OUTLOOK Economic Data and Commentary

June 2016 Volume 13 Number 6

The Presidential Election and Free Trade

Donald Trump and Hillary Clinton, the presumptive Republican and Democratic presidential nominees, vehemently disagree on a host of issues – from taxes and gun control to foreign policy, immigration and national defense.

But the campaign rhetoric of both candidates is surprisingly aligned when it comes to the issue of trade. Clinton and Trump have each voiced a fair amount of animosity toward free trade agreements the U.S. has executed in recent years, complaining that they have accelerated the migration of manufacturing jobs overseas and harmed America's working class.

So is the era of free trade in the U.S. drawing to a close, no matter who wins the presidency? For perspective on that question, Outlook turned to Jonathan Lieber, the U.S. director of the Eurasia Group, one of the world's leading consulting firms focused on global risk. Lieber says the net benefits of free trade for the U.S. are enormous – and that the next president will do far more harm than good if he or she tries to roll back trade agreements that have lowered costs for consumers and cemented economic ties between America and countries around the world.

OUTLOOK: Why has trade been such a big focus in this election in particular?

Jonathan Lieber: Trade is always a hot-button campaign issue. What makes this election a bit different is there's no one out on the campaign trail openly defending it. George W. Bush, despite approving some steel tariffs, was an unabashed free trader and campaigned as one. Even in Congress, the voices for free trade are few and far between right now. Before, you had people like California Republican Bill Thomas, who was chairman of the House Ways and Means Committee, out there making the case for free trade. Today we just don't have folks doing that. Trade is missing a champion, and we're missing the opportunity to make the case to the public that trade actually benefits Americans and the world.

OUTLOOK: What are the key differences in the trade positions of candidates Clinton and Trump?

JL: Both have criticized international trade as harmful to the American job base. But with Clinton, it's pretty clear to me that when she's alone with her briefing book, thinking about what policies she supports, she's pro-trade. As secretary of state, she was part of the Obama cabinet that laid the groundwork for the Trans-Pacific Partnership. She was a strong advocate for the treaty – until, during the campaign, she's suddenly decided she has problems with it. But her criticisms of the TPP have been pretty narrow and political, having to do with rules-of-origin labeling and what percentage of foreign parts would disqualify cars from the treaty.

Although she's been no cheerleader for NAFTA on the campaign trail, she was first lady when it was negotiated and passed. And she was a senator from New York, where exports are massively important. For all the contradictions, the balance suggests she's pro-trade.

It's harder to know where Donald Trump stands. He bashes China for taking our jobs and dumping manufactured products in the United States. He's spoken out against the TPP and has clearly touched a populist nerve by being willing to say things that most other major candidates for president wouldn't. Trump realizes there's anxiety over Hispanic immigrants changing our demographics, and he says we're going to build a wall. He realizes people are anxious about jobs being shifted overseas, and he says we'll slap a tariff on Chinese-made goods. His populist stance has been a huge part of his appeal to voters. Precisely because of that, he's going to have a harder time stepping back from his campaign promises if he gets into office.

Outlook: Aside from her nominal opposition to the TPP, are there other protectionist policies that Clinton has favored?

