverage fluency in English and the country's strong educational system.

For an update on India and where it's headed, *OUTLOOK* turned to Devesh Kapur, director of the Center for the Advanced Study of India at the University of Pennsylvania, and Nicholas Burns, Harvard University international politics professor and former U.S. undersecretary of state for political affairs.

***OUTLOOK: Characterize the importance of India from an economic and international trade standpoint.***

**Nicholas Burns:** India is a country of contrasts. The country has one of the world's fastest growing economies, along with China and Brazil, and it's emerging as one of the great powers of the world, politically, economically and militarily. It has a highly capable and highly educated middle class, draws plenty of business investment and is on track to become one of the world's dominant economies.

On the other hand, India has 600 million people who live in poverty and survive on small subsistence farming. The nation is still in need of major economic reforms in order to feed its poor population and bring them electricity and clean water. It's this dichotomy of great strength and great weaknesses that defines India today and makes its future both challenging and promising.

In the next decade, one out of four people joining the global workforce will be Indian. That's a phenomenally young population joining the workforce that can drive the country's growth in a significant way.

#### About this article



Nicholas Burns is a professor at Harvard University and former U.S. undersecretary of state for political affairs. At Harvard, he serves as Professor of the Practice of Diplomacy and International Politics at the Kennedy School.

Mr. Burns is a member of the Council on Foreign Relations and served in the U.S. Foreign Service for 27 years until his retirement in 2008. He was Under Secretary of State for Political Affairs from 2005 to 2008 and also served as U.S. Ambassador to NATO (2001–2005) and to Greece (1997–2001) and as State Department Spokesman (1995–1997).

He earned a bachelor's in history from Boston College, a master's in international relations from the Johns Hopkins School of Advanced International Studies and earned the Certificat Pratique de Langue Francaise at the University of Paris-Sorbonne.

**Devesh Kapur:** India today is the world's 10th-largest economy and the fourth largest in terms of purchasing power. By the end of the decade, India is expected to be the fifth-largest economy and the third largest in terms of purchasing power.

Much of that growth has come from information technology, which grew from a \$10 billion industry in 1990 to \$100 billion today. The country also has a rising middle class of more than 200 million people with discretionary spending who are driving consumer demand for cell phones and cars. India's favorable demographics also make the country very promising: In the next decade, one out of four people joining the global workforce will be Indian. That's a phenomenally young population joining the workforce that can drive the country's growth in a significant way.

#### **OUTLOOK: How has India changed over the past 20 to 30 years?**

**NB:** India has seen remarkable change. From its founding in 1947 to the early 1990s, India operated as a semi-closed economy with a heavy dose of state socialism and restrictions on investment and trade. Then, in 1990 and 1991, a series of economic reforms opened up India to the international economy. Those reforms enabled competition, opened up investment and trade and led to the great expansion of India's economy.

**DK:** In the past 20 years, the growth rates basically doubled and the population growth and per capita growth rates tripled. Indicators like literacy, life expectancy, infant mortality all have seen considerable improvements.

#### **OUTLOOK: What about its population growth?**

**DK:** India is likely to surpass China in population in the next few decades. To give you one way to think about it: In the 20 years between 1991 and 2011, India added 364 million people to its population. That's more than the total population of the United States. The country has added more people in 20 years than it did in two millennia. That is putting considerable pressures on natural resources and at the same time driving growth.

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**About this article**

Devesh Kapur is the director of the Center for the Advanced Study of India at the University of Pennsylvania. He is also a non-resident fellow at the Center for Global Development, a think-tank in Washington, D.C. Before joining the University of Pennsylvania, he held appointments at the Brookings Institution, Harvard University and the University of Texas-Austin.

His most recent book, “Diaspora, Democracy and Development: The Impact of International Migration from India,” received the 2012 Distinguished Book Award of the Ethnicity, Nationalism, and Migration Section of International Studies Association.

