# Farmer Mac Refresh: Current Economic Events & How They Impact Net Yields

June 2015

# *Upcoming Events*


**Dr. David Kohl:**
**Post Commodity Super Cycle**

***Wednesday, July 1st, at 12:00 PM ET***

https://www.farmermac.com/Resources/calendar-of-events

# *Today's Presenters*

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# Summary & Market Trends

- Interest rates increased significantly since bottoming in January
  - 10-year Treasury rates have increased by just 0.15% this year, however have jumped nearly 0.65% since the end of January
  - Recent jump in rates driven by overseas markets, improving job market, large corporate bond issuance and technical factors

- Job growth remains strong with an average 255,000 jobs added each month over the last year
  - The unemployment rate is at 5.5%, the lowest since 2008 and down from 6.3% in June 2014

- GDP growth was very weak in the first 3-months, contracting 0.70%
  - This follows 2.2% in 4$^{th}$ quarter 2014, 5.0% in 3$^{rd}$ quarter 2014 and 4.6% in 2$^{nd}$ quarter 2014
  - Fed officials awaiting more data to see whether 1$^{st}$ quarter weakness was weather induced

- Stable job growth with mixed GDP helping to keep interest rates below historical levels
  - Inflation remains contained, well below 2%
  - Lower commodity prices (oil, corn, soybeans) driven by stronger dollar
  - Weaker growth picture than in 2014
    - IMF recently downgraded US 2015 GDP growth forecast to 2.5% from 3.1%

# Agency Debt Market Trends

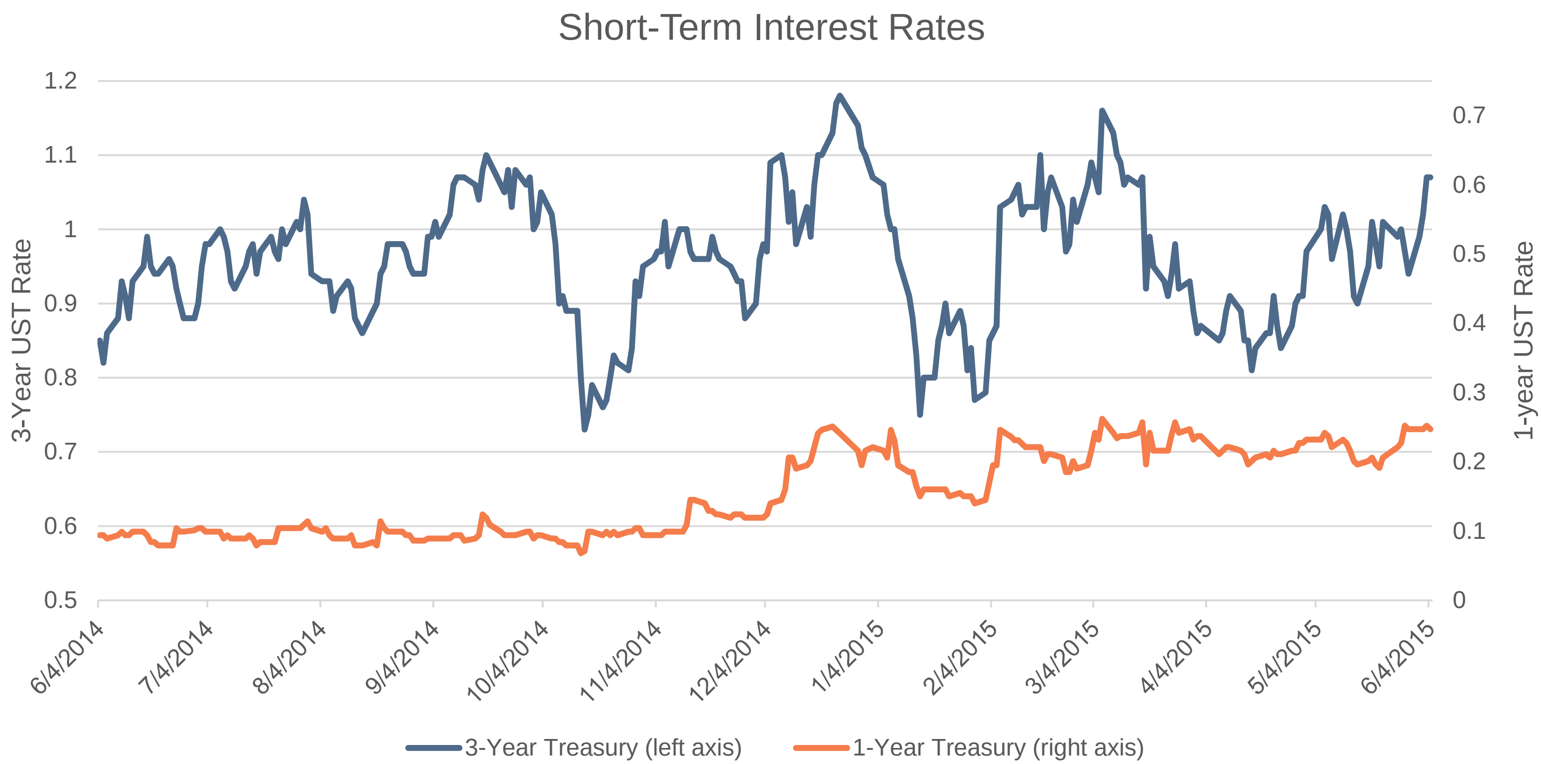
- Total issuance is down slightly from 2014, helping to keep spreads tight
  - Larger issuers like Fannie Mae and Freddie Mac are reducing issuance, which is helping the supply-demand dynamic for new issuance