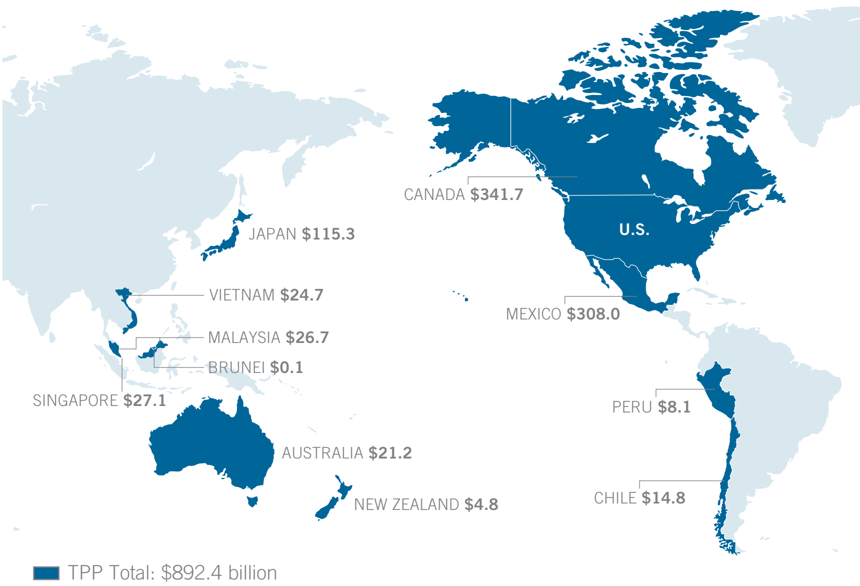
JL: Although Clinton's outlook is very internationalist and she generally seems to support freer trade, she has opposed trade deals when it was expedient. For example, even though she supported most of the trade deals signed by the Bush administration, in 2005 she voted against one of the largest, the Central America Free Trade Agreement, based on concerns voiced by unions. However, most of her specifically anti-trade policy proposals have been pretty shallow and not truly what I would call "protectionist," such as very mild tax changes to discourage outsourcing, or endorsing the idea of a "trade prosecutor" who would be empowered to initiate trade cases and take the burden off of private actors who now have to sue to initiate such a case.

This Month's Expert

A self-described "policy wonk," Jonathan Lieber is a U.S. Director at Eurasia Group, advising U.S. and global companies on how political developments and changing public policies may affect their businesses and investments. Prior to Eurasia Group, Lieber served as chief economist for the consumer service website Thumbtack, Inc., based in San Francisco. From 2010–2014 he served as a policy advisor to Senate Majority Leader Mitch McConnell on tax, trade, financial services, and other issues.

A SNAPSHOT OF THE TRANS-PACIFIC PARTNERSHIP

U.S. Trade With TPP Countries, in Billions of Dollars



Source: Wall Street Journal

OUTLOOK: Trump argues that we should retaliate against China's protectionist policies. Why shouldn't we reciprocate in kind?

JL: It's true that China has built its manufacturing base by exporting to the United States and the world while tightly controlling access to its own markets. But let's keep in mind that the United States, precisely because of our steadfast commitment to free trade, has benefited from growth taking place in China and throughout the emerging world. Chinese goods are often cheaper than what we can produce here, and consumers like them and want to buy them. So the idea that the Chinese are taking advantage of us by selling us things that we want to have at a price we want to pay is a little narrow-minded.

Many standard complaints about Chinese protectionism and currency manipulation are becoming outdated as China transitions from an export-based to a consumer-driven economy. Their currency has been moving toward a more balanced exchange rate for years now. And their domestic markets, while still plagued by red tape, burdensome capital controls, and local corruption, represent a huge opportunity for American companies as Chinese consumption rises. The way forward is for China to move increasingly towards free trade, not for the United States to regress into protectionism. The world needs China to be more transparent and open, just as much as it needs America to remain as open and transparent and global as it already is.

OUTLOOK: How likely is it that a President Trump would get his wall on the Mexican border? How would that affect our trade policy with Mexico?

JL: Trump is not going to build a physical wall of the kind he is talking about – the logistical challenges are too great and the financial resources are not there. It's worth remembering that we already have over 600 miles of fencing on the southern border currently that the government has been struggling to extend for years, and a large enforcement regime that monitors and attempts to stop illegal immigration. Increasing these resources without constructing a full concrete wall that runs the length of the border is far more likely in a Trump administration.

Trump's rhetoric about Mexico is unlikely to soften as president, but he seems intent on opening negotiations with them to earn more concessions in our trade relations with them. We have no idea what those concessions are, "If ratified, the TPP would be the largest and probably the most important trade pact in history.

however, and they seem just as likely to be bad for U.S. firms as they are for Mexico, to the extent that U.S. firms and consumers benefit from the lower costs of production south of the border.

