



A Sunny Economy, A Cloudy Farm Policy

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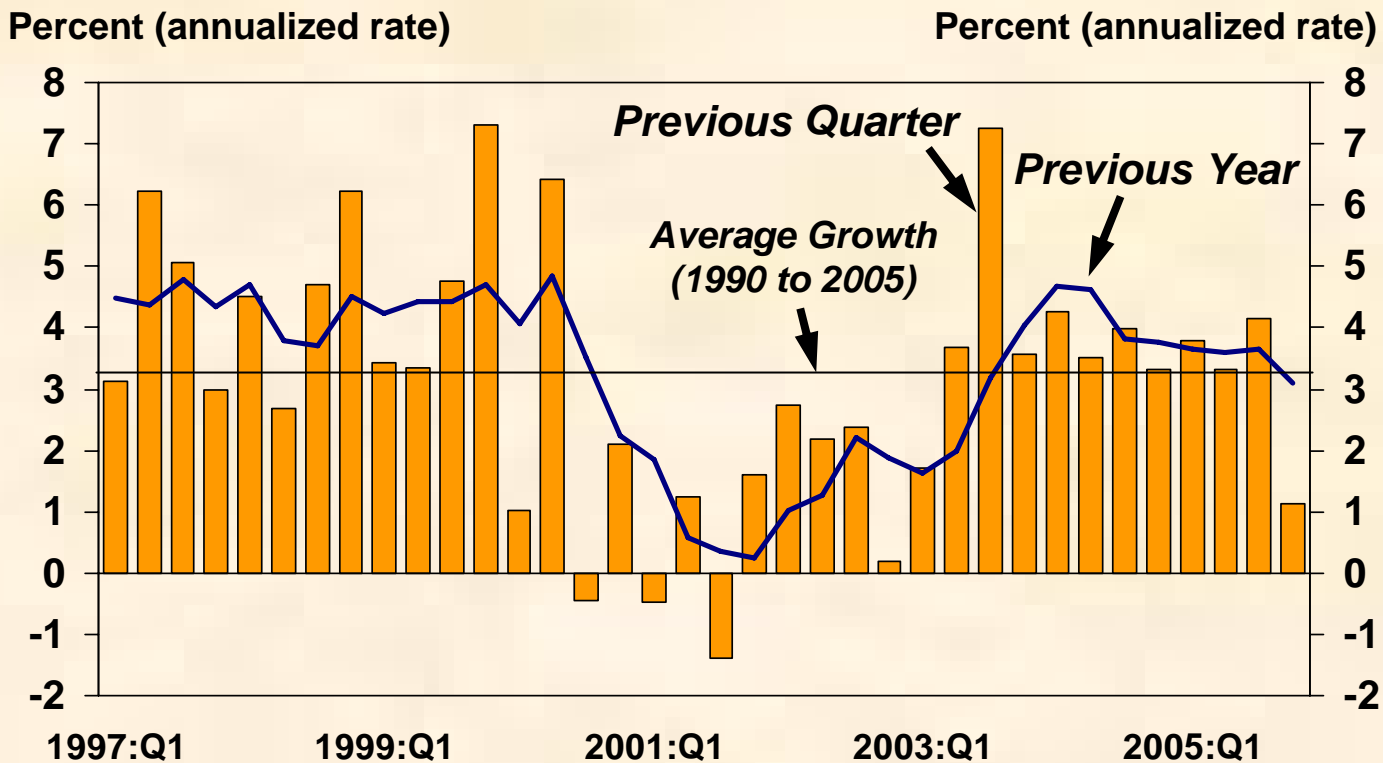
The Economic Outlook

- A robust U.S. economy in 2005.
- Continued growth in 2006?
 - *Will business activity and global strength underpin a soft landing?*
 - *Or, will higher energy prices and a slower housing market collapse consumers spending?*



***Despite higher energy prices,
the U.S. posted above average growth.***

Real Gross Domestic Product

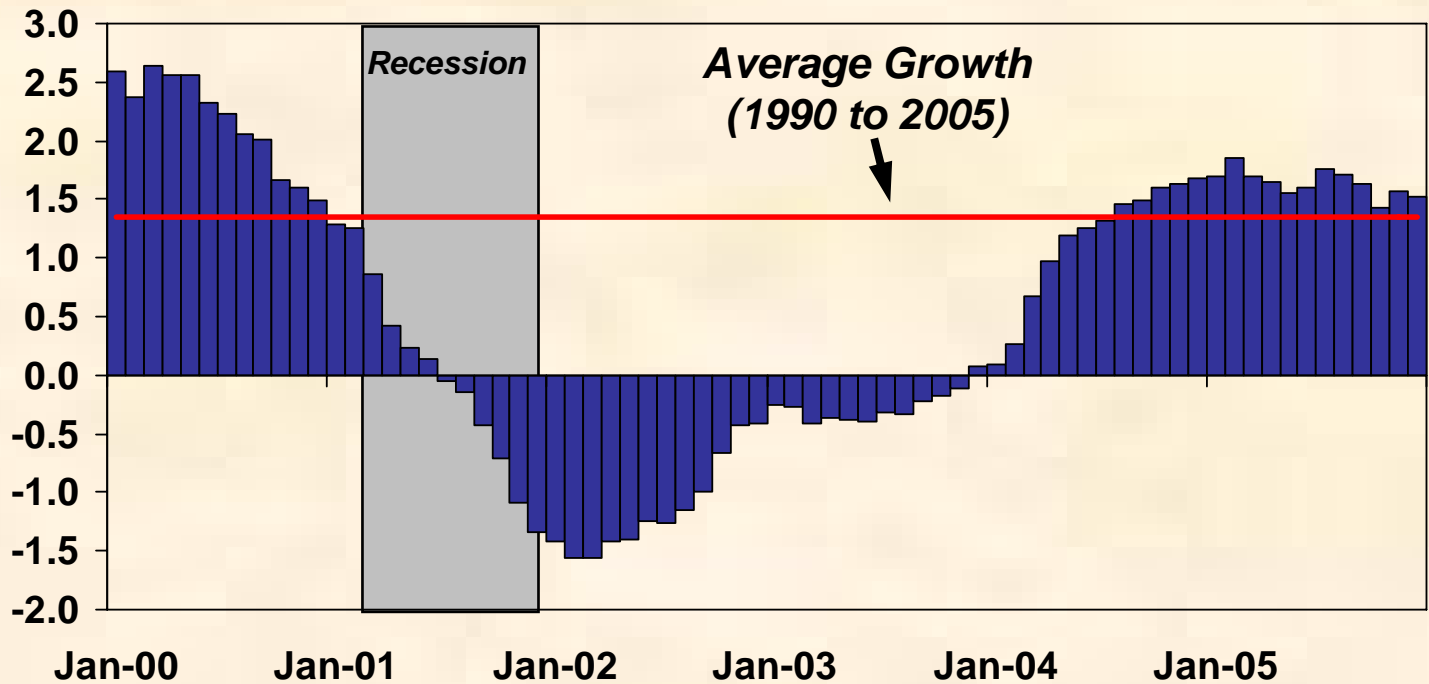


Source: Bureau of Economic Analysis

The pace of U.S. job growth was solid.

U.S. Job Growth

Percent change from a year ago

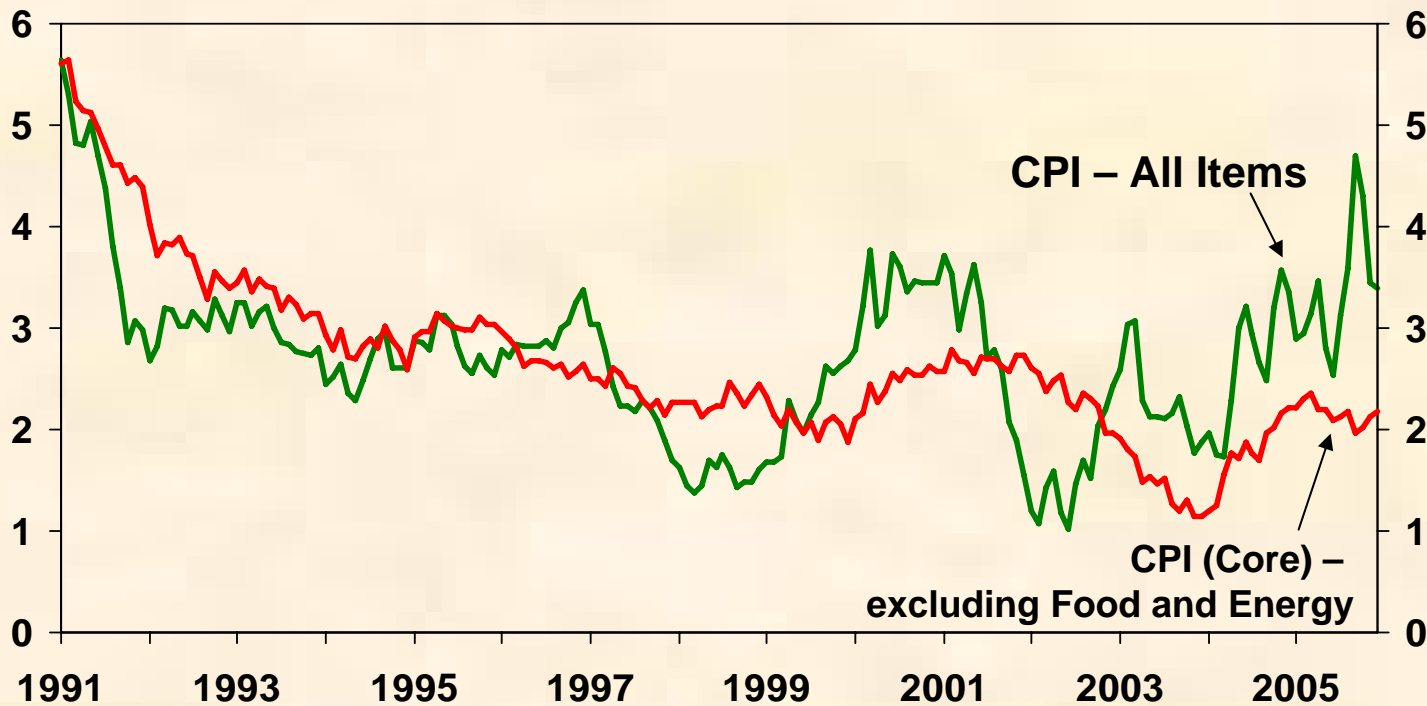


Source: Bureau of Labor Statistics, CES data (payroll survey)

Rising energy prices boosted inflationary pressures.