Dr. Kapur has a master’s in chemical engineering and a doctorate in public policy from Princeton University. He received the Joseph R. Levenson Teaching Prize awarded to the best junior faculty at Harvard College in 2005.

The big question is will India succeed in utilizing this labor force, or will it become a demographic disaster with lots of young people without jobs? For the rest of the world, India could either become a powerhouse like China or the country will have internal instabilities, which have implications. You cannot afford to be affected by instability when you’re talking about a fifth of humanity.

***OUTLOOK: How rapidly has the economy been growing in recent years, and what are the prospects for growth ahead?***

**DK:** India is among the fastest growing of the G20 countries. India’s GDP growth rate has climbed as high as 10 percent over the past decade. Even with its economic slowdown projected to drop to 5.5 percent, it’s still growing faster than most other countries.

Yet if you look at per capita income, India is the poorest country of the G20. India would have to continue growing at the pace it has for another 20 years in order for much of this huge population to reach middle-income status.

***OUTLOOK: How well is India’s government positioned to manage the challenges facing the country?***

**NB:** India has a stable political system, especially compared to some of its neighbors. India is democratic and has a very vibrant political culture, a tradition of free and fair elections and a very active parliament. There is every reason to believe that India is going to maintain that political stability.

**DK:** That’s true, but the one thing about democracies is that they can be messy, and right now, India’s democracy is very messy. That’s partly because you have a coalition government of multiple parties, so no single party has an absolute majority. That means different parts of the coalition pull in different directions and you get policy paralysis – nothing gets done and reforms do not get passed – and parties extract resources for supporting the government and you can get very high levels of corruption.

India is the only emerging market that has been consistently democratic since independence 65 years ago. Hence, democracy has deep roots in the country. But could there be government instability? Quite likely. And when the main national parties get fewer seats of power, the power starts to flow to regional parties and to states. That is not necessarily good for national security or a cohesive foreign policy or for implementing reforms in areas which are constitutionally the mandate of central government. But it also strengthens federalism and allows different states to experiment and compete with each other, which could accelerate reforms in areas where states have greater leeway.

**OUTLOOK: What are the key issues facing the Indian government today?**

**DK:** One thing India desperately needs is infrastructure. Over the next decades it needs transportation systems, such as airports and highways, urbanization projects like sewage and water, electric power – you name it. That requires a much more transparent policy environment and better regulation. The nation’s laws for land acquisition – both for new business development and government projects – have not changed since 1894 and do not reflect issues of present-day India. So acquiring land has become a huge headache.

There’s also a real concern that the country’s rapid growth has given rise to serious crony capitalism. Politicians know that with a stroke of a pen, agricultural land can be designated for industry or commercial purposes such as urban housing. The analogy is that it’s a lot like the late 19th century United States with powerful robber barons. But unlike the United States that



India’s agriculture sector is relatively insulated from the rest of the world, so rising global food prices do not always have an immediate impact.

**INDIA BY THE NUMBERS**

Population.....	1,205,073,612
Life Expectancy .....	67 years
Median Age .....	26.5 years old
Pop. Below Poverty Line .....	25 percent
Inflation Rate (2011) .....	6.8 percent
GDP (2011) .....	\$4.515 trillion
GDP Growth (2011) .....	7.2 percent
<b>GDP by Sector</b>	
Agriculture .....	17.2 percent
Industry .....	26.4 percent
Services.....	56.4 percent
Labor Force .....	487.6 million
Unemployment (2011).....	9.8 percent
Exports .....	\$298.2 billion
Imports.....	\$451 billion
Airports.....	352
Railways.....	63,974 km
Roadways .....	3,320,410 km
Merchant Marine Fleet .....	240 vessels
Number of cellphones .....	752 million*

*\*Second highest number in the world behind China*

Source: CIA World Factbook

had some 63 million people in 1890, India has 1.2 billion people. Managing their aspirations in a much more resource-constrained environment is far more difficult.

