COBANK

OUTLOOK

ECONOMIC DATA AND COMMENTARY

January 2019 • Volume 16 • Number 1

Washington Outlook: What to Expect from a Split Congress

Historically, the party in the White House almost always loses congressional seats in midterm elections, and the 2019 shift to Democratic control of the House of Representatives fits this trend. Yet expected or not, the outcome clearly signals significant changes ahead for Washington policies and politics that could affect the U.S. economy and financial markets.

During the first two years of the Trump Administration, with Republican majorities in the Senate and the House of Representatives, Congress passed major tax legislation, while the President pushed for deregulation in every part of the economy and imposed tariffs on major U.S. trading partners to try to address a growing trade deficit and win other concessions.

Now, with control of Congress split between parties unlikely to find much middle ground, the next two years may be notable largely for what doesn't get done, says Sarah Binder, senior fellow in governance studies at the Brookings Institution and professor of political science at George Washington University. But gridlock has its own impact, and even if neither Democrats nor Republicans can do much to implement their policy agendas, they'll still have to govern, passing spending bills and other necessary legislation. Binder describes what may be ahead.

OUTLOOK: What does history tell us to expect from a split Congress?

Sarah Binder: In the 70 or so years of the postwar era, it's actually been rare for parties to split control of Congress. The most recent times were 2011-2014 and 2001-2002. Before that, you'd have to go back 20 years to the early days of the Reagan Administration, and before that to the years of the Great Depression. If we look at legislative performance during recent periods of split control, not surprisingly, there was a considerable amount of gridlock, since parties come to the table with different priorities. And it's not just that they don't agree on how to solve problems, they often don't even agree on what the problems are. A good example today is climate change, which many Republicans say isn't a problem, and which Democrat believe is something Congress should act on immediately.

This Month's Expert

Sarah Binder is senior fellow in governance studies at the Brookings Institution and a professor of political science at George Washington University, where she specializes in Congress and legislative politics. Binder's current research explores the historical and contemporary relationship between Congress and the Federal Reserve. She is also an associate editor of *The Washington Post's* "Monkey Cage" blog.

Binder is the co-author of "The Myth of Independence: How Congress Governs the Federal Reserve," and the author of "Stalemate: Causes and Consequences of Legislative Gridlock," both of which were awarded the Richard F. Fenno, Jr., Prize by the American Political Science Association for the best book published on legislative politics. Binder earned a bachelor's degree in history from Yale University and a doctorate in political science from the University of Minnesota. She was elected to the American Academy of Arts and Sciences in 2015.

OUTLOOK: Is the partisan divide as sharp as it feels, compared with previous times?

Binder: Parties certainly have become more competitive. The last time we looked at the United States on election night and saw a big blue or red map was 1984, with Ronald Reagan's reelection. When parties win these days, the majorities are often smaller than in the past, which intensifies the partisan battle to re-capture control of Congress and the White House. That's hardly a recipe for cooperation to tackle big, public problems.

OUTLOOK: What's the likelihood that things will get done, or are we looking at two years of gridlock?

Binder: I don't think our baseline expectation should be zero. On the other hand, you have to consider what the incentives are for both parties to go to the bargaining table. Do both parties see an incentive to deliver something to voters, particularly in the run-up to a presidential election year? Each party will ask itself what the costs are for refusing to go to the negotiating table.

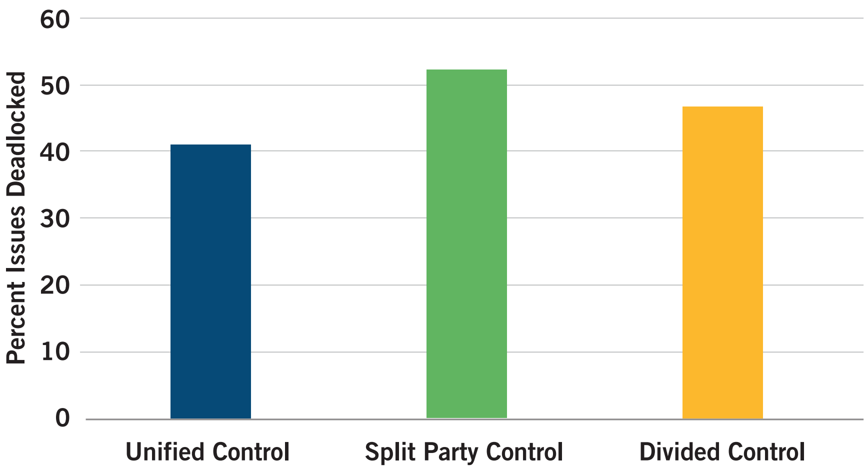
In 1996, despite having a Democratic president and a Republican Congress, both parties seem to have decided they needed something to show the voters, so we saw major welfare reforms and environmental laws introduced. In 2015, with President Obama and a Republican Congress, there was quite a lot of legislative action. Senate Majority Leader Mitch McConnell and Senate Republicans decided after several years of being the party of "No" that they needed to show voters that the GOP could be trusted to govern. The result was landmark education reform, a multi-year highway bill, a mammoth spending deal and a solution to a decade-old Medicare "doc fix" problem. So, there may be issues on which a Democratic House and a Republican Senate each decide they can't afford to be seen as blocking progress.