Consumer Price Inflation

Percent change from a year ago



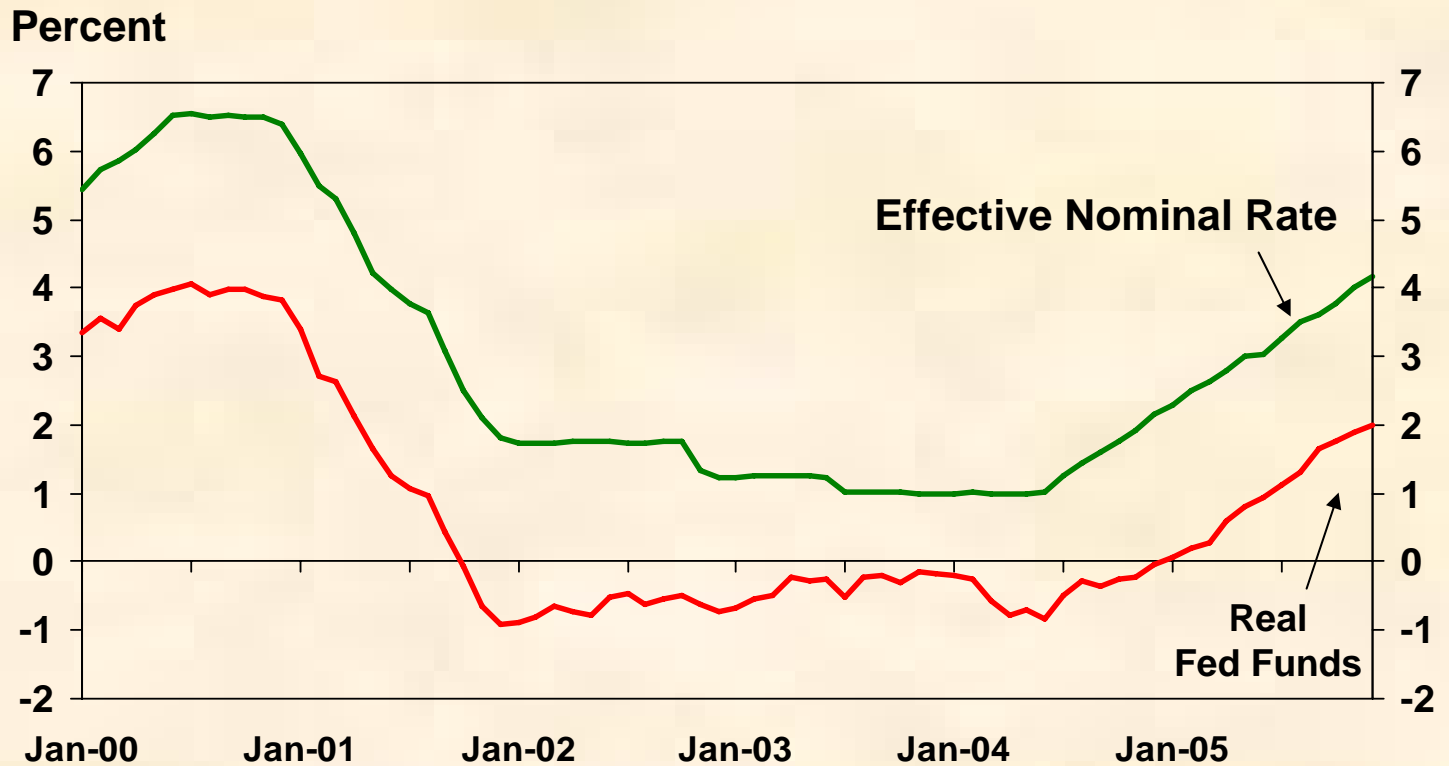
Source: Bureau of Labor Statistics



Photos courtesy of USDA

***With solid growth and inflation pressures,
the Fed is removing monetary stimulus.***

Fed Funds Rates



*Real rate is effective nominal rate minus core consumer price inflation.

Source: Federal Reserve Board and BLS

Continued Growth in 2006?

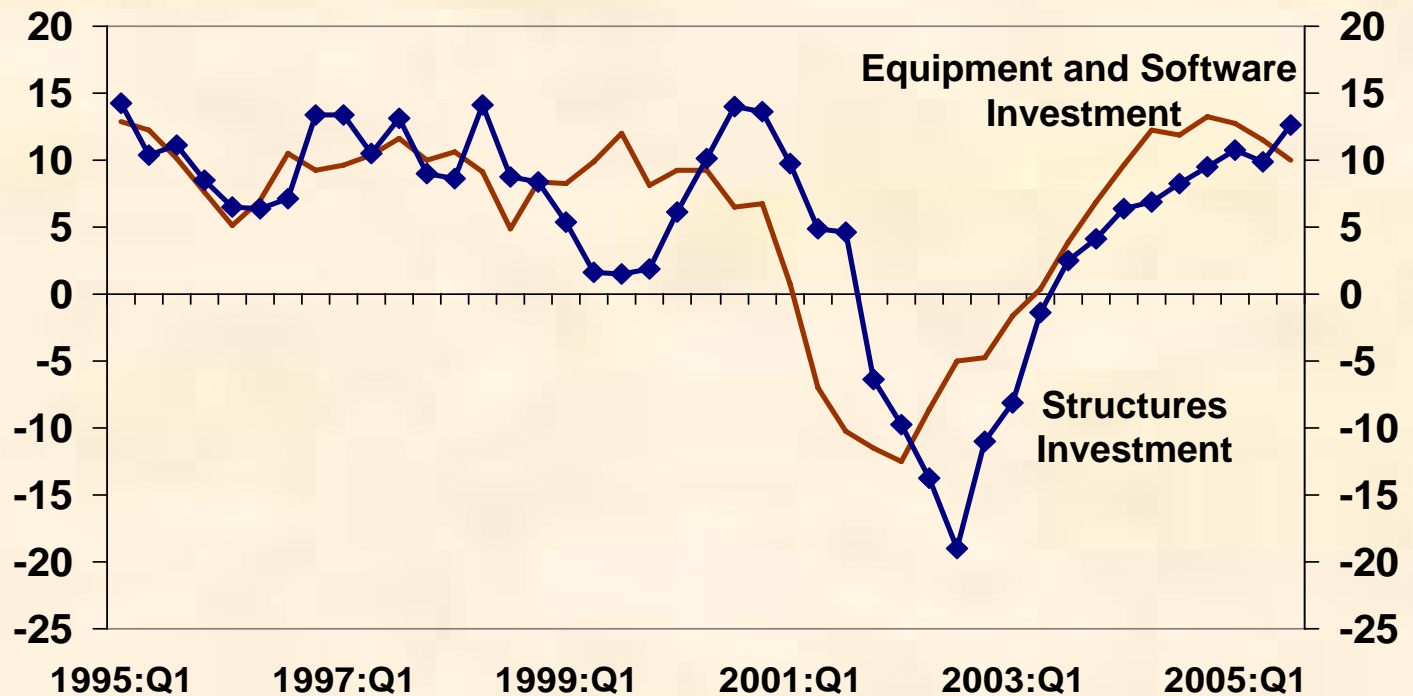
1. Flush with cash, will business spending underpin the economy in '06?



After a sharp contraction, business investment rebounded...

Business Investment

Percent change from year ago



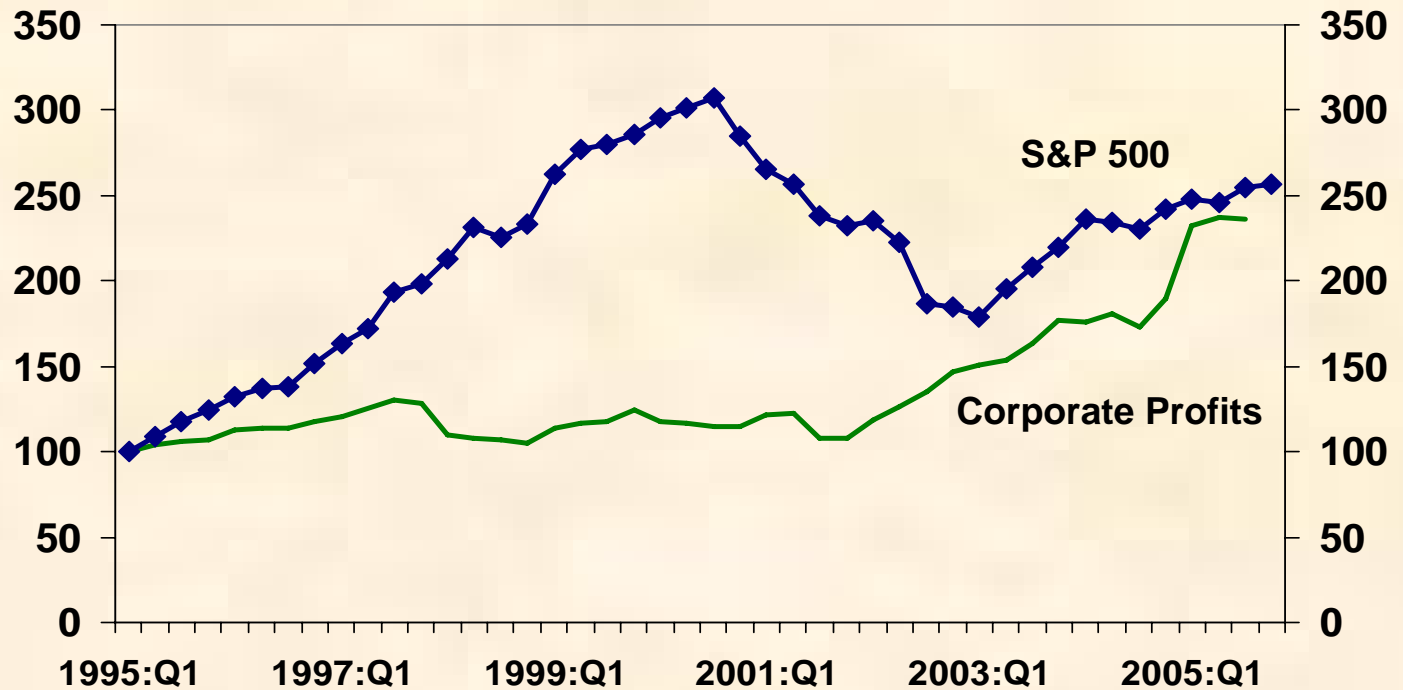
Source: Bureau of Economic Analysis



Reflecting strong corporate finances.