**OUTLOOK: Is inflation a problem in India, as it has been in China and other high-growth emerging economies?**

**DK:** India’s inflation is in the 7 to 8 percent range, which is much higher than other G20 countries. In a country with so many poor people, that’s a huge problem because the poor have very few ways to manage price increases when wages do not increase too. The rich obviously are much more protected.

When you have a coalition government, spending increases and fiscal deficits climb. That is partly why inflation in India has been so high. One way to keep inflation in check is for the central banks to raise interest rates, but that then dampens growth.

**OUTLOOK: Food prices in India have risen even faster than inflation this year. Why is that?**

**DK:** India is facing a drought, which has had an impact of rising food prices. Back in the 1960s, the country once was a major food importer but it has since been able to boost crop yields and improve its agriculture production. India’s agriculture sector is relatively insulated from the rest of the world, so rising global food prices do not always have an immediate impact within India.

**OUTLOOK: Does India hold significant promise as an export market for American agriculture?**

**DK:** Indian agriculture is currently protected by relatively high tariffs, mainly because agriculture employs about 600 million to 700 million people. But as pressures on land in India grow, it will become more open to U.S. agricultural imports.

**OUTLOOK: Has India grown into a more market-oriented economy over the past 20 years?**

**DK:** If you believe the corruption stories, then everything is up for sale in India, including parts of government. That's a bit facetious but it's indicative of perceptions. India has moved to become a much more market economy, but it still has parts of the economy where the government controls prices and exercises discretionary powers. The government still controls the prices for energy – petroleum, diesel, kerosene as well as electric power. This has increased fiscal deficits and reduced investment in this sector. Much of India's recent huge blackout can be blamed on excessive government controls and not allowing markets to work. No one is going to spend billions of dollars on setting up power plants, transmission lines and distribution systems if they know that prices might be regulated in ways that are not transparent.

**HISTORIC GDP AND CPI INFLATION RATE TRENDS IN INDIA**



Sources: World Bank. CMIE. [global-rates.com](http://global-rates.com)

**OUTLOOK: What are the exports of India?**

**DK:** The top exports include software and outsourced IT services, transportation equipment, machinery, pharmaceuticals and refined petroleum products. India has a strong generic drug sector, which has mixed effects on a country like the United States. On one hand, generics are much less expensive so American pharmaceutical companies face considerable cost pressures, but it's great for the U.S. consumers looking to cut health care costs.

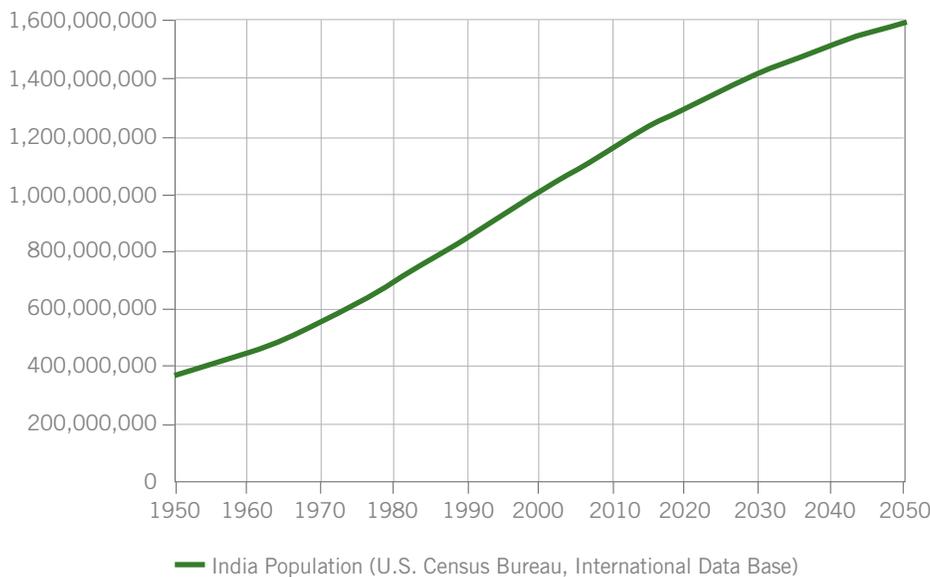
**OUTLOOK: How does the bad global economy affect Indian exports?**