OUTLOOK: What are some possibilities?

Binder: Student debt might be one. Or prescription drugs – neither party wants to be seen as in the pockets of Big Pharma. Then it's a question of how far parties are willing to go in terms of setting drug prices. So we may get some incremental measure on prescription drugs. We could see some kind of infrastructure bill, but I'm a little skeptical, in part because the Democratic Senate leader, Senator Chuck Schumer [D-NY], said recently that any infrastructure bill would need a green component to it. That means climate change, and, potentially, some kind of carbon tax. Republicans are unlikely to embrace a carbon tax, so Democrats have a license not to participate in a Republican infrastructure bill.

MORE FREQUENT GRIDLOCK WITH SPLIT CONTROL OF CONGRESS

(1947-2016)



Source: Dr. Sarah Binder 1/2019

OUTLOOK: Now that Democrats control the House, what do you expect them to push for?

Binder: My guess is Democrats will push their agenda in two ways. First, they'll do a lot of messaging about key economic and social priorities that most Democrats agree on, such as controlling health care costs, implementing a $15 minimum wage and campaign finance reform. They'll push bills through the House, knowing full well that Republicans in the Senate will take up almost none of them. But, passing them in the House will give Democrats a message to voters for the 2020 election: Return us to full power and this is what we'll do.

The second approach will be to use their power of the purse, through annual spending bills, effectively to make incremental down payments on policy priorities. One area where we might see additional spending is in expanding access to broadband internet service, a key concern for rural businesses and residents, as well as for electric cooperatives. Congress has already been making these investments in the Farm Bill and the National Defense Authorization Act, and we may see more of this approach. That's the sort of incrementalism that's possible in a period when it's hard to muster support for larger initiatives.

OUTLOOK: The midterm election saw a surge in victories by women and people of color, and an influx of political newcomers. How will this impact the Democratic Party's agenda?

Binder: The key question is, what does it mean for House Democrats and their ability to coalesce behind a single agenda? The influx of freshman members is going to pull the Democratic caucus to the left and create potential friction with the more moderate Democrats from suburban districts that had traditionally been Republican turf. This leftward shift is going to create pressures on newly reelected Speaker Nancy Pelosi to keep the peace and to not make deals with the Republicans and the president.

There will also be pressures on the freshman members, many of whom have little legislative or prior electoral experience. They face a steep learning curve and don't have a sense of the reality of how difficult it is to get things done in Washington, of what's actually possible. On the one hand, there's the idealism, activism and protests against Trump that helped get them into office. But when that idealism hits the reality of how hard it is to build bipartisan super majorities for major change, there will be some frictions and some fireworks.

> "In any case, the economy in 2019 will likely be affected by factors that have little to do with whether or not there's political gridlock"

OUTLOOK: What's likely to happen with regard to the Republicans' focus on deregulation, a hallmark of the Trump presidency?

Binder: Republicans have been using a procedure in the Congressional Review Act that allows Senate Republicans to avoid a filibuster of motions to repeal Obama-era regulations. In the last Congress, the GOP House readily agreed with the Senate and pushed to repeal more than a dozen regulations. That effort won't fly with the House controlled by Democrats. In fact, I wouldn't be surprised if Democrats put riders into spending bills explicitly prohibiting the Environmental Protection Agency, for example, from dismantling the Clean Power Plan, or requiring the Energy Department to commission studies on damage from coal-fired power plants.