Corporate Profits and Stock Prices

Index (1995:Q1=100)



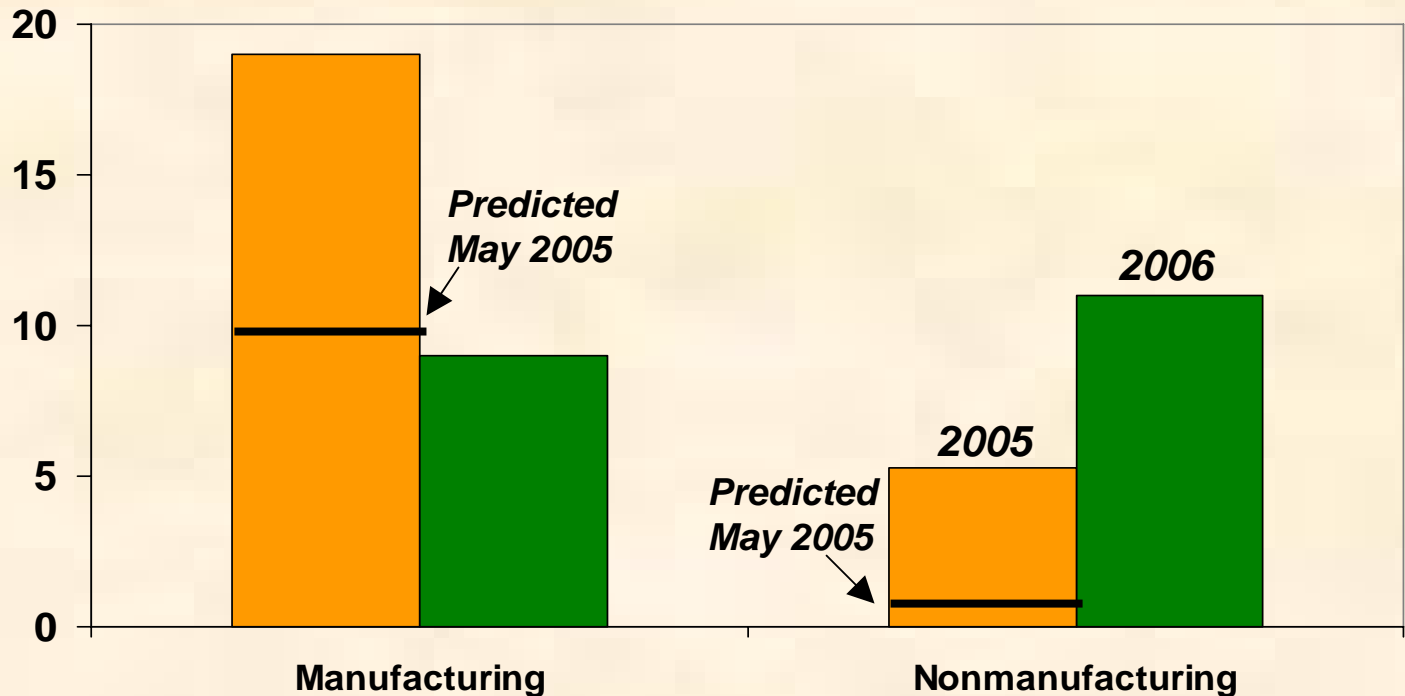
Source: Dept. of Commerce and Wall St. Journal



Capital expenditures are expected to strengthen further in 2006.

Capital Expenditures

Percent change from year ago



Source: Institute of Supply Management (ISM)

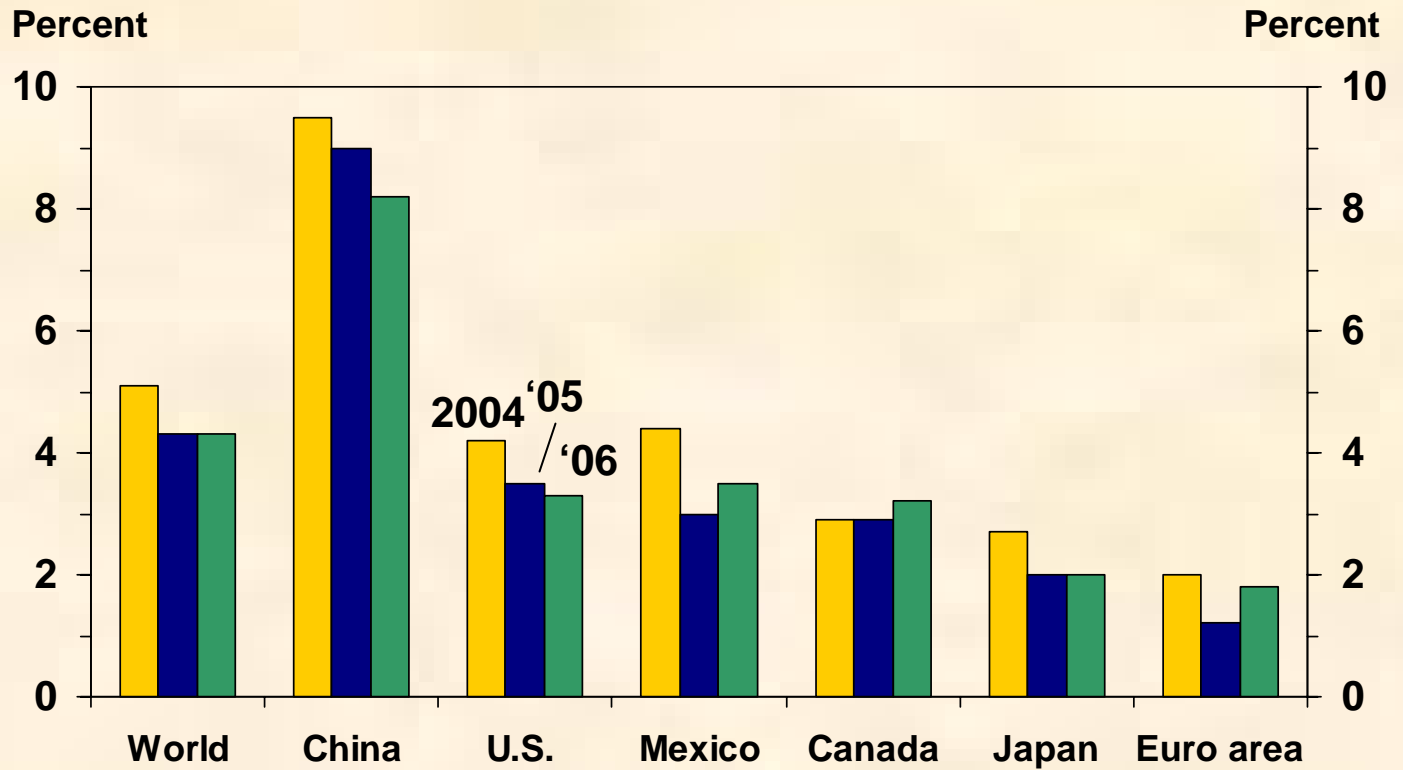
Continued Growth in 2006?

1. Flush with cash, will business spending underpin the economy in '06?
2. Will a stronger global economy fuel new export activity?



Slightly above-trend world growth is expected.

World GDP Growth

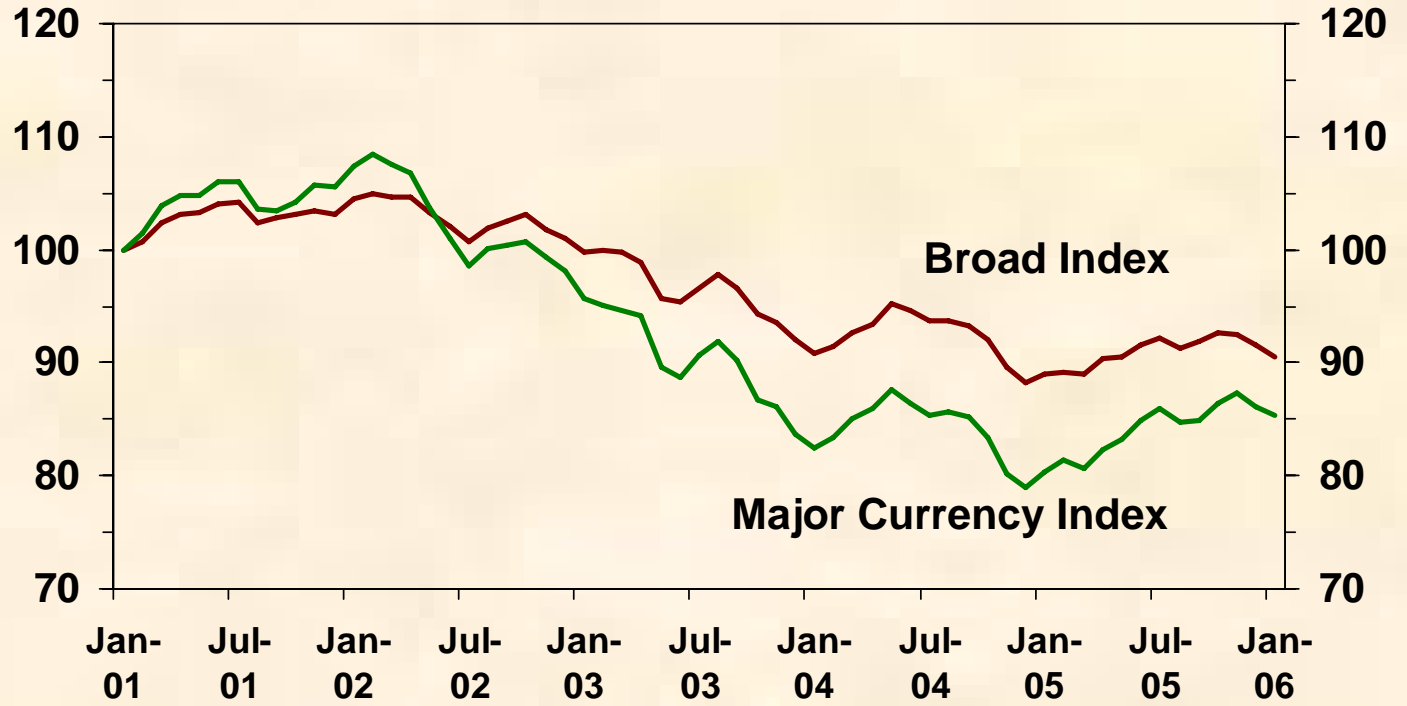


Source: IMF

Recent weakness in the \$ will boost export prospects.