**DK:** Last quarter India's exports registered a slight decline of 1.5 percent. While it may not seem much of a drop, they had been growing very strongly in double digits so it's large relative to trend forecasts. It's an effect of low growth in global demand.

**OUTLOOK: India's growth forecasts were recently revised downward to 5.5 percent. Why?**

**DK:** That is clearly driven by the governance issues. When you have policy paralysis and the perception of widespread corruption in government then businesses begin to lose confidence. That's important but not the only reason. The world economy has also gone down in general.

**POPULATION IN INDIA**



Source: [www.360.org](http://www.360.org)

When you have a country as large as India and it grows rapidly it has linkages to the rest of the world. You get more innovation, more demand for goods and services as well as the supply of goods and services at cheaper rates.

***OUTLOOK: How does what is going on in India impact the U.S. economy?***

**DK:** Indian IT has reduced the cost for American businesses. If they outsource to India, it lowers the overall costs of their business. Back in 1990, the Indian IT market was too small to be bothered with – but not today. If you look at the Indo-U.S. Chamber of Commerce it has the crème de la crème of American companies.

**NB:** Trade and investment is at an all-time high between the United States and India. One of the bridges between the two countries has been the high-tech sector. We see more Indian-U.S. joint ventures and more Indian-Americans succeeding in the United States. There has been a wholesale transformation in the way the United States and India work together over the last 20 years.

***OUTLOOK: What does a strong India mean to the rest of the world?***

**DK:** Emerging markets doing well economically through democratic means is congruous with U.S. values. When you have a country as large as India and it grows rapidly it has linkages to the rest of the world. You get more innovation, more demand for goods and services as well as the supply of goods and services at cheaper rates.

***OUTLOOK: How will India's long-term growth impact energy markets?***

**NB:** As an industrial power, India is becoming a major importer of oil and gas from sources around the world. Together with China, their energy needs are having a significant impact on global energy markets. India and the U.S. reached a landmark Civil Nuclear agreement during the Bush administration which should, once implemented, help India to increase its share of peaceful civil nuclear power with the help of U.S. firms.

***OUTLOOK: What should the posture of the United States be toward India from a foreign policy standpoint?***

**NB:** India and the U.S. have become close friends and partners during the last decade. Presidents Clinton, Bush and Obama have all worked to bring our two countries closer together. On Afghanistan, for example, India has given significant assistance to the Karzai government. Our two militaries also train and exercise together in the Indian Ocean. The U.S. also hopes to see conflict avoided between India and Pakistan, two nuclear weapons powers. India is fast becoming one of our most valuable friends in the Asia-Pacific theater – now the most important region in the world for U.S. strategic interests.

***OUTLOOK: Where do you see India 20 years from today? Are you optimistic or pessimistic?***

**NB:** I am optimistic about India. Think of its advantages. It is the world's largest democracy, has a very strong high tech sector and enormous mathematics and engineering talent in its population. Like the United States, it is also a multi-ethnic and multi-religious country that prizes its diversity. I see India as one of the future global success stories. Sure, it faces serious challenges and problems in its development but there is enormous room for further progress and growth. ■

# Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 07/31/12. 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

	2012	GDP	CPI	Funds	2-year	10-year
Q3	2.10%	1.40%	0.15%	0.30%	1.60%	
Q4	2.30%	1.80%	0.15%	0.30%	1.80%	
2013						
Q1	1.90%	2.10%	0.15%	0.40%	1.90%	
Q2	2.40%	2.00%	0.15%	0.50%	2.10%	
Q3	2.70%	2.30%	0.20%	0.60%	2.20%	
Q4	2.90%	2.20%	0.20%	0.60%	2.30%	