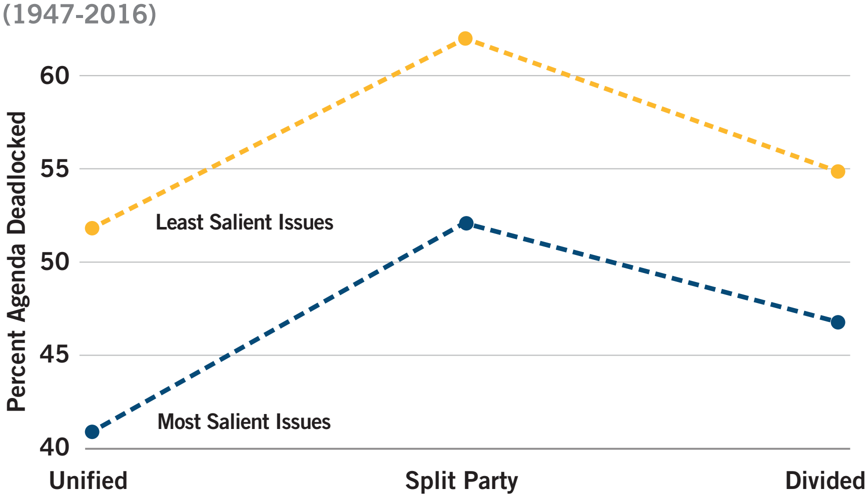
House Democrats will likely also use their investigative powers to force greater public and media scrutiny on recent deregulation. They may hold hearings and call leaders of corporations that have benefited from deregulation to testify. The House Financial Services Committee may look at what deregulation has meant in terms of financial consumer protection, public access to credit and the health and stability of mortgage markets.

OUTLOOK: How does political gridlock tend to affect financial markets?

Binder: Some studies suggest that gridlock is good for markets, particularly for stocks, though I'm a little suspicious of these conclusions. To me, it's hard to draw a causal link between a legislative stalemate and investor enthusiasm for the stock market. For example, when the economy started taking off in the mid-1990s after the recession of 1992, some observers attributed the strong economy to partisan gridlock. But Congress had been taking significant actions in the preceding years: There was a budget deal in 1989 that raised taxes, there were spending caps enacted in 1990, and tax increases passed again in 1993. One might argue that those actions, rather than political gridlock, helped create the strong economy. In any case, the economy in 2019 will likely be affected by factors that have little to do with whether or not there's political gridlock.

SPLIT CONTROL OF CONGRESS AND IMPACT BASED ON SALIENCE OF ISSUE

(1947-2016)



Source: Dr. Sarah Binder 1/2019

OUTLOOK: What are those factors?

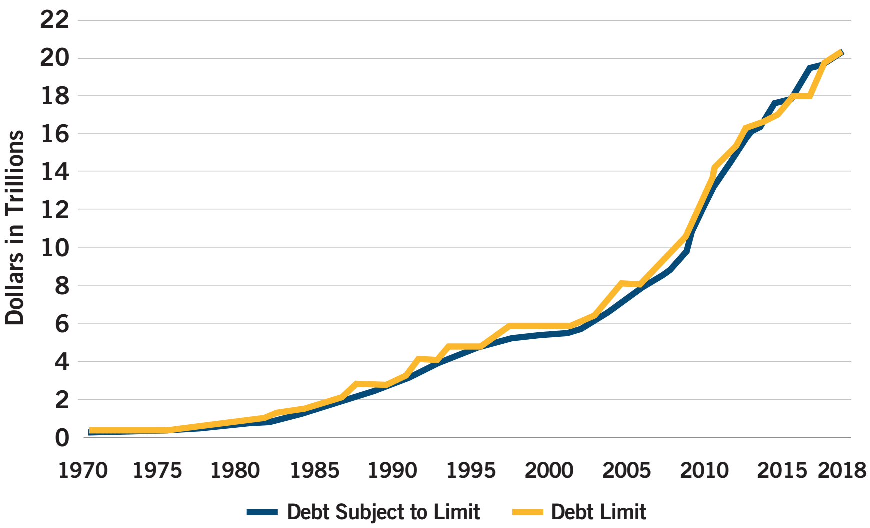
Binder: One key question is where trade issues are going, particularly with China. President Trump clearly believes that tariffs are the route to getting the economic outcomes he wants, and I think he'll keep at it in an effort to increase investments in the United States and gain concessions from trading partners. He may, at some point, simply declare victory and bring the trade war to an end, and I imagine equity markets would be quite pleased.