U.S. Exchange Rates

Index: January 2001 = 100

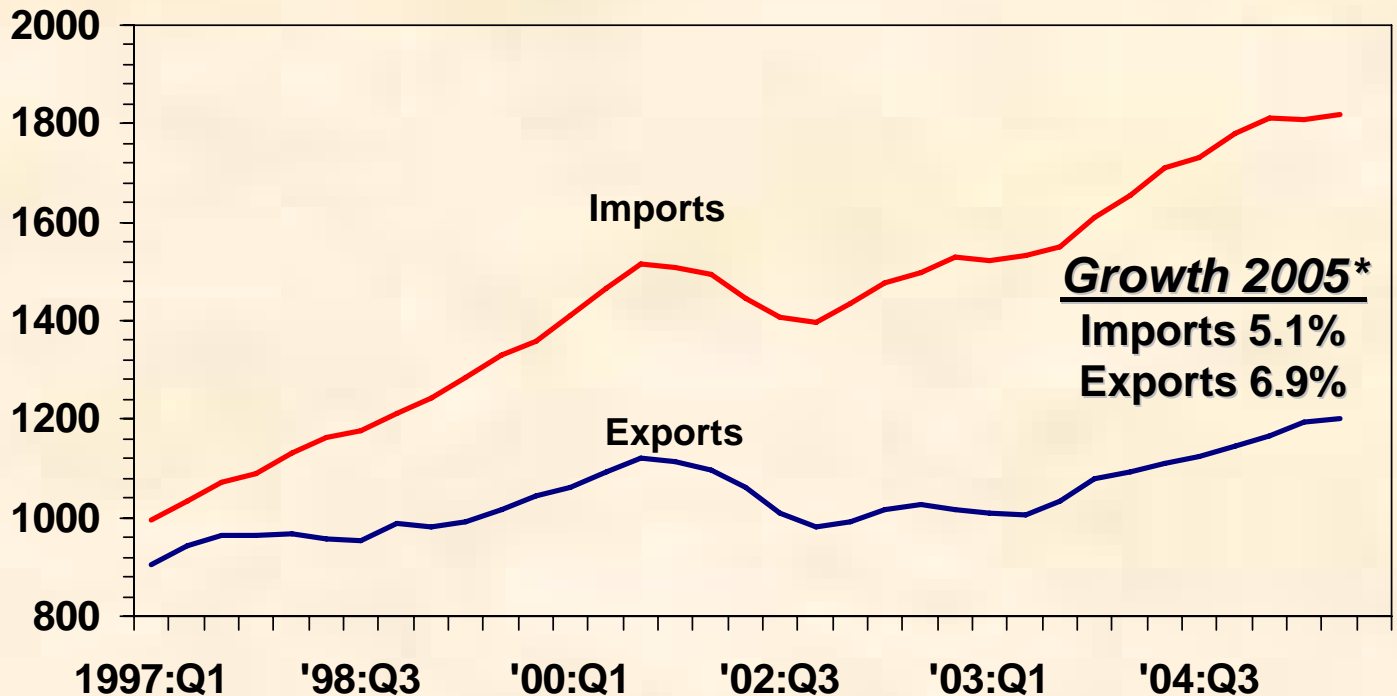


Source: Federal Reserve Board

Export growth should continue, but imports may be slowing.

U.S. Exports and Imports

Billion dollars



Source: Bureau of Economic Analysis
*2005 data through third quarter.

Continued Growth in 2006?

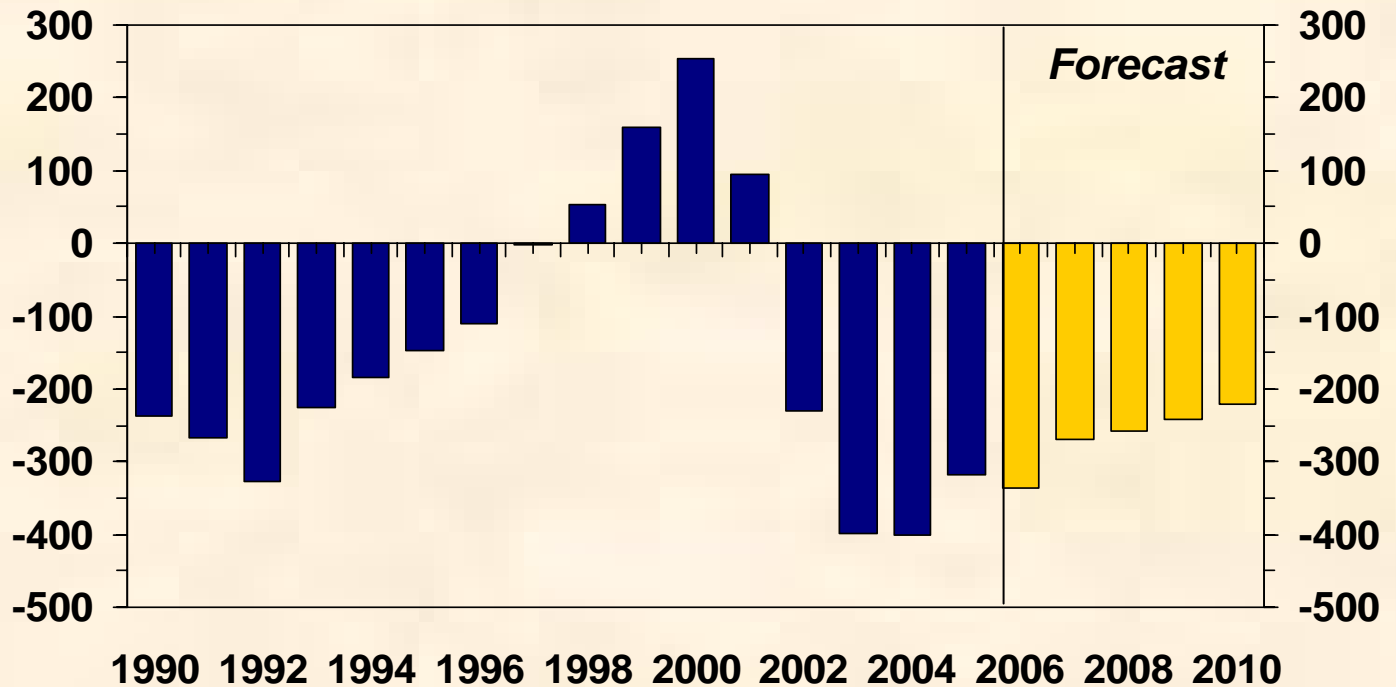
1. Flush with cash, will business spending underpin the economy in '06?
2. Can a stronger global economy fuel new export activity?
3. Will government contribute to growth?



While large, the federal deficit is expected to shrink.

Federal Government Fiscal Balance

Billion dollars



Source: Congressional Budget Office

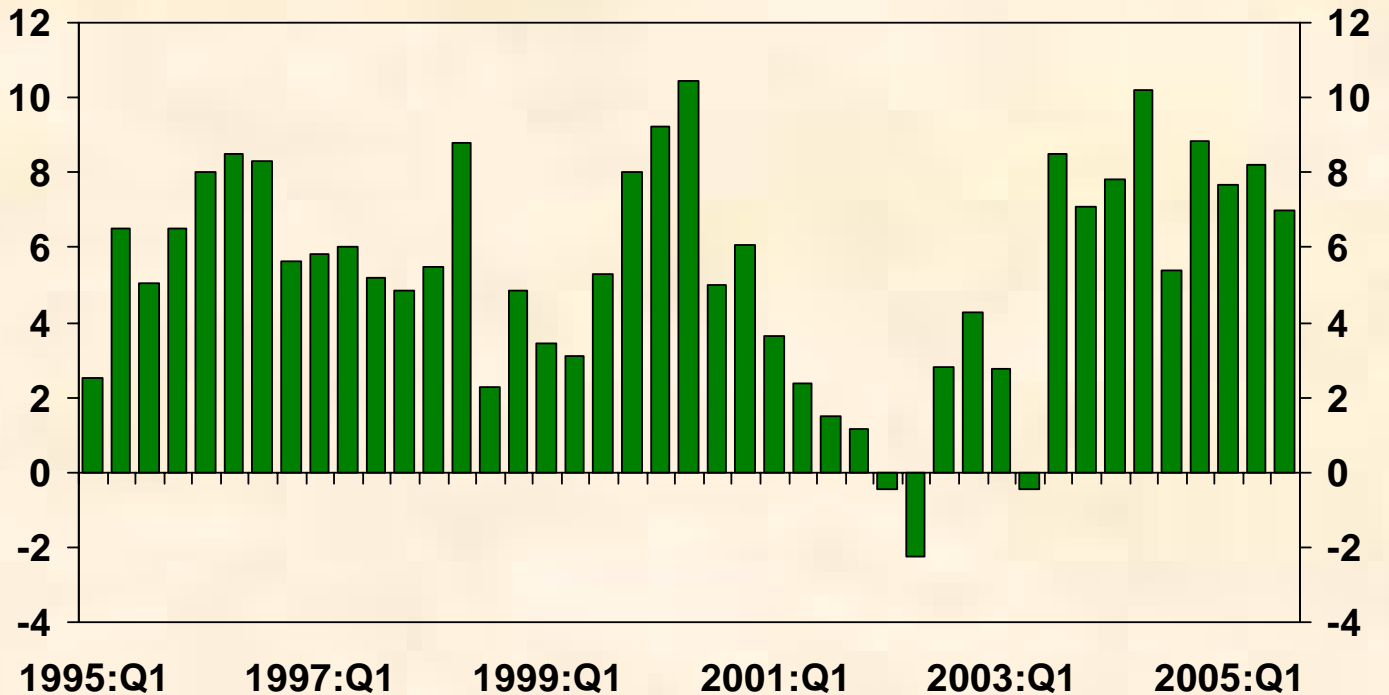


Photos courtesy of USDA

State and local government revenues rebounding strongly.

State and Local Government Tax Revenues

Percent change from year ago



Source: Bureau of Economic Analysis

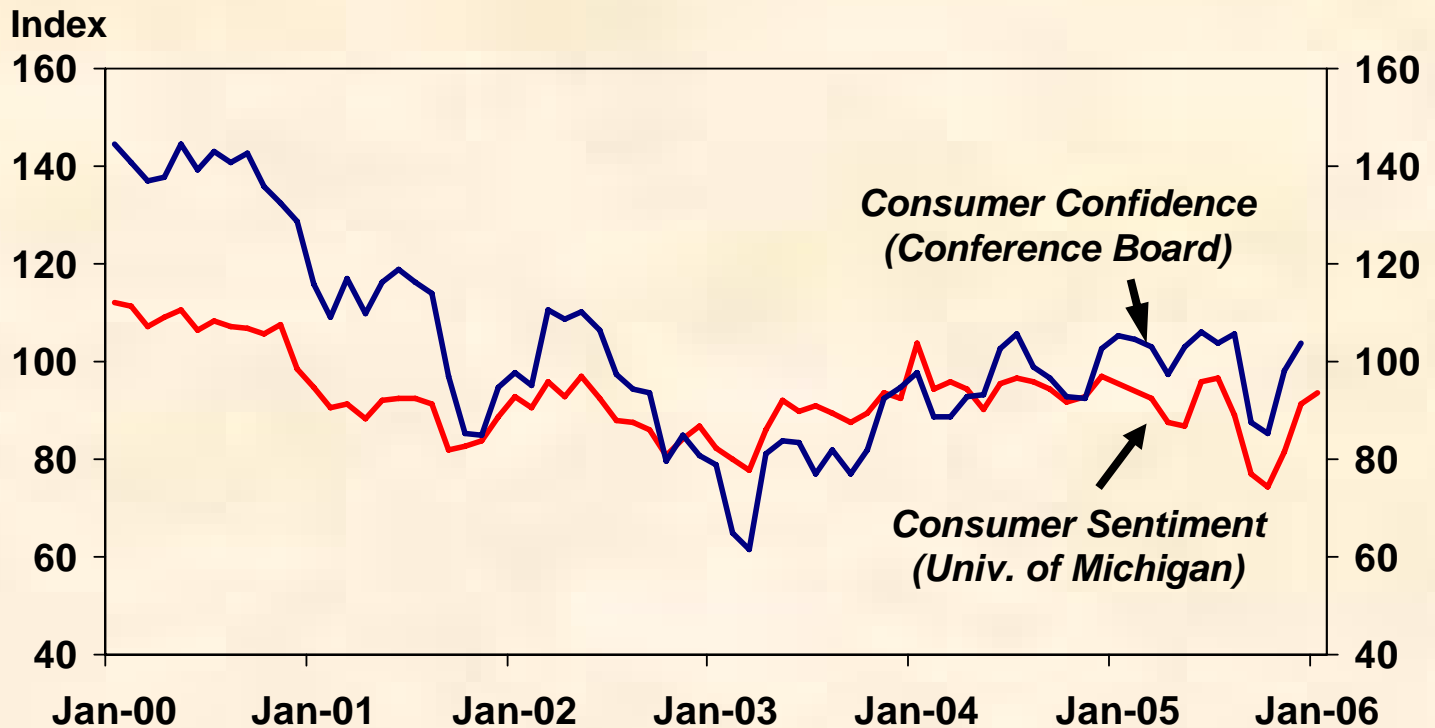
Continued Growth in 2006?