OUTLOOK: How is the upcoming Congressional election likely to affect our trade policy?

JL: You should expect the 115th Congress to be more skeptical of trade than the 114th Congress. Not only will Democrats, who tend to be less in favor of trade, pick up seats in the House and Senate, but several strong free-trade Republicans like Ohio's Rob Portman and Pennsylvania's Pat Toomey are at risk of losing their seats and being replaced by more protectionist senators. This makes passage of any new trade bills less likely.

OUTLOOK: What makes the Trans-Pacific Partnership so important?

JL: If ratified, it would be the largest and probably the most important trade pact in history. It encompasses 12 countries and 40 percent of global GDP. Among its benefits, the TPP would eliminate many tariffs on U.S. agricultural exports – which account for 20 percent of income for U.S. farmers. Among the 11 other countries signing the treaty, current agricultural tariffs include 16 percent for Vietnam to 19 percent for Japan, with tariffs on some individual agricultural products running higher than 300 percent. The agreement is designed to easily expand to accommodate new countries down the road, which means that its impact could actually grow over time to encompass an even more significant portion of global GDP.

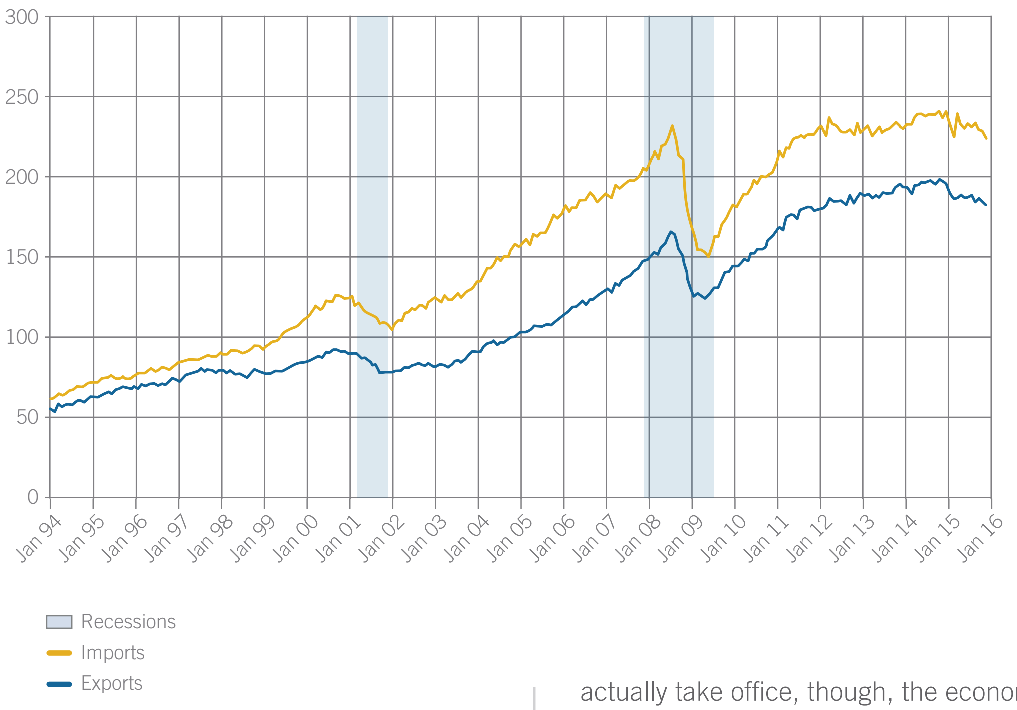
Perhaps even more important than the TPP's economic importance is its geopolitical significance. The pact would set standards and would allow the U.S. rather than China to set the terms of trade in the Pacific region for a generation or more.

OUTLOOK: What are the chances Congress will pass the treaty?