Another issue concerns the Federal Reserve's plans for a series of interest rate increases in 2019. The tax cuts enacted in late 2017 created economic stimulus in 2018. Now that we're coming off of that "sugar high" and the president's trade wars are making investors and businesses nervous about the economy in 2019, we'll have to keep an eye on what the Fed does. Fed chair Jay Powell has already reacted to signs of economic unease by announcing the Fed is likely to "pause" their rate hikes in 2019. That, in itself, might help stabilize the economy, without any action by Congress.

OUTLOOK: Budget battles caused a partial shutdown of the government in December and into 2019, even before the Democrats assumed control of the House. What do you expect on the budget front in 2019?

Binder: Congress and the president first need to find a way to resolve the current government shutdown. The new budget process for the coming fiscal year begins in February with submission of the president's budget. But there doesn't seem to be a whole lot of discussion from either party about fiscal responsibility right now. The government shutdown, for example, was about immigration and the wall, not spending. In contrast, when Republicans took control of Congress during the Obama presidency, they were clearly in favor of spending austerity and argued for retrenching entitlements, although the latter didn't happen. But now, after two years of unified Republican control under the Trump presidency, concern about fiscal austerity doesn't seem to have remained as relevant. For example, lawmakers typically don't cut taxes when an economy is already doing well, but that's what happened. In the end, arguments about deficits and spending seem to be somewhat politically shaped and dependent on whether it's a useful position or not at a given moment. On that issue, there seem to be very few pure ideologues.

STATUTORY DEBT LIMIT AND FEDERAL DEBT SUBJECT TO LIMIT



Source: Office of Management and Budget, Treasury Department.

Note: Does not show debt limit suspensions since 2013, which is why the debt subject to limit sometimes appears over the limit

That said, a split Congress will face challenges this year when it comes to negotiating the next budget for fiscal year 2020, which begins in October 2019. That's because spending caps put in place under the Budget Control Act of 2011 are set to expire in fiscal 2020. Without a bipartisan agreement, the spending caps will automatically revert to a lower level that neither party wants. The last time these negotiations occurred in 2018, without a split Congress, the agreement included major new spending for both defense and the domestic agenda. We'll see whether Democrats and Republicans, sharing power, are able to come up with an agreement both can live with.

OUTLOOK: The federal debt ceiling, which determines how much the government can borrow, was suspended in early 2018. It is set to be reinstated on March 2, and because the U.S. is running a budget deficit approaching $1 trillion a year, the debt ceiling will immediately need to be raised. What is likely to happen then?

Binder: My guess is that Treasury will invoke what are known as "extraordinary measures," enabling the government to continue meeting its obligations for a few months after the March reinstatement. When it comes to a longer-term solution, formally raising or suspending the ceiling would normally fall to the party in power – in this case, to Republicans, because they control the White House in addition to the Senate. But Senate Republicans will probably look for a way to keep their fingerprints off such an action, to try to show that they still care about fiscal responsibility. As one possibility, they might authorize the administration and the Treasury to raise the debt ceiling, but then leave themselves room to pass a resolution disapproving of it. Or raising or suspending the ceiling could get wrapped into a broader spending bill.

> "And in this Congress, no matter the diversity of views within each party, those disagreements pale in comparison to the ideological gulf between the parties"

OUTLOOK: Both House Democrats and Senate Republicans have only relatively slim majorities in their chambers. Looking at what has happened historically, does that increase or decrease the likelihood that they'll cooperate with each other?

Binder: The size of the parties in the majority – whether they have a narrow or large margin over the minority party – by itself doesn't tell us all that much about the prospects for cooperation. We also need to know something about the ideological cohesiveness within each party and the ideological differences between the two parties. And in this Congress, no matter the diversity of views within each party, those disagreements pale in comparison to the ideological gulf between the parties. And given how polarizing President Trump is to the Democrats (as were Presidents Obama and Bush to their opposition parties), the prospects for significant cooperation to solve major problems seem diminished.

OUTLOOK: Given President Trump's apparent willingness to secure policy through executive order and other means, could Republicans just attempt to wait out the split Congress in hopes of winning majorities in 2020?

Binder: For sure. That's the dilemma for polarized parties that divide control of the Congress. Each party thinks that control of the government – Congress and the White House – could be just around the corner in the next election. And if that's true, why cooperate and share the credit with the other party? Unless the public weighs in decisively in favor of one party's positions over the other, it's really hard to break the logjam in Congress.