1. Flush with cash, will business spending underpin the economy in '06?
2. Can a stronger global economy fuel new export activity?
3. Will government contribute to growth?
4. **The wildcard is consumer spending.**



Consumer confidence rebounded after a post-hurricane drop.

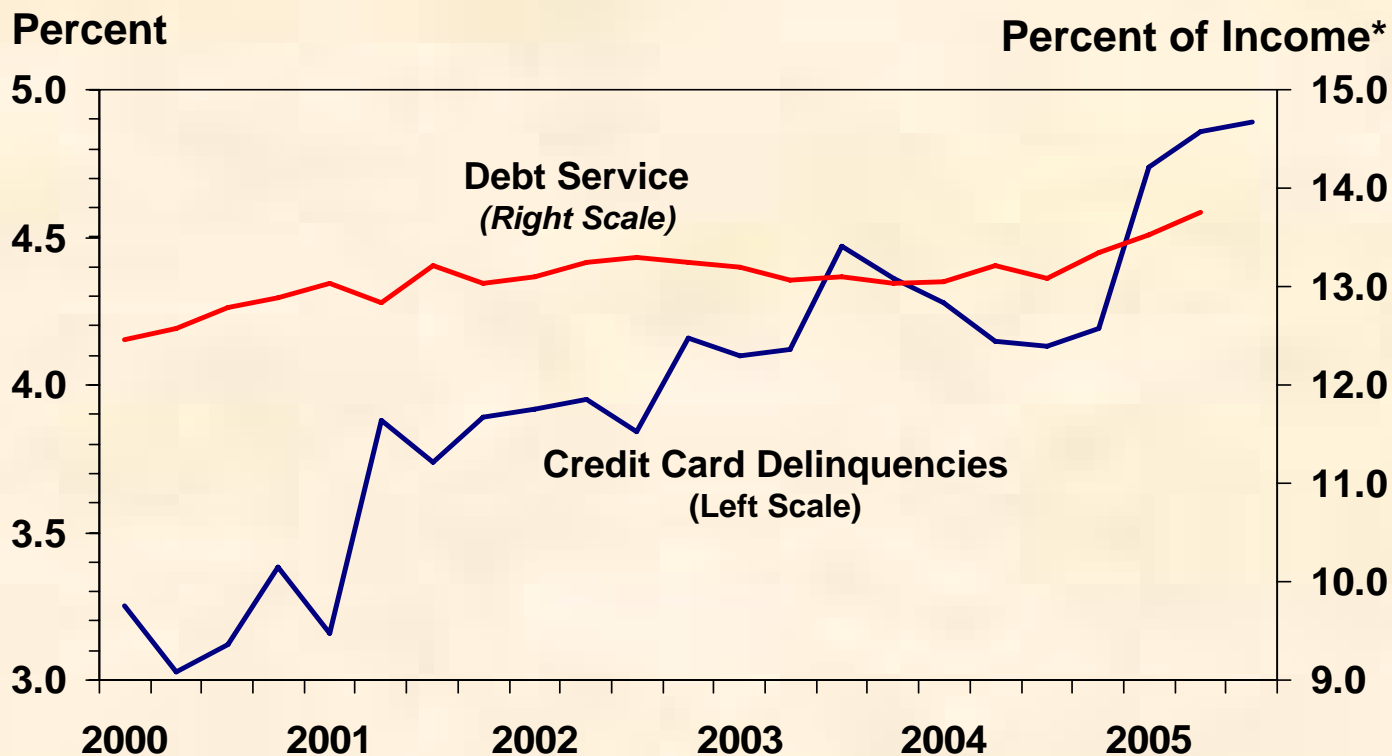
Consumer Confidence



Source: Bureau of Labor Statistics, CES data (payroll survey)

Debt burden and delinquencies are on the rise.

Credit Card Delinquencies and Debt Service



- Debt payments as a percent of disposable personal income
- Source: DISTFAME

Risks to the Outlook

- A weakening housing sector.

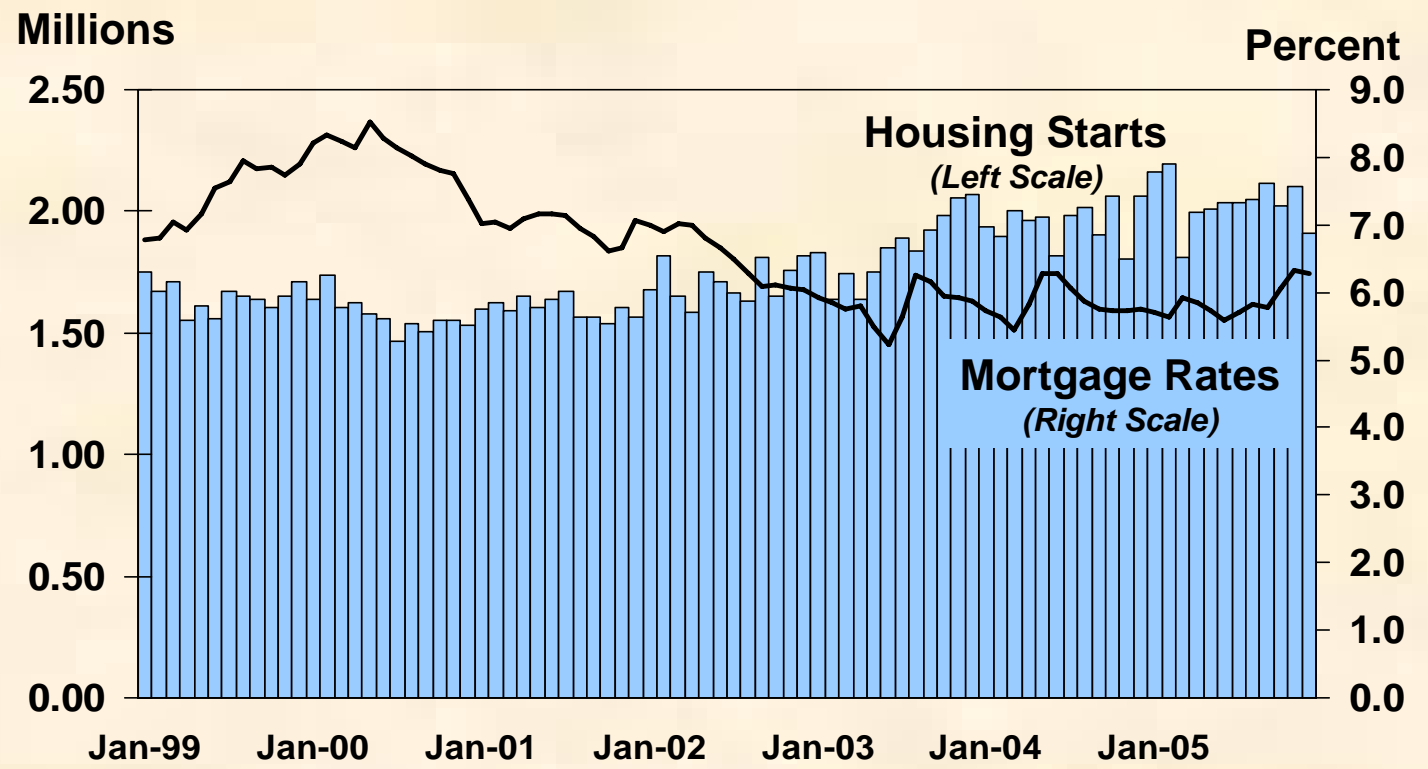




Photos courtesy of USDA

Housing activity has slowed with higher mortgage rates.

