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 4th quarter 2014, 5.0% in 3rd quarter 2014 and 4.6% in 2nd quarter 2014
  – Fed officials awaiting more data to see whether 1st 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

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<tbody>
<tr>
<td>Farm and Ranch 15-year Fixed</td>
<td>4.60%</td>
<td>4.16%</td>
<td>4.68%</td>
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<tr>
<td>Farm and Ranch 5-year ARM</td>
<td>3.08%</td>
<td>3.10%</td>
<td>3.42%</td>
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<td>USDA 20-year Fixed</td>
<td>4.07%</td>
<td>3.39%</td>
<td>3.92%</td>
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<tr>
<td>USDA 5-year Reset</td>
<td>2.82%</td>
<td>2.61%</td>
<td>2.99%</td>
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- 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

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<tbody>
<tr>
<td>Overnight Fed Rate</td>
<td>0.25%</td>
<td>0.45%</td>
<td>0.70%</td>
<td>0.95%</td>
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<tr>
<td>3-month LIBOR</td>
<td>0.28%</td>
<td>0.53%</td>
<td>0.79%</td>
<td>1.05%</td>
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<tr>
<td>2-year US Treasury</td>
<td>0.71%</td>
<td>0.99%</td>
<td>1.22%</td>
<td>1.49%</td>
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<tr>
<td>10-year US Treasury</td>
<td>2.42%</td>
<td>2.31%</td>
<td>2.43%</td>
<td>2.62%</td>
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*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