JL: Passage in the remaining months of Obama's presidency will be difficult, but I believe it is doable. We expect the president will submit the bill to Congress after the November elections, and that the votes are there in both chambers to pass it before Congress adjourns. That assumes, first, that enough members show up to vote, and second, that the populist nature of the current political campaigns doesn't harden Washington into terminal opposition to free trade.

U.S. TRADE, EXPORTS AND IMPORTS

In Billions of Dollars per Month



Source: Calculated Risk blog

OUTLOOK: The North American Free Trade Agreement (NAFTA) had bipartisan support when it was signed in 1994. Why are candidates criticizing it now?

JL: Though it offers ongoing benefits, NAFTA has always been controversial. It's always been an easy way for those seeking office to fire up voters concerned about jobs. Barack Obama ran for president in 2008 saying he was going to pare back NAFTA. Ross Perot ran in the 1990s by predicting a "giant sucking sound" of jobs leaving the country if NAFTA was passed. Once presidents actually take office, though, the economic benefits of trade become much more persuasive to them. Not only did President Obama not follow through on his pledge to renegotiate NAFTA, he made it a priority to pass several additional trade agreements that the Bush Administration had negotiated. And he negotiated the TPP. That's a great illustration of how campaign rhetoric, especially around trade, doesn't always translate into action.

OUTLOOK: What's been NAFTA's true impact on the U.S. economy? Has it destroyed jobs?

JL: There's no doubt that NAFTA has played a role in U.S. manufacturing jobs going to Mexico over the last couple of decades. But it's difficult to cite a specific number of jobs directly attributable to that treaty, especially because of the massive loss of jobs that we've seen in manufacturing thanks to automation over the same time period. When we think of automobiles, keep in mind that before, during, and after NAFTA was passed, the auto industry was also being battered by competition from Asia, even though we didn't have a trade deal with Asia. In other words, it's fair to ask whether jobs that went to Mexico would have been saved if NAFTA hadn't been in effect, or if they would've been taken away by competition and robots anyway.

Free trade isn't a competition where one country wins and the other loses. When Mexican workers have good jobs, and their GDP rises, that's a good thing for the United States. It helps us by creating new markets for our own exports. And with all the focus on the southern border, people forget that

> Protecting favored industries from trade competition ultimately harms the economy and consumers.

NAFTA has been incredibly important in integrating our economy with our neighbor to the north. Together, Canada and Mexico account for a third of all U.S. exports.

OUTLOOK: What about the suggestion that foreign trade is destroying our manufacturing base?

JL: That's simply not true. U.S. companies are making more goods today than ever before, albeit with more reliance on capital and less reliance on labor. Twelve million Americans, about 9 percent of the workforce, still work in manufacturing. After dipping from a peak of 20 million around 1980, the number of U.S. manufacturing jobs has actually been rising since 2010. It's true that manufacturing has become a smaller part of our overall economy – 13 percent of GDP today versus 24 percent in 1970. But that's not because we're making fewer products. It's because of the rise of the service economy.

OUTLOOK: Could tariffs or import quotas help save industries such as textiles that have gone overseas?

JL: Sure. The government could certainly help the textile industry, if we were to slap tariffs on apparel coming in from places such as Guatemala or Vietnam. But you'd be eliminating choices for consumers and raising prices, not to mention possibly starting trade wars. Protecting favored industries from trade competition ultimately harms the economy and consumers. If you want to take that idea to absurd lengths, look at North Korea, where all outside trade is banned. But their economy is totally backwards and there's nothing to buy.

OUTLOOK: What impact could a large-scale trade war have on the U.S. and global economies?