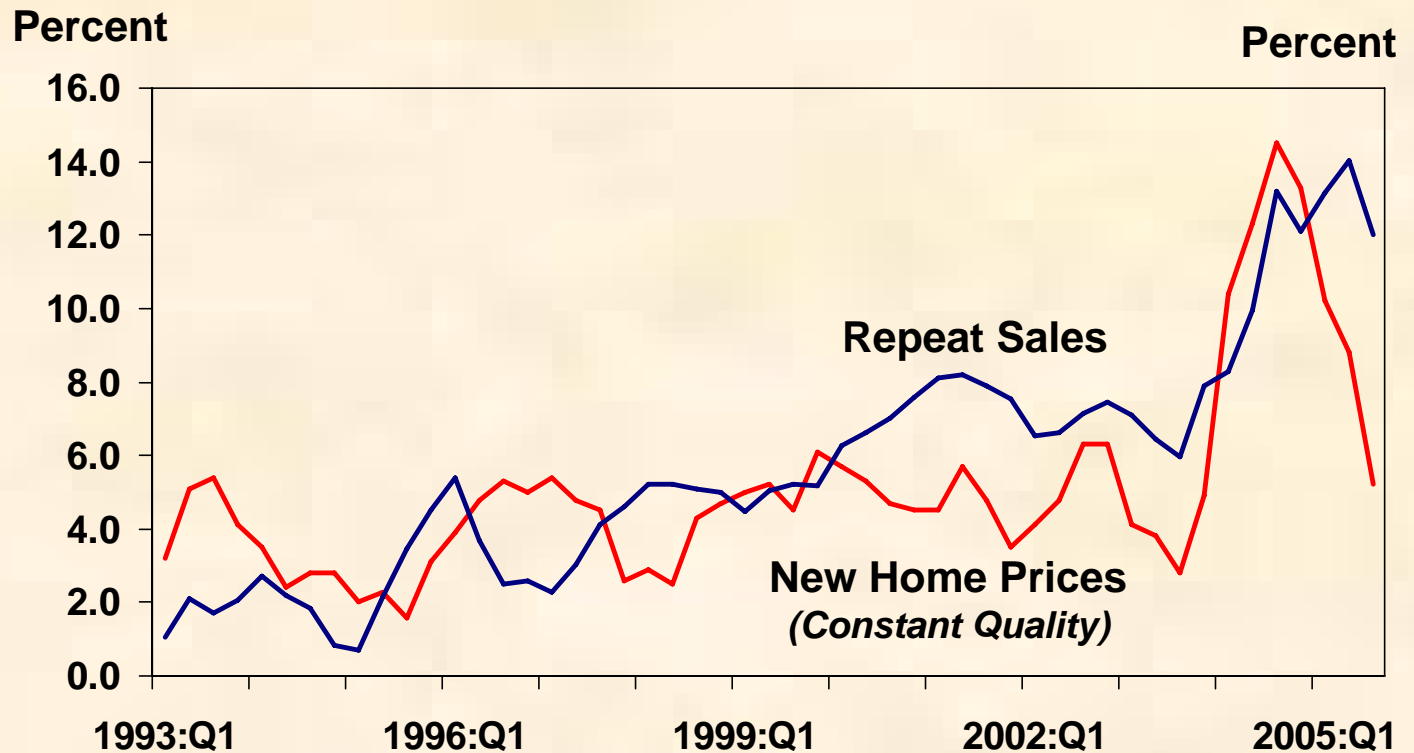
Housing Starts and Mortgage Rates



Source: Census Bureau and Federal Housing Finance Board

Will higher mortgage rates slow home price appreciation?

U.S. Home Prices



Source: OFHEO and Census Bureau

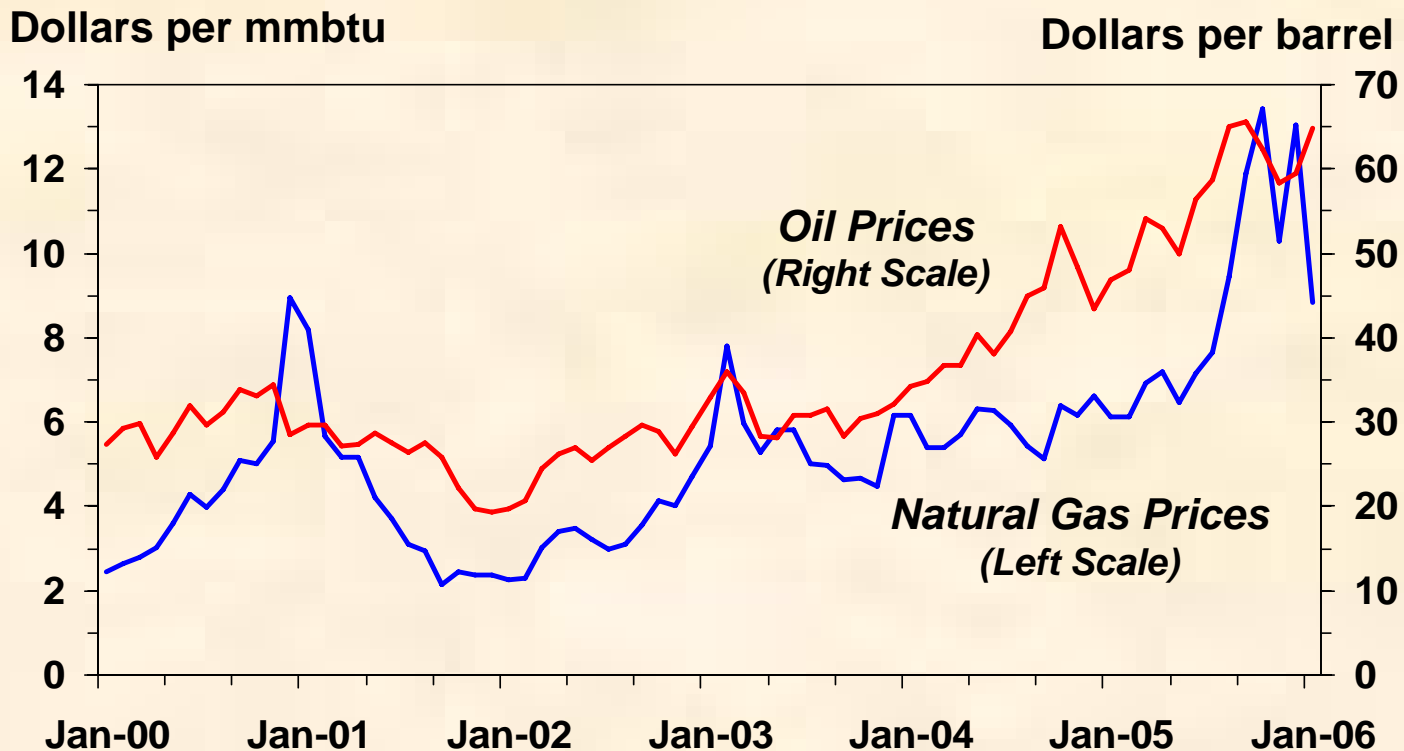
Risks to the Outlook

- A weakening housing sector.
- High energy prices.



Rising energy prices spiked after Hurricanes Katrina and Rita.

Energy Prices

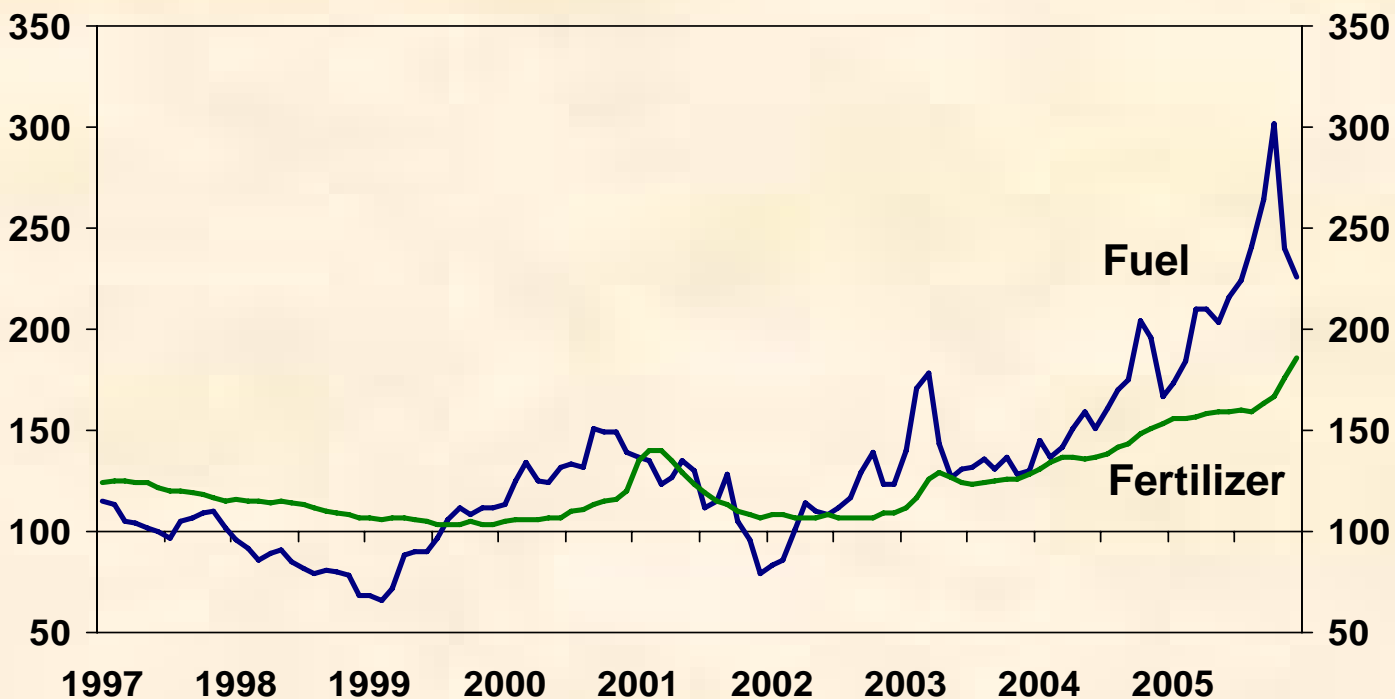


Source: Wall Street Journal

For agriculture, high energy prices mean higher fuel and fertilizer prices, ...

Prices Paid by Farmers

Index (1990-1992=100)



Source: National Agricultural Statistics Service, USDA



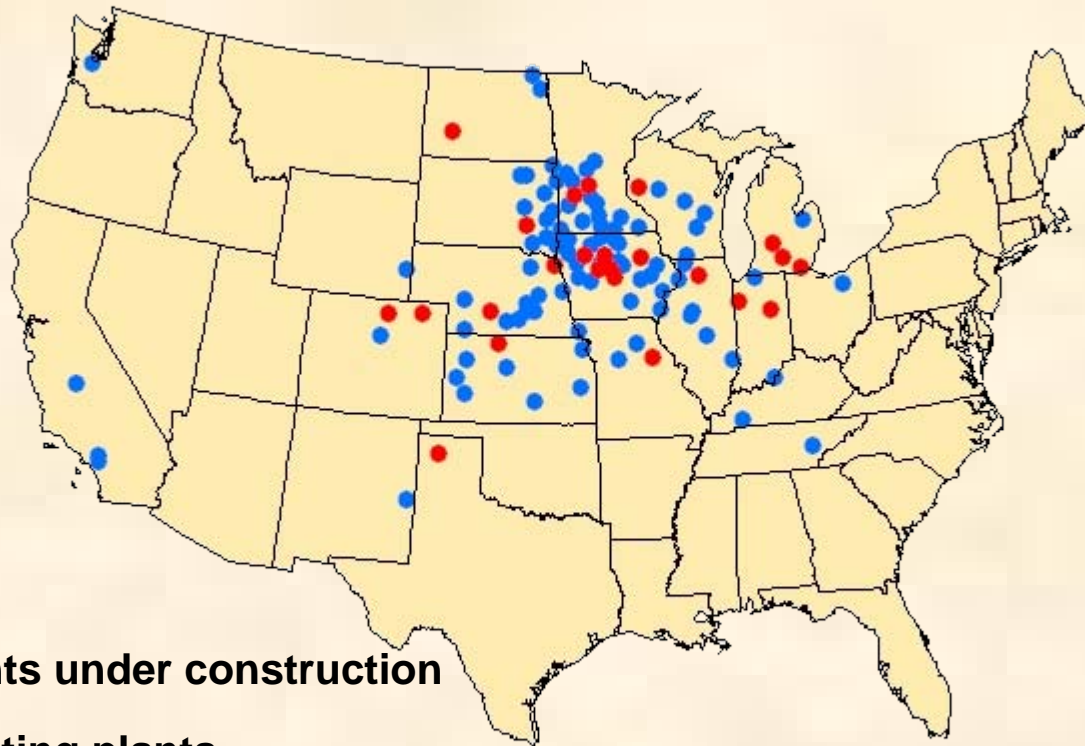
Photos courtesy of USDA





Photos courtesy of USDA

And new investments in bio-fuels.