OUTLOOK: With many House committees poised to investigate the Trump White House, will that undercut congressional attempts at policymaking?

Binder: The Democratic House will have to learn to multi-task as it staffs up its committees to pursue investigations. But keep in mind that most of the Democrats' legislative initiatives will be framed as messaging efforts. The GOP Senate is likely to be a graveyard for Democrats' key priorities, so the goal for Democrats will often be to build internal party consensus – rather than the harder work of securing bicameral, bipartisan coalitions for change.

Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 12/31/18. 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

Forecasts courtesy of Bloomberg and Blue Chip Economic Indicators

				U.S. Treasury Securities	
2018	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q4	2.70%	2.40%	2.28%	2.95%	3.20%
2019	**GDP**	**CPI**	**Funds**	**2-year**	**10-year**
Q1	2.40%	2.50%	2.46%	3.05%	3.30%
Q2	2.50%	2.20%	2.58%	3.16%	3.36%
Q3	2.20%	2.20%	2.65%	3.24%	3.41%
Q4	2.00%	2.30%	2.70%	3.28%	3.44%

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	2.74%	2.90%	2.96%	2.96%	2.98%	3.04%
0.25	2.95%	2.94%	2.96%	2.95%	2.97%	3.03%
0.50	2.96%	2.99%	3.00%	2.95%	2.97%	3.04%
0.75	2.98%	3.03%	2.98%	2.98%	3.00%	3.07%
1.00	3.00%	3.02%	2.96%	2.95%	2.98%	3.05%
1.50	2.99%	2.97%	2.96%	2.98%	3.02%	3.08%
2.00	2.93%	2.95%	2.93%	2.96%	3.01%	3.08%
2.50	2.91%	2.93%	2.93%	2.97%	3.03%	3.10%
3.00	2.88%	2.91%	2.94%	2.99%	3.05%	3.11%
4.00	2.89%	2.93%	2.98%	3.04%	3.10%	3.15%
5.00	2.93%	2.98%	3.03%	3.13%	3.15%	3.19%

HEDGING THE COST OF FUTURE LOANS

A forward fixed rate is a fixed loan rate on a specified balance that can be drawn on or before a predetermined future date. The table below lists the additional cost incurred today to fix a loan at a future date.

FORWARD FIXED RATES

Cost of Forward Funds

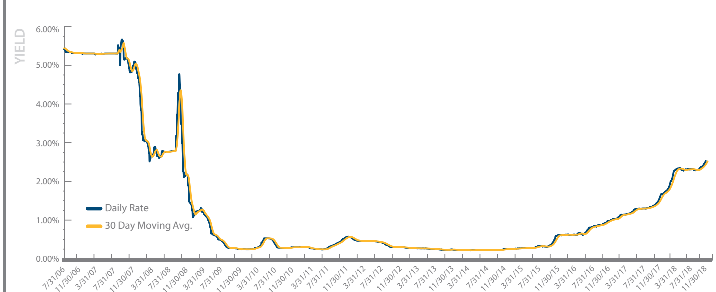
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	5	5	5	5
90	6	5	6	5
180	9	6	9	8
365	16	9	18	15

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.

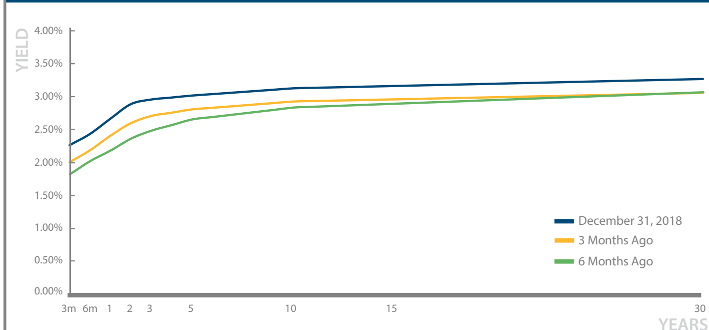
3-MONTH LIBOR



RELATION OF INTEREST RATE TO MATURITY

The yield curve depicts 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 UPDATE

Dr. Scheherazade S. Rehman Joins CoBank Board

Dr. Scheherazade S. Rehman, a renowned professor of international finance and business, has been named to the CoBank board as an appointed director. Rehman will serve a four-year term on the board expiring in 2022.