JL: If you want to imagine what a modern-day trade war might look like, look back to the 1930s and the Smoot-Hawley tariffs, which drastically increased the price of many foreign products sold in the United States. The idea was that the tariffs would protect American jobs and companies battered by the Great Depression. For a short period Smoot-Hawley seemed successful, cutting off imports and raising demand for U.S. factories. Then, our trading partners launched retaliatory measures of their own, with disastrous results for U.S. exports and for our economy, at a very sensitive economic time. Today, the Smoot-Hawley tariffs are considered one of the critical contributors to prolonging the Great Depression.

OUTLOOK: How would agriculture be affected?

JL: Agriculture would be squarely in the cross hairs. Ag exports totaled $133 billion in 2015, or 6 percent of all U.S. exports. We export to China, India, Europe, and Latin America. Only 5 percent of the world's consumers live in the United States. The other 95 percent have access to U.S. grown food. It's an enormous source of revenue for U.S. farmers.

And Americans wouldn't be the only ones to suffer. The reason people buy American-grown food is because our advanced production methods create a huge cost advantage. We're lowering food costs for people in developing countries all over the world. If you cut off access to American exports, you also risk triggering a humanitarian crisis.

OUTLOOK: What other industries might suffer if free trade is curtailed?

JL: The list is broad. One area people don't think of as an export is services. Services today are our bread and butter, representing around 70 percent of the American economy. We have consulting, financial services and accounting firms operating all over the world. Even if it was just some saber-rattling in the United States that led to a slowdown in world trade, or actual protectionist measures by other countries, you have to assume that many, many American businesses and workers world suffer. You're not only talking about blue-collar workers in Michigan, you're talking about white-collar workers in skyscrapers in Manhattan.

Today, our economy is in a long, slow recovery from a very challenging financial crisis. Tariffs that would slow down the pace of world trade and prevent Americans from selling overseas could have devastating consequences. It's hard to tell how long it would take us to undo the damage. The liberalization of trade over the last 30 years has resulted in a world that's much more economically integrated than ever before. Each step has been painful, slow, and hard-fought. Stepping back would mean fighting those battles all over again.

Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 5/31/16. 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	
2016	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q2	2.30%	2.10%	0.39%	0.81%	1.86%
Q3	2.40%	2.20%	0.54%	0.96%	1.99%
Q4	2.40%	2.30%	0.64%	1.13%	2.14%
2017	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q1	2.30%	2.20%	0.73%	1.29%	2.28%
Q2	2.30%	2.30%	0.80%	1.44%	2.42%

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	0.70%	0.88%	1.17%	1.35%	1.51%	1.70%
0.25	0.86%	1.00%	1.24%	1.39%	1.56%	1.72%
0.50	0.95%	1.08%	1.29%	1.44%	1.60%	1.78%
0.75	1.05%	1.14%	1.35%	1.50%	1.64%	1.82%
1.00	1.13%	1.20%	1.40%	1.55%	1.68%	1.85%
1.50	1.21%	1.31%	1.48%	1.63%	1.75%	1.91%
2.00	1.34%	1.42%	1.54%	1.70%	1.82%	1.98%
2.50	1.42%	1.48%	1.61%	1.77%	1.89%	2.01%
3.00	1.50%	1.55%	1.69%	1.84%	1.95%	2.05%
4.00	1.62%	1.68%	1.85%	1.96%	2.06%	2.14%
5.00	1.77%	1.86%	1.95%	2.08%	2.14%	2.22%

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

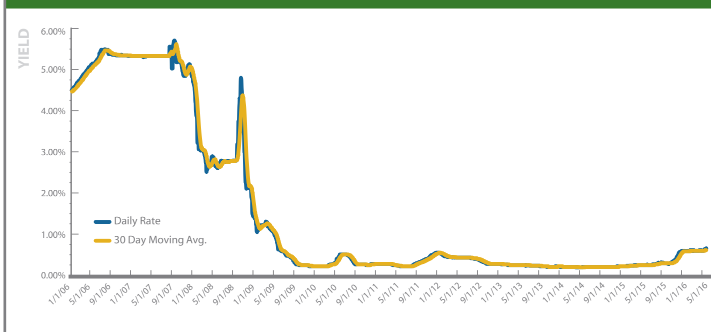
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	5	6	5	5
90	9	12	10	10
180	10	17	16	16
365	25	36	33	31

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.