## 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	0.45%	0.40%	0.49%	0.81%	1.20%	1.63%
0.25	0.28%	0.36%	0.52%	0.88%	1.27%	1.69%
0.50	0.37%	0.40%	0.58%	0.96%	1.35%	1.76%
0.75	0.39%	0.42%	0.64%	1.05%	1.43%	1.82%
1.00	0.41%	0.45%	0.71%	1.13%	1.51%	1.89%
1.50	0.44%	0.50%	0.89%	1.33%	1.67%	2.02%
2.00	0.52%	0.62%	1.09%	1.52%	1.81%	2.16%
2.50	0.71%	0.85%	1.32%	1.71%	1.99%	2.28%
3.00	0.90%	1.09%	1.56%	1.90%	2.17%	2.41%
4.00	1.44%	1.56%	1.99%	2.25%	2.45%	2.61%
5.00	1.91%	2.04%	2.33%	2.53%	2.67%	2.78%

## 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	5	5
90	5	8	10	11
180	5	10	17	19
365	5	23	34	36

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.

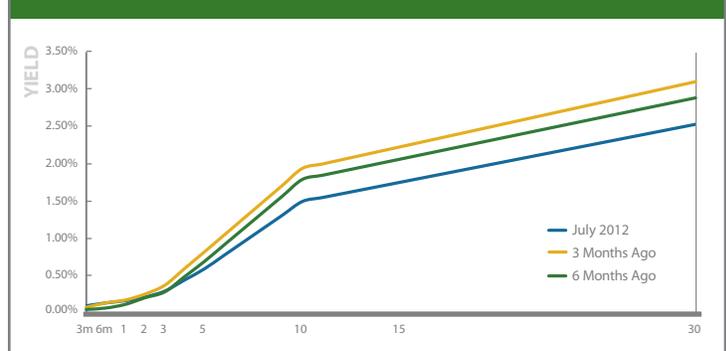
## 3-MONTH LIBOR



## 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





### About CoBank

CoBank is a \$90 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 more than 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](http://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.*

## CoBank Reports Second Quarter Financial Results

CoBank recently announced financial results for the second quarter of 2012.

Second quarter net income rose almost 40 percent to \$252.4 million, compared with \$180.7 million for the second quarter of last year. Net interest income for the quarter was \$307.1 million, compared with \$276.5 million a year ago. Average loan volume for the quarter was \$69.4 billion, compared to \$52.1 billion for the same period in 2011.

For the first six months of 2012, net income increased 23 percent to \$482.9 million from \$392.8 million for the same period in 2011. Net interest income increased 7 percent to \$620.2 million. Total loan volume for the bank at June 30, 2012 was \$69.2 billion.

The bank's results reflected the benefits of its merger with U.S. AgBank, which closed on January 1, 2012. Through the merger, the bank acquired U.S. AgBank's assets and liabilities, including approximately \$20 billion in wholesale loans to 25 Farm Credit associations. The transaction increased average loan volume as well as net interest income, net income and certain other key measures of financial performance.

Second-quarter and year-to-date results also included the impact of \$44.6 million in refunds from the Farm Credit System Insurance Corporation.

"We're pleased with CoBank's results through the midpoint of 2012," said Robert B. Engel, president and chief executive officer. "The merger with U.S. AgBank continues to deliver significant benefits for our business at a time of real challenge in the broader market environment. We remain focused on building the financial strength and flexibility of the bank and meeting the needs of our customers across all of the industries we serve."

