OUTLOOK Economic Data and Commentary

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Can India Drive the Global Economy?

In 2016, India surpassed China as the world's fastest-growing major economy. That's the result, among other things, of a number of important steps India has taken to modernize itself, including a major simplification of its complex tax code and a new defense agreement with the United States aimed at bolstering security. With a population of 1.25 billion people and a pro-business, reform-minded government, India would seem to have many of the ingredients to join China as one of Asia's dominant economic powers.

But getting there won't happen easily or quickly, says Sasha Riser-Kositsky, an Asia analyst for Eurasia Group, a leading consulting firm dedicated to global risk. For all of its potential – not to mention vast intellectual and cultural richness and diversity – India faces a staggering array of social and economic challenges.

Riser-Kositsky spoke with *OUTLOOK* about Prime Minister Nerendra Modi's ambitious plans to ramp up foreign investment, breathe life into India's manufacturing base, and convince millions of traditional farmers to move from the fields to the factory floor. As Riser-Kositsky makes clear, the stakes couldn't be higher for India. They are also high for the United States, for which India is a key trading partner and a vital democratic ally in an uncertain world.

OUTLOOK: What is the overall outlook for the economy of India?

Sasha Riser-Kositsky: India's new role as the fastest-growing economy is largely because China is slowing down – not because India is accelerating. While India's growth rate of about 7.5 percent is certainly robust, India has a number of challenges to overcome to capture the double-digit growth that leaders believe is the country's true potential.

This Month's Expert

Sasha Riser-Kositsky is an Asia analyst for Eurasia Group, a global political research and consulting firm with offices in New York, Washington, and London. He received his bachelor's degree in South Asia studies, comparative politics, and diplomatic history at the University of Pennsylvania. While at Penn, he studied Hindi and worked as a research assistant at the Center for the Advanced Study of India.

OUTLOOK: What are the bright spots in the Indian economy?

SR: Among the factors driving Indian economic growth are private consumption of consumer goods, consumer durables, vehicles, health, education, and travel. For example, recent figures show sales of passenger vehicles up by nearly more than 7 percent in 2016, and airline travel by 20 percent. There's also been significant public infrastructure investment, particularly in roads, and private investment in energy. India doesn't produce much in the way of commodities, so it's actually benefited from the low commodity prices that have deeply hurt many other emerging market economies.

OUTLOOK: What is the future of the middle class in India?

SR: While it's certainly growing, India remains an extremely poor country. Even by the government's own figures for 2013–2014, India has a higher percentage of underweight children than sub-Saharan African countries. India has made great strides in reducing poverty, but elevating large numbers of people into a solid middle class has proved elusive. A Bain study found that from 1990 to 2015, the number of Indians earning the equivalent of less than $5,000 per year dropped from 90 percent to 46 percent. Yet only 18 percent made between $10,000 and $45,000 – which might constitute a global standard for middle class. In China, by comparison, 48 percent of the working population earned $10,000 to $45,000.

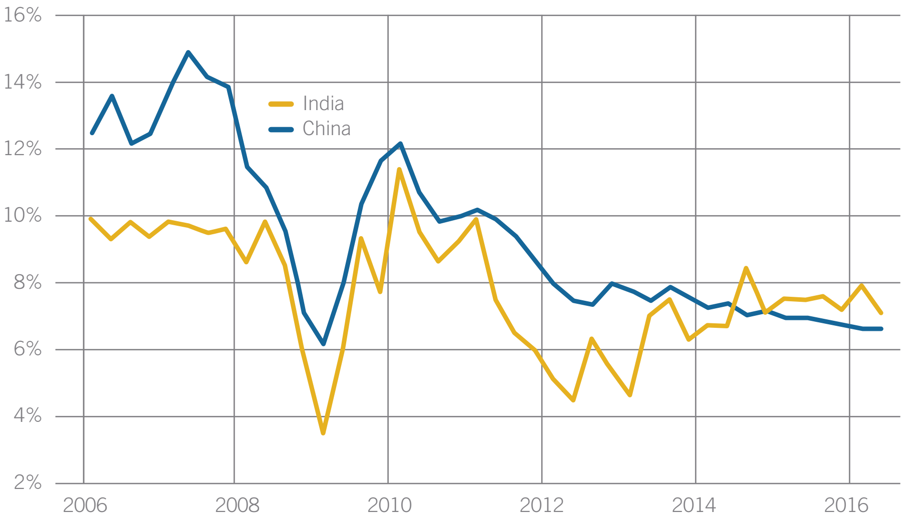
OUTLOOK: What has been the result of all the outsourcing of American jobs to India – has it been a boon to economic growth?