- Treasury spreads on Agencies are close to narrowest on record
  - Rate volatility over the last few weeks is widening spreads slightly as investors reassess expectations for interest rates

- Farmer Mac issuance spread to Treasuries slightly improved from 2014
  - Narrower spreads lowers Farmer Mac's cost of funds and translates into lower net yields being offered for cash window loans

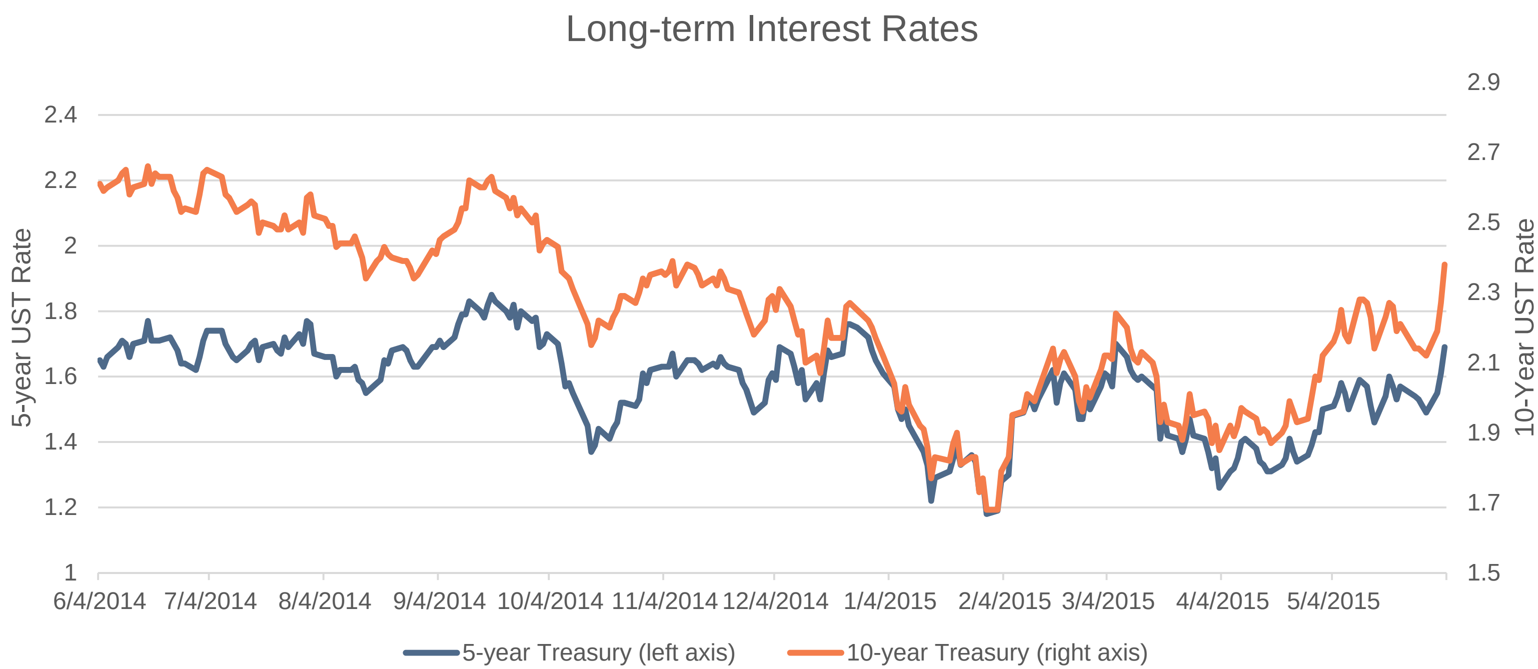
# *Product Impact*

# *Market Update: Short-term Rates*




- Shorter-term rates trending higher over last 12 months
  - Short-term rates more influenced by Federal Reserve
  - Increases in Fed Funds rate may cause more volatility in these rates in the near-term

# *Market Update: Long-term Rates*




- 10-year rates still 0.30% lower than last summer
- 5-year rates nearly unchanged from last summer
- Rates bottomed out in January driven by weak economy, lower global yields, concerns about deflation
- Recent move higher driven by global factors, improving economy and higher term premiums being priced into market

# Interest Rates: Product Impact

- Rates on long-term fixed rate products near year-ago levels; short-term fixed rate products higher from last year
  - Short-term interest rates have gradually increased over the past year as the market begins to slowly price in higher interest rates from the Federal Reserve
  - Recently all rates have been moving higher since late January

| Product | 6/9/2014 | 1/30/2015 | 6/8/2015 |
|---|---|---|---|
| Farm and Ranch 15-year Fixed | 4.60% | 4.16% | 4.68% |
| Farm and Ranch 5-year ARM | 3.08% | 3.10% | 3.42% |
| USDA 20-year Fixed | 4.07% | 3.39% | 3.92% |
| USDA 5-year Reset | 2.82% | 2.61% | 2.99% |