Ethanol Production Plants (As of November 18, 2005)



-  **Plants under construction**
-  **Existing plants**

Source: American Ethanol Coalition



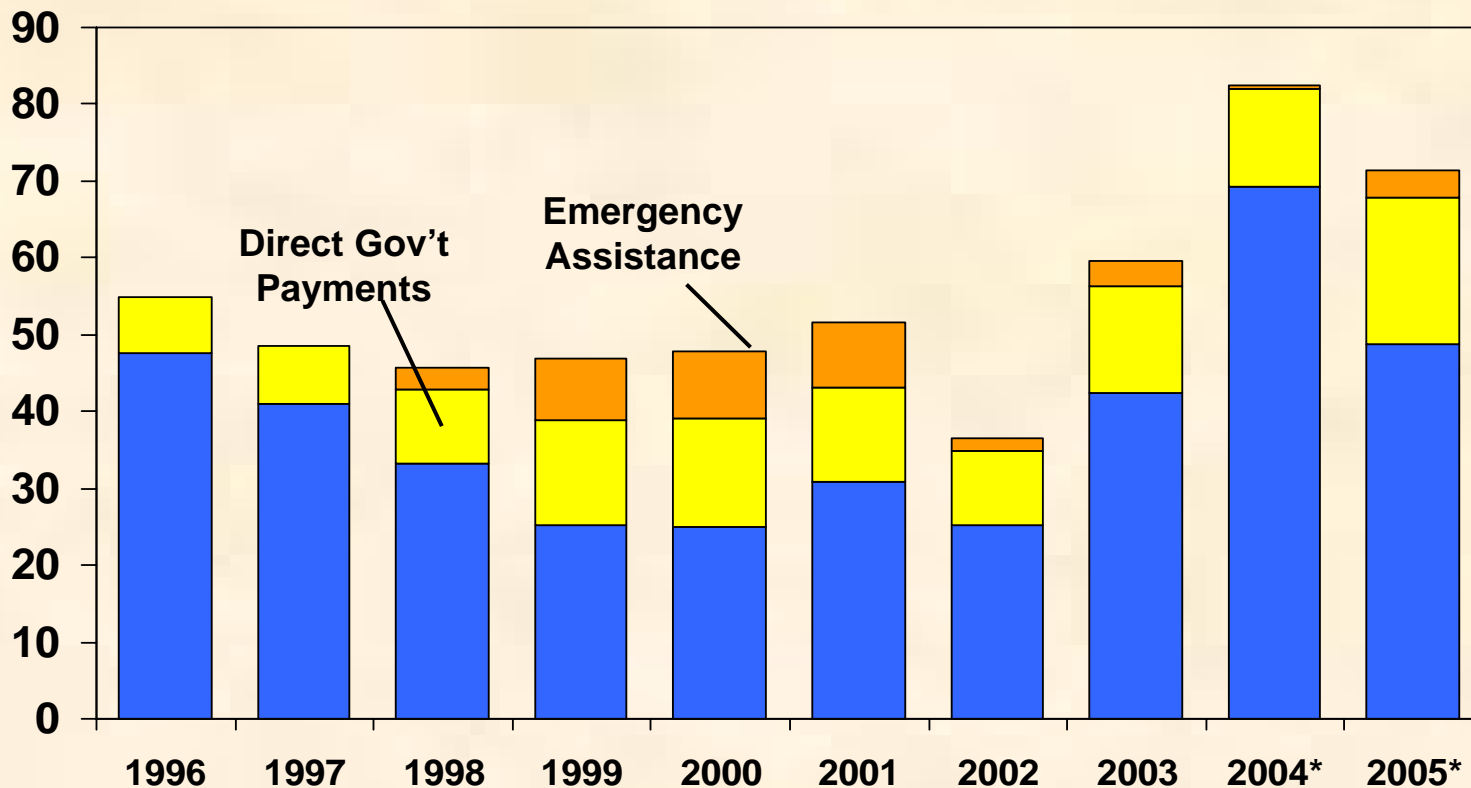
The FOMC Statement (January 31, 2006)

- **Economic growth is solid and inflation is contained.**
“... the expansion in economic activity appears solid. Core inflation has stayed relatively low in recent months and longer-term inflation expectations remain contained.”
- **Yet, inflation pressures appears on the horizon.**
“Nevertheless, possible increases in resource utilization as well as elevated energy prices have the potential to add to inflation pressures.”
- **In the future, additional increases may be necessary.**
“some further policy firming may be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance.”

U.S. agriculture is healthy...

U.S. Net Farm Income

Billion dollars



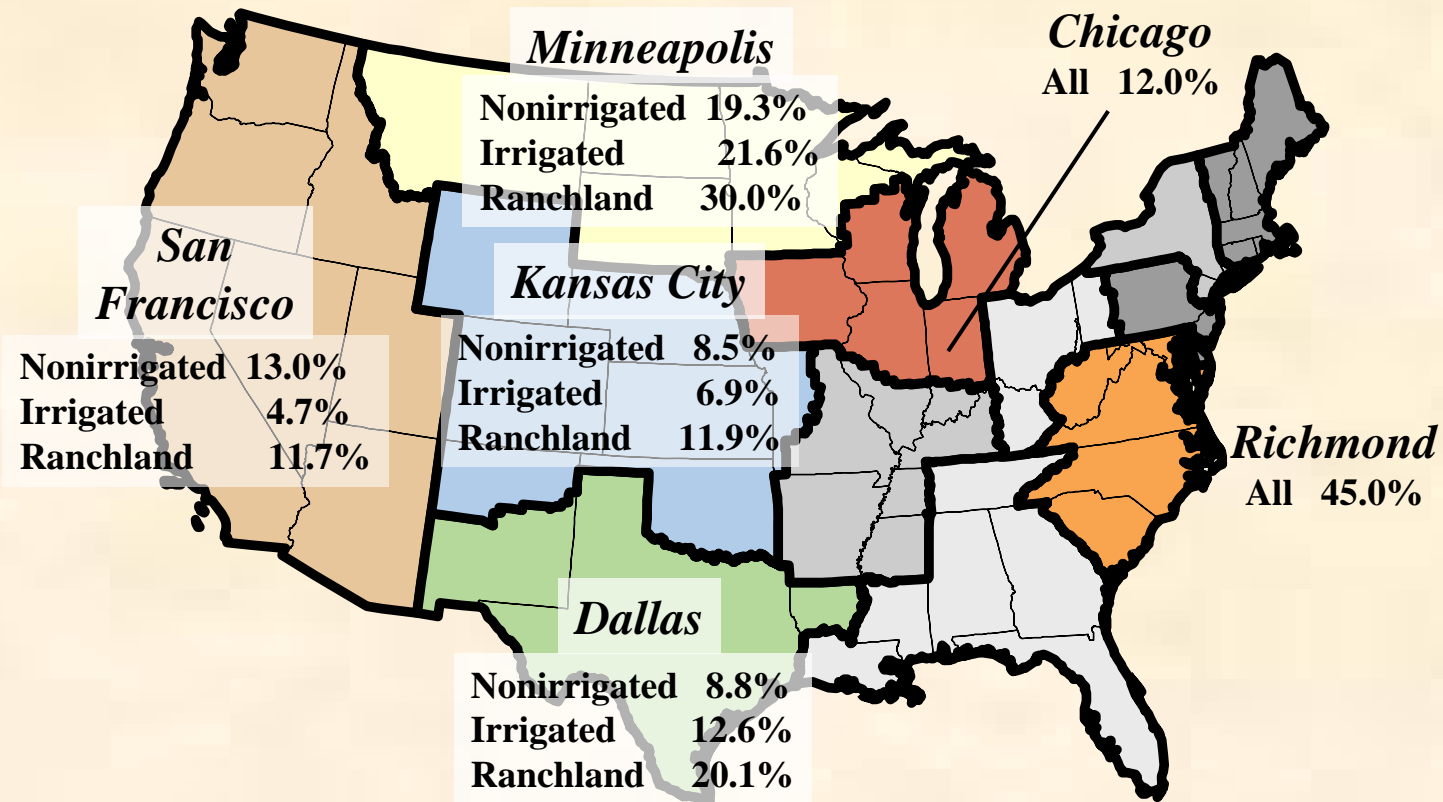
Source: USDA

*Forecast, November 2005

And farmland values are booming.