SR: Outsourcing of call center, IT, and similar jobs accounts for about 4-6 million jobs in India. While those jobs are certainly welcome, in a population of 1.2 billion people, they're a relative drop in the bucket compared with the hundreds of millions of Indians employed in agriculture alone. The broader impact for India as a whole is that those service jobs help offset India's perpetual trade deficit, stemming from the fact that India doesn't export much in the way of goods. Services exports also help to strengthen and stabilize India's currency, the rupee.

In addition, that outsourcing trend is slowing, since most of the jobs that were easy to export have already been exported. Others are going to new outsourcing centers in countries such as the Philippines. And in many cases, those jobs are being replaced by technology.

GDP GROWTH FOR INDIA AND CHINA

2006–2016



Source: www.TradingEconomics.com

OUTLOOK: You've described Indian Prime Minister Narendra Modi as a pro-business leader who also sees a vital role for government in the economy. Can you explain?

SR: Modi believes government should run more efficiently, but that there are significant benefits to having state-owned companies in key sectors like railways, coal mining, power, oil and gas, and banks, because you can use them to pursue broader societal goals. A prime example is India's massive "financial inclusion" program, launched with the goal of giving every household in India a bank account. They've opened 246 million in just the last two years, and state banks hold the vast majority. Private banks avoid them because they don't make any money on such modest accounts, but from the government's perspective, mass participation in the financial system is an important goal.

On the other hand, some industries are very open to private investment – such as tech, e-commerce, airlines, and telecommunications. Thanks to the explosion in private sector competition, India now has some of the cheapest flights and phone bills in the world.

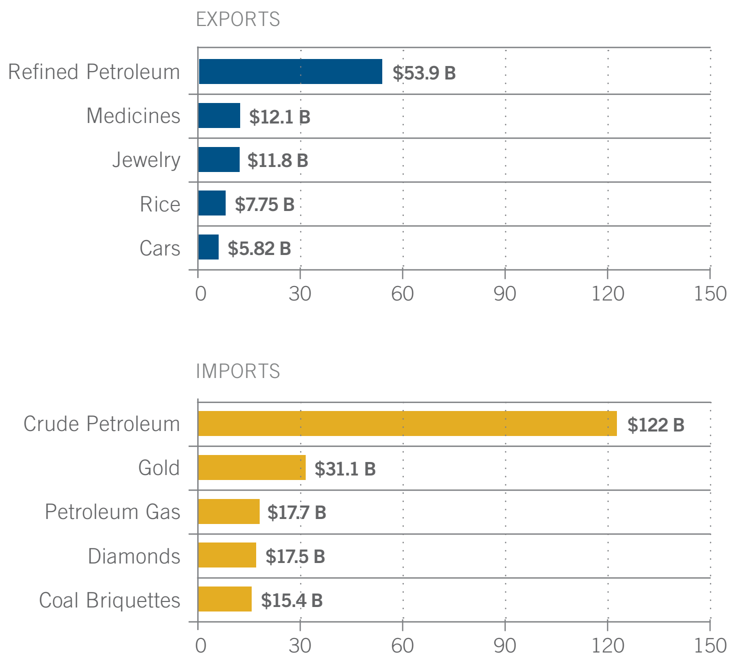
OUTLOOK: What are the trends in American exports to India? Which products are we selling over there?

SR: India is the United States' ninth-largest trading partner in terms of goods. We export everything from gems, diamonds and gold to civilian aircraft, chemicals, petroleum, telecom equipment, medical equipment and nuts. As India's economy – for all of its challenges – continues to grow, U.S. exporting companies are counting on higher demand for all kinds of products. That's why companies such as Boeing are so bullish on India.

While the U.S. exports some agriculture, India's policymakers have for decades used tariffs to reduce dependence on foreign food. There's more trade in non-food agricultural commodities, such as industrial byproducts from sugar, corn, and cotton. One area where American exports have lagged is automobiles. The most successful car manufacturers in India today are Japanese, Korean and homegrown Indian makes. Suzuki has led the market for decades, by designing and marketing low-cost, high quality, robust small vehicles.

INDIA'S TOP EXPORTS AND IMPORTS

In Billions of Dollars



Source: Observatory of Economic Complexity; all figures as of 2014

OUTLOOK: What does India's own agricultural sector look like?

SR: It's still a large part of their economy, accounting for roughly 15 percent of Indian GDP. The sector has been very strong this year: Indian economists say favorable weather, especially better rains, could boost the country's overall growth above 8 percent for the 2016–2017 financial year. International observers are more cautious, saying growth will remain in the 7.5 to 7.6 percent range.