- LIBOR-based reset product (1-month ARM, AgEquity) have been very popular and benefit from very low short-term rates
  - These products are much more sensitive to actions by the Federal Reserve than products with initial fixed rate periods greater than 5-years

# Interest Rate Forecasts

# Interest Rate Forecasts

- Economists have lowered interest rate forecasts to reflect a slower pace of interest rate increases from the Federal Reserve
  - Most economists expect rates to rise between 0.75% and 1.25% over the next 12 months
  - Short-term interest rates are expected to increase more than long-term interest rates
  - Low inflation and stronger dollar are key drivers of interest rate increases proceeding at a slower pace

| Interest Rate Forecasts | 6/9/2015 | *9/30/2015 | *12/30/2015 | *1/31/2016 |
|---|---|---|---|---|
| Overnight Fed Rate | 0.25% | 0.45% | 0.70% | 0.95% |
| 3-month LIBOR | 0.28% | 0.53% | 0.79% | 1.05% |
| 2-year US Treasury | 0.71% | 0.99% | 1.22% | 1.49% |
| 10-year US Treasury | 2.42% | 2.31% | 2.43% | 2.62% |

*Note: Estimates pulled via Bloomberg consensus forecasts of Economists polled. Surveys include greater than 20 economists estimates however do not include the view of Farmer Mac's on staff Economist

# Interest Rate Forecasts

- Current futures markets call for first increase in Fed Funds rate in September 2015 at the earliest (65% probability)
  - This probability has been falling in recent weeks with some market participants thinking December 2015 or early 2016 for the first rate hike

- Recent speeches from Federal Reserve members have indicated the rate normalization process will be gradual and any increases will proceed slower than past cycles

- IMF recently called on Federal Reserve to wait until 2016 before beginning interest rate increases