The performance of the bank's individual operating segments has varied in 2012 due to the merger as well as external economic and market factors. Average agribusiness loan volume declined significantly owing to lower average prices for grains and other commodities earlier in the year and reduced inventory financing at agricultural cooperatives. At the same time, the bank continues to experience solid growth in lending to rural infrastructure customers, particularly in the power supply and electric distribution industries. Loans to Farm Credit associations have increased significantly due to the merger, but organic growth in that segment is soft due to continuing low demand for debt capital at the producer level of the U.S. farm economy.

At quarter end, 1.02 percent of the bank's loans were classified as adverse assets, the same level as at the end of the first quarter and down from 1.25 percent at December 31, 2011. Nonaccrual loans improved to \$106.9

million, compared to \$125.0 million in the prior quarter and \$134.9 million at the end of the year. During the second quarter, the bank recorded a \$5.0 million provision for loan losses, increasing the provision to \$10.0 million for the first half of the year. The provision for loan losses in the first six months of 2011 was \$37.5 million.

“Credit quality in CoBank’s loan portfolio remains strong compared to historical averages,” said David P. Burlage, CoBank’s chief financial officer. “CoBank continues to benefit from the addition of U.S. AgBank’s portfolio of high quality loans to Farm Credit associations, as well as relatively strong conditions in the U.S. rural economy.”

The bank’s allowance for credit losses totaled \$547.7 million at June 30, 2012, or 1.77 percent of non-guaranteed loans outstanding excluding loans to Farm Credit associations.

Capital and liquidity levels at CoBank remain well above regulatory minimums. As of June 30, 2012, shareholders’ equity totaled \$6.2 billion, and the bank’s permanent capital ratio was 15.8 percent, compared with the 7.0 percent minimum established by the Farm Credit Administration, the bank’s independent regulator. At quarter end, CoBank’s cash and investments totaled \$19.7 billion and days liquidity totaled 193 days. During the quarter, the bank recorded \$3.0 million in impairment losses on certain investment securities, compared with \$4.0 million in impairment losses during the same quarter last year.

Engel noted that overall conditions in the U.S. and global economies remain weak, putting downward pressure on loan demand in many of the industries served by the bank. Many areas in the United States are also currently being impacted by drought conditions, which has the potential to reduce revenues at grain and farm supply cooperatives and increase costs in the protein and biofuels sectors. In addition, extremely low interest rates and a flattened yield curve make it more difficult to generate meaningful earnings on invested capital.

“Despite these challenges, we believe CoBank remains well positioned to continue fulfilling its mission to agriculture, rural infrastructure, and rural America,” Engel said. “Under the guidance of our board, we remain committed to providing our customers with exceptional, sustainable value and to managing the enterprise for the long term.” ■

## CoBank Supports Urban Agriculture

CoBank has joined forces with two other Farm Credit institutions to provide financial support for beginning urban farmers in Cleveland as part of the city's "Gardening for Greenbacks" program.

Minneapolis-based AgriBank, Denver-based CoBank and Louisville-based Farm Credit Mid-America each committed \$45,000 to the program for a total donation of \$135,000. All three institutions are members of the Farm Credit System, a nationwide network of banks and associations chartered to meet the credit needs of agriculture and other key rural industries.

Gardening for Greenbacks is an initiative developed by the city of Cleveland to increase the production of local foods and establish Cleveland as a model for local food system development. By providing financial assistance to local entrepreneurs for the development of for-profit urban food gardens, the program aims to encourage economic development while helping to ensure that every resident has access to fresh, healthy and affordable food.

"As a mission-based lender, we are committed to encouraging the development of local food systems, including urban farming," said Andrew Jacob, executive vice president at CoBank. We're delighted to be partnering with other Farm Credit organizations in support of this innovative program."

The Farm Credit donation will fund grants of up to \$5,000 to enable program participants acquire the necessary equipment for urban gardening, such as tools, fencing and irrigation systems. Grant recipients are required to successfully complete a market gardener training class offered by the Ohio State University Extension and to sell their produce locally. ■