Scheherazade Rehman

Rehman is the director of the World Executive MBA program with cybersecurity, director of the European Union Research Center, and a professor of international finance/business and of international affairs at the George Washington University (GWU). Since 1989, she has served as president and managing partner of the International Consultants Group, an international risk and financial markets consulting company. She is also a director of the American Consortium on European Studies since 2001 and of the International Trade and Finance Association since 2002. She was the recipient of the dean's Professorial Fellow of International Finance and Business at GWU from 2012 through 2017, and a Senior Research Fulbright Scholar in 1998. Prior to joining GWU, Rehman served as a foreign exchange and money market trader in the Middle East. She has advised numerous government agencies and international entities, including the World Bank, the International Monetary Fund, the U.S. Agency for International Development (USAID), OPIC, and the U.S. State Department, and is often called upon to speak to financial matters before Congress and with media, and has authored several books and scholarly publications. Rehman holds a bachelor's in International Banking and Finance, an MBA in International Business/International Finance, and a doctorate in International Finance, all from GWU.

"I'm delighted to welcome Scheherazade as an appointed director," said CoBank Chair Kevin G. Riel. "Her deep expertise in international finance and business will contribute greatly to our board and bring added strength and experience as we continue to serve our customers."

"It's a privilege to be joining the board of CoBank," Rehman said. "I appreciate its mission to support the growth and development of the U.S. rural economy, and I look forward to working with the rest of the board to help the bank position itself for continued success."

Also today, CoBank announced board officers for the coming year.

Kevin Riel

Riel, who became board chair in 2018, will continue to serve as chair for 2019. He joined the CoBank board in 2014 and became first vice chair in 2017. He is the president and chief executive officer of Double 'R' Hop Ranches, Inc., a diversified farming operation primarily growing hops, together with apples, grapes and row crops, and of Tri-Gen Enterprises, Inc., an agricultural marketing operation. Riel is also managing partner of WLJ Investments, LLC, a land holding and management company. All three businesses are located in Harrah, Washington. He is a member and former chair of Northwest Farm Credit Services, ACA, and a board member of the Hop Growers of America, a nonprofit association promoting the interests of U.S. growers. He is also a member of the Nationwide Insurance Board Advisory Committee.

Jon Marthedal

Jon E. Marthedal will serve as first vice chair. Marthedal is the owner and operator of Marthedal Farms, a grape, raisin and blueberry farming operation; owner and president of Marthedal Enterprises Inc., a provider of farm management and custom agriculture services; and owner and operator of Keystone Blue Farms, LLC, a blueberry farming operation, all located in Fresno, California. He serves on the board of The Farm Credit Council. Marthedal is a director of Sun-Maid Growers of California and of the California Blueberry Commission. He also serves as president of the California Blueberry Association Board and vice chair of the California Raisin Marketing Board and the Raisin Administrative Committee. Marthedal has served on the CoBank board since 2013, served as first vice chair in 2018, as second vice chair in 2017 and as Governance Committee chair in 2016.

Kevin Still

Kevin A. Still will serve as second vice chair. Still is president and chief executive officer of Co-Alliance, LLP, a partnership of five cooperatives supplying energy, agronomy and animal nutrition, producing swine and marketing grain in Avon, Indiana. Still is also chief executive officer and treasurer of Midland Co-op, Inc., IMPACT Co-op, Inc., LaPorte County Co-op, Inc., Frontier Co op, Inc., and Excel Co-op, Inc., and president of Michiana Agra, LLC, which are agricultural retail cooperatives. Still is also an officer of Agronomy Services, LLP, and president of Northwind Pork, LLC, a pork-producing operation. He is chair of Local Harvest Food, a food broker, and an advisory

About CoBank

CoBank is a $128 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, 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 www.cobank.com.

committee member of Wholestone Farms, a food company. He is the owner and president of Still Farms, LLC, a grain farm. Still has served on the CoBank board since 2002; he served as second vice chair in 2015, 2016 and 2018, and as the Risk Committee chair from 2008 through 2017.

"I look forward to continuing to work closely with Jon, Kevin and the rest of our directors in the coming year," Riel said. "Our board and executive management team remain committed to preserving and building the long-term financial strength of the bank so it can continue fulfilling its mission of delivering dependable credit and financial services to our customers."

Also today, the bank announced that director Richard W. Sitman has resigned from the board. Sitman, an elected director from the board's South region, had served on the board since 1999 (and previously from 1995-1996) and was a member of the board's Risk Committee. An election will be held in 2019 to elect a director to fill this seat for a four-year term starting January 1, 2020. ■