India is the world's second-largest producer of rice, wheat, tea, cotton, and sugar cane, and the third-largest producer of tobacco. Yet while the output is enormous, there are serious inefficiencies. India has been slow to adopt new technologies, and agricultural land is scattered and divided into farms that are too small to justify mechanization. Combining these small plots into larger, more economically rational units isn't easy. That's starting to happen in some areas as more people move to cities to pursue better lives, but not fast enough to raise productivity dramatically on a year-to-year basis. To this day, around 70 percent of India's population lives in rural areas, and agriculture accounts for about half of all employment. It's unsustainable to have an industry that employs half your people but accounts for only 15 percent of GDP, because productivity and incomes can't sufficiently grow.

OUTLOOK: How is India dealing with that problem?

SR: There's a multiparty consensus that India needs more manufacturing, particularly mass employment in lower-skill manufacturing. Around 1 million young people will enter the workforce each month over the next five to 10 years, and the economy is simply not creating the volume of jobs required to employ them. As much as people want to talk about high-end fields such as medicine, technology, pharmaceuticals and engineering, those sectors are unlikely to create enough jobs – hence the emphasis on more basic manufacturing. The plan is to increase manufacturing from about 16 percent of GDP to 25 percent by 2022 through a wide variety of incentives and regulatory tweaks, creating about 100 million new jobs.

As China tries to rebalance its economy by closing down its excess production capacity, India would love to attract some of that lower-skill, mass-employment manufacturing. This is a moment when people see India as poised for take-off, where China was 10, 15 or 20 years ago.

> India's enthusiasm for free trade is at best tepid.

OUTLOOK: How would you describe current relations between the U.S. and India?

SR: I would argue that they're closer than ever. But I'm wary of such phrases as "the world's two largest democracies," "shared values" and "natural allies." Is there really any such thing as a permanent natural ally in this geopolitical day and age? I would point to shared interests over shared values. The first is on defense and security. The Indian-U.S. defense and security relationship is as close as it's ever been. This is being driven by Indian wariness over rising Chinese power. Though of course the U.S. and India aren't formal enemies with China – and everybody hopes it stays that way – there's no question that shared concern is driving unprecedented levels of joint military exercises and cooperation.

At the same time, the U.S. government and public are growing more skeptical about India's longtime rival, Pakistan, due to concerns about terrorism. The new defense agreement signed by India and the United States in 2016 didn't change logistics much in a practical sense – they were already cooperating closely – but it was a huge symbolic step, demonstrating Indian eagerness to work with the U.S. The defense and security relationship is strong enough that occasional trade disputes don't spill over and ruin the overall relationship.

OUTLOOK: What is India's overall position on free trade with the U.S. and others?

SR: Because of its emphasis on boosting domestic manufacturing, India's enthusiasm for free trade is at best tepid. India isn't yet a manufacturing power, and there's a strong feeling that in the areas where they do manufacture, their companies aren't globally competitive and need protection. So the government is very skeptical of major international initiatives such as the proposed Trans-Pacific Partnership involving the United States and 11 Pacific Rim countries. Even if the TPP comes to fruition, it would be well into the 2020s before India would be in a position to join. India has pending trade agreements with the European Union that have been on the table now for almost 10 years. I think you'll see interest in trade building over the next five to 10 years, assuming that the planned investment in infrastructure takes place and the country gains more confidence in its ability to compete internationally in manufacturing.

A rising India has the potential to lift all boats, as much as China's economic acceleration over the last 10 years helped drive global growth and global trade.

OUTLOOK: What are the biggest surprises you foresee coming out of India over the next decade or so?

SR: To successfully address vexing issues from job creation to climate change to water shortages, India's going to have to get very innovative. Over the next 10 years you might see a lot of new technology coming out of India in terms of water saving and recycling. We could see greater use of mechanization and technology in agriculture, along with political reforms and improvements in the country's education system. If these innovations don't happen, India will not be a rosy picture in 10 years. But if they do, it could be a very different place, vastly more urban, better educated, and better connected to the world.

Individual regions of India could become major economic, social and cultural powerhouses. Consider that as many of the world's people speak Hindi as Arabic, as many people speak Bengali as Portuguese, Russian or Japanese, and as many people speak Punjabi as German. With a population of more than 1 billion, better education will mean more prodigies coming to the fore. You'll see India capturing a larger share of the international stage in everything from science competitions to the Olympics.

OUTLOOK: Are you optimistic or pessimistic about India's economy? What do you expect to be its impact on the U.S. over the next few years?

SR: I am very optimistic on the near-term prospects for continued rapid Indian economic growth. That growth and development will benefit the U.S. economically and geopolitically – a wealthier India will consume more U.S.-made goods and services. Over the longer term, India will represent a new center of power in Asia, potentially presenting a democratic counterweight to China. A rising India has the potential to help lift all boats, much as China's economic acceleration over the last 10 years helped drive global growth and global trade.

Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 9/30/16. 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**
Q4	2.40%	2.40%	0.50%	0.93%	1.74%
2017	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q1	2.20%	2.20%	0.60%	1.01%	1.85%
Q2	2.30%	2.30%	0.65%	1.11%	1.96%
Q3	2.20%	2.30%	0.68%	1.24%	2.07%
Q4	2.10%	2.40%	0.73%	1.39%	2.17%

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	0.88%	0.97%	1.11%	1.22%	1.35%	1.50%
0.25	0.96%	0.99%	1.14%	1.26%	1.38%	1.51%
0.50	1.00%	1.03%	1.17%	1.29%	1.41%	1.56%
0.75	1.05%	1.10%	1.20%	1.32%	1.44%	1.58%
1.00	1.09%	1.12%	1.23%	1.35%	1.47%	1.61%
1.50	1.13%	1.17%	1.29%	1.41%	1.52%	1.66%
2.00	1.19%	1.23%	1.33%	1.41%	1.58%	1.70%
2.50	1.31%	1.29%	1.40%	1.50%	1.63%	1.75%
3.00	1.44%	1.34%	1.47%	1.59%	1.68%	1.79%
4.00	1.58%	1.47%	1.60%	1.70%	1.71%	1.86%
5.00	1.97%	1.61%	1.65%	1.80%	1.87%	1.93%

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

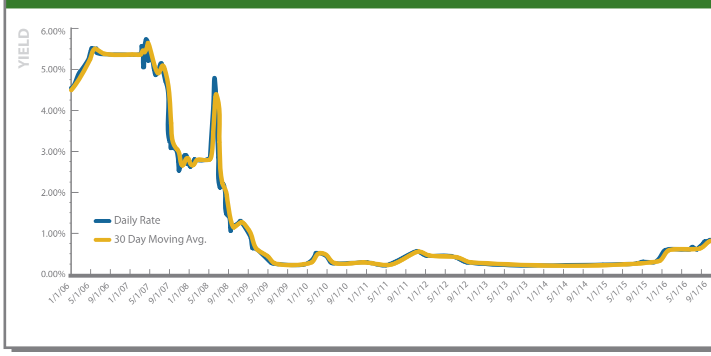
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	5	5	5	5
90	5	8	8	7
180	5	8	10	10
365	5	15	21	19

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.

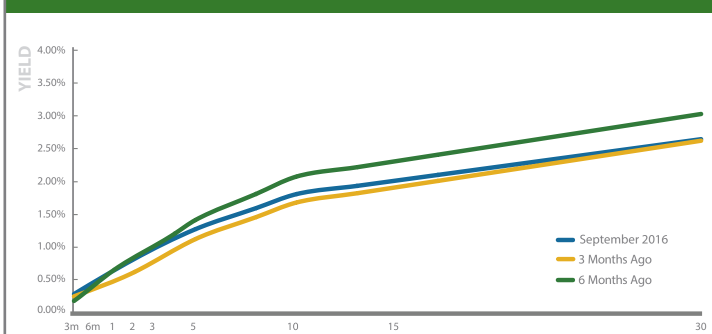
3-MONTH LIBOR



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 2017 Customer Meetings

CoBank has announced the schedule for its 2017 customer meeting program. The meetings will take place at locations around the country and are an opportunity for managers and directors of all CoBank's customer and partner organizations to receive valuable knowledge, insight and information they can use every day in their business and personal lives. The full schedule of meetings is listed in the table below:

REGION	DATE	LOCATION
Midwest	February 23–24	La Vista Conference Center *Omaha, NE*
Northeast	March 2–3	DoubleTree by Hilton Syracuse *Syracuse, NY*
Pacific West	March 9–10	Park Hyatt Aviara Resort *Carlsbad, CA*
Central	March 13–14	Bloomington-Normal Marriott *Normal, IL*
Western Plains	March 16–17	Hyatt Regency Wichita *Wichita, KS*
Minnesota	March 20–21	JW Marriott Mall of America *Minneapolis, MN*
North Dakota	March 27–28	Hilton Garden Inn Fargo *Fargo, ND*
Southwest	April 4–5	Westin Riverwalk Hotel *San Antonio, TX*
Southeast	April 10–11	Ritz-Carlton Amelia Island *Amelia Island, FL*

Information about speakers, registration and venues is available at www.cobank.com/meetings. There is no charge to attend the conference beyond travel and hotel expenses. For more information, contact your CoBank relationship manager or the bank's Corporate Communications Division at 303-740-6442.

About CoBank

CoBank is a $125 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.