- Federal Reserve Views:
  - Fed is expecting inflation to gradually pick up over medium term
  - Wage growth continues to be below trend in short term
  - Economy will continue to need low rates so rate increases should be gradual
  - Stronger dollar could be hurting US exports and growth at home

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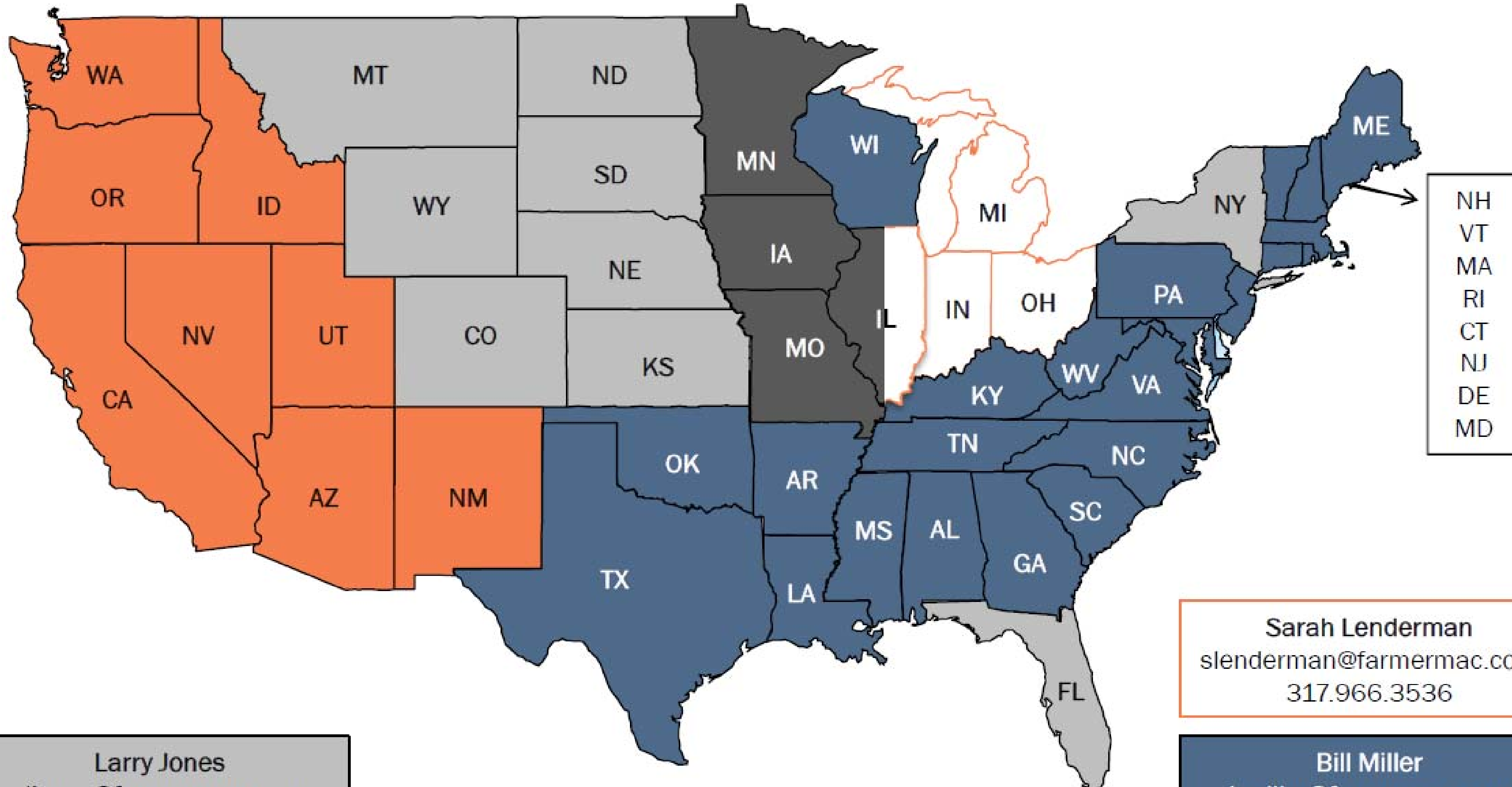



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