Farmland Value Gains

Federal Reserve District Ag Credit Surveys 2004:Q2 to 2005:Q2

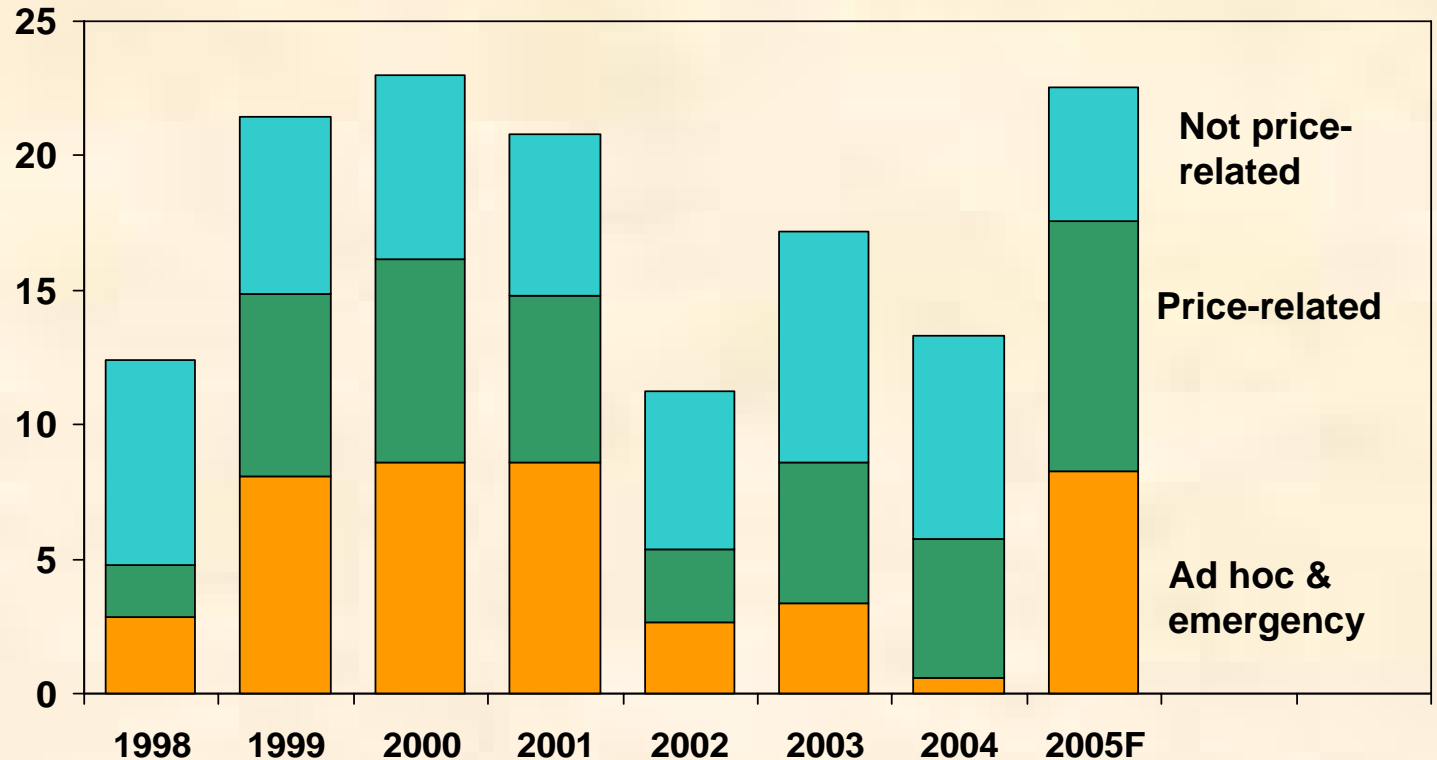


Sources: Federal Reserve Banks of Kansas City, Chicago, Dallas, and Minneapolis (San Francisco computed by Kansas City).

But subsidies are a major factor...

Federal Farm Payments

\$billion

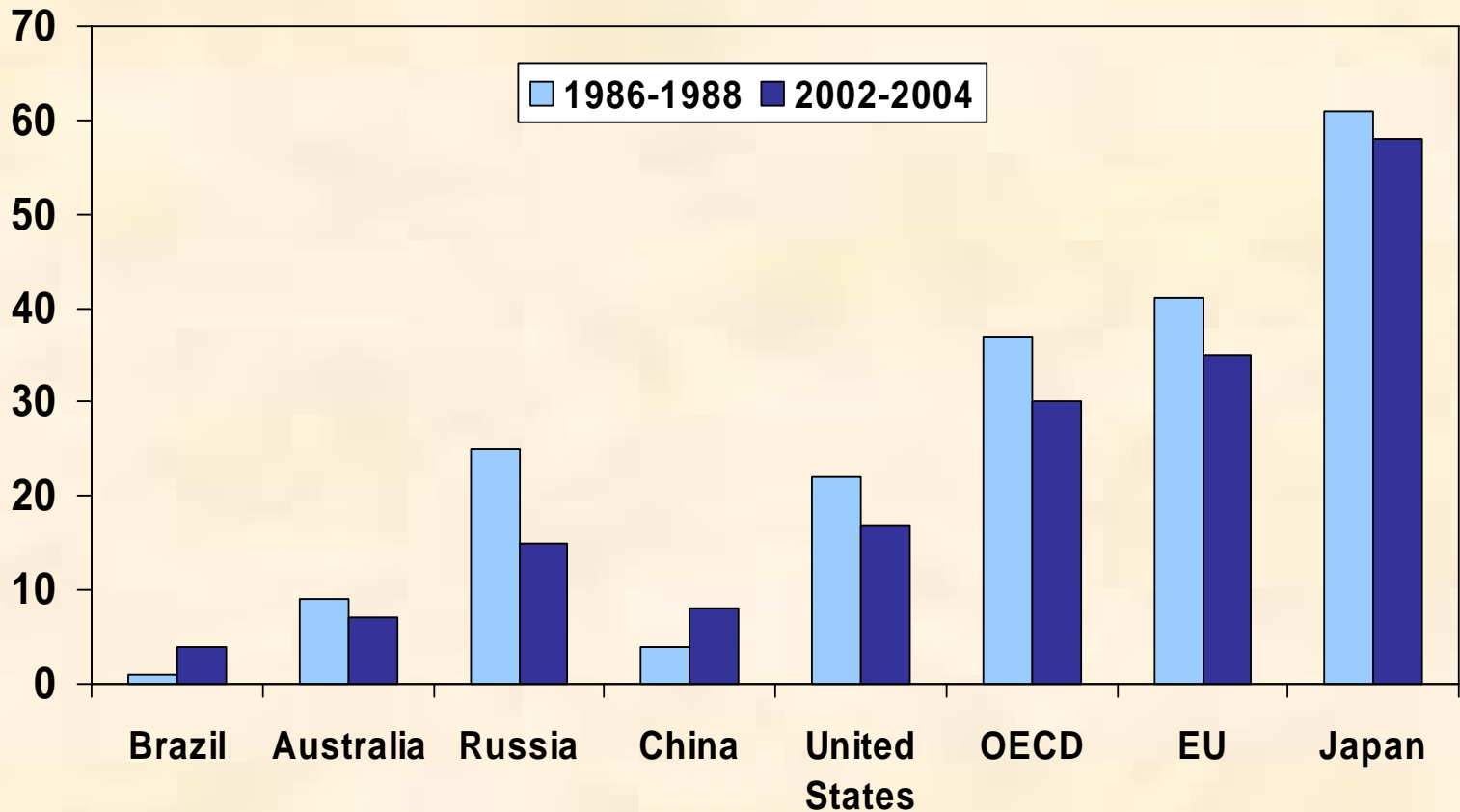


Source: USDA

*Forecast, November 2005

And the target of Doha WTO Round.

Transfers to Farmers as a Percent of Value of Gross Farm Receipts



Source: OECD

A Perfect Storm for Farm Subsidies?

- **Yawning federal deficit**
- **Decisive conclusion to WTO Round**
- **Taxpayer angst**





Withdrawing Subsidies Might...

Raise Commodity Prices

- Rice 33-50%
- Sugar 20-40%
- Dairy 20-40%
- Cotton 10-20%
- Peanuts 10-20%

Source: Robert Thompson 2005



Withdrawing Subsidies Might...

- Trim farm output by 3%
- Boost farm commodity prices 6%
- Drop land values 20%
- Reduce number of farms 10%
 - Though many would have exited regardless

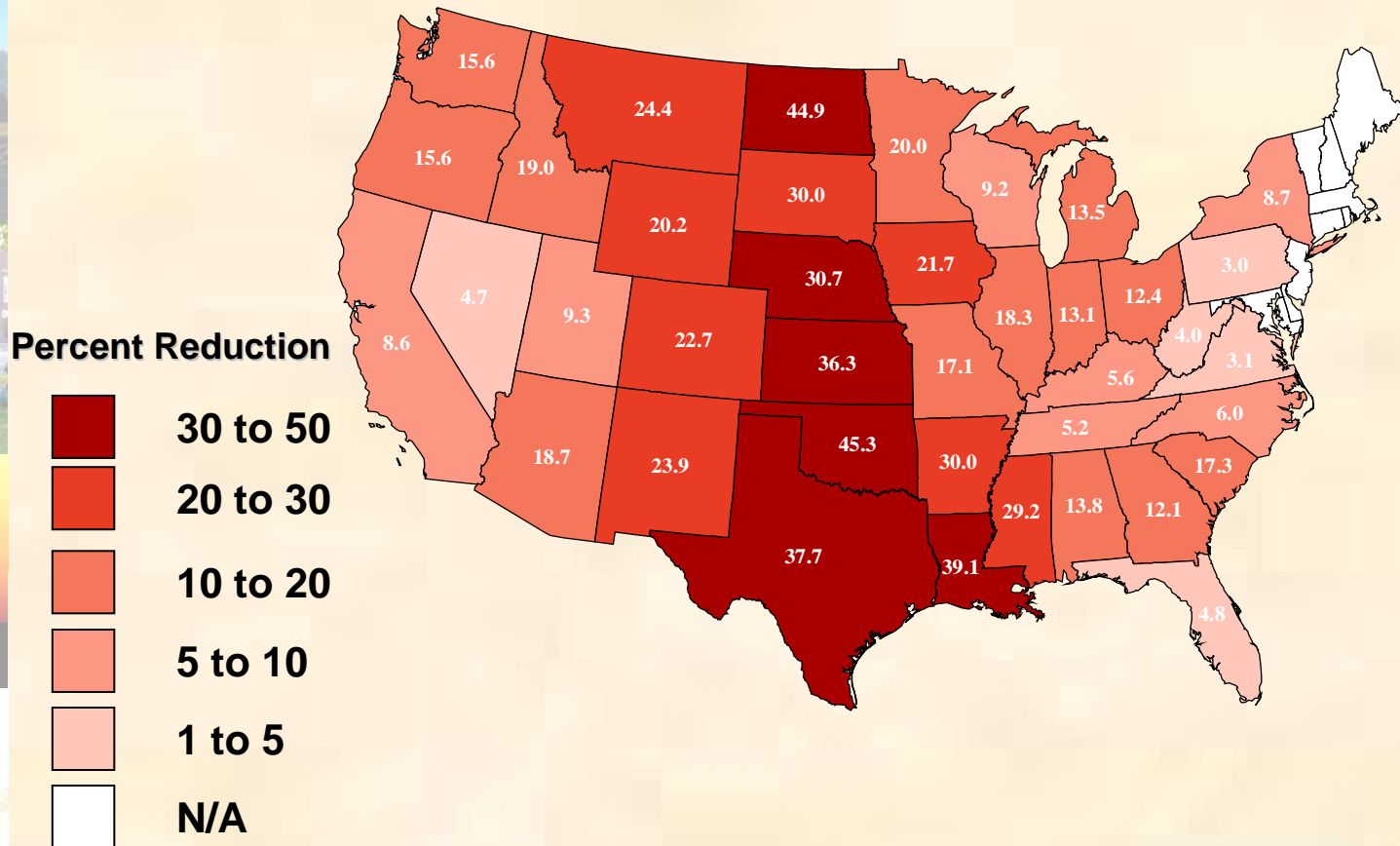
Source: Luther Tweeten 2006



Photos courtesy of USDA

A key question is land values

Potential impact on land value ranges widely



Source: Kastens and Dhuyvetter



Photos courtesy of USDA

The bigger question is how to make rural America more competitive

- **Innovation and entrepreneurs drive economic gains.**
- **Commodity programs thwart *both*.**
- **Technology makes exciting new rural economic engines possible.**
- **Thus, withdrawing farm subsidies *could* eliminate a hurdle.**
- **But farmers and lenders must manage the transition.**