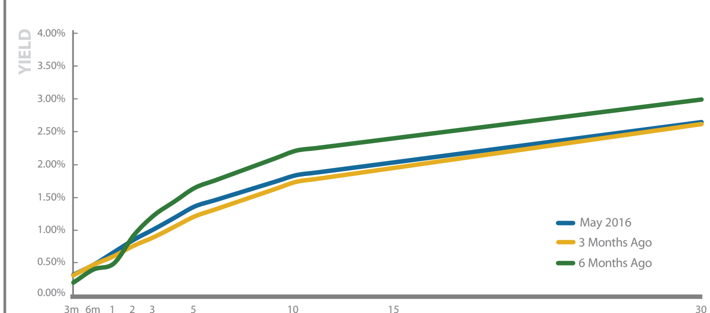
3-MONTH LIBOR



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 CEO Bob Engel Announces Plans to Leave in 2017

Tom Halverson Named CEO-Elect

CoBank CEO Bob Engel announced earlier this month that he will leave CoBank upon the completion of his current employment agreement in June 2017. Tom Halverson, currently chief banking officer, has been named by the board of directors as CEO-elect.

Bob Engel

"Having the opportunity to work at CoBank has been one of the great privileges of my life," Engel said. "When I joined the organization in 2000, CoBank had about $24 billion in assets and earnings of $121 million. Our growth since then has been truly remarkable – to $118 billion in assets and $937 million in net income last year. More importantly, the bank has fulfilled its vital mission of service in rural America while becoming a leading socially responsible corporate citizen. As I have remarked countless times, CoBank is a reflection of our customers' success, and I am deeply grateful for the tremendous support I have received from our customers, who have made leading the bank such an incredibly rewarding and gratifying experience.

"While I am leaving CoBank, I am merely redirecting my passion for two of our country's most underappreciated assets – rural America and higher education," Engel added. "I have continually held that the high quality of life in the U.S. has everything to do with the 15 percent of people who call rural America home. I am very proud of what we have accomplished as an organization, of our many successes beyond our financial success. It is a reflection of the power of the cooperative model and of a commitment by my colleagues to knowing more and caring more about our mission and customers. I want to express my deepest gratitude to our customer-owners, our associates, our partners, our investors and other key stakeholders for their tremendous support of CoBank. I am also thankful to you and all those in rural America who have welcomed me into their businesses and homes with such warmth."

Engel and Halverson will remain in their current positions until January 1, 2017, after which Engel will move into a strategic advisor role.

About CoBank

CoBank is a $118 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 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, rural infrastructure and rural communities. 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.

Tom Halverson

Halverson joined CoBank in 2013 and has responsibility for banking groups serving agribusiness, communications, power and project finance customers. He is a member of the bank's Management Executive Committee and serves as vice chairman and director of the bank's leasing subsidiary. Previously, Halverson spent more than 16 years in a variety of executive positions with Goldman Sachs, including managing director and chief of staff for Goldman Sachs Bank USA, head of credit risk management for Goldman Sachs in Asia (ex-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 the European Bank for Reconstruction and Development.

"It is an honor to be selected as CoBank's next CEO," Halverson said. "I am grateful for the confidence of the board and for the opportunity to build on CoBank's long track record of success. We will continue to fulfill our mission of service to rural America by focusing on building the financial strength and flexibility of the bank, creating an exceptional experience for our customers, and attracting an outstanding team of people who can deliver on our value proposition. CoBank has a bright future ahead and I feel privileged to be part of such a great organization."

Halverson will be the fourth CEO in the history of CoBank, which was formed in 1989 through a merger of 11 Banks for Cooperatives. Prior CEOs include W.M Harding (1989-1993), Doug Sims (1994-2005), and Engel (2006-2016).