AgCountry Farm Credit Services
Q2 2022 ECONOMIC REVIEW
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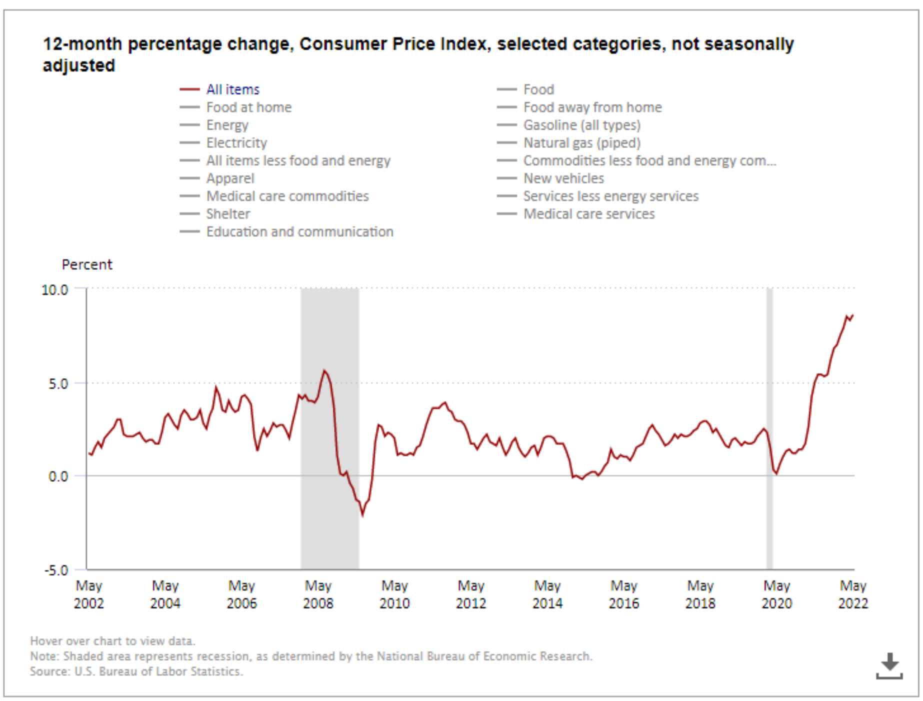
The nation's economic condition, as measured by gross domestic product (GDP), is expected to improve during the second quarter of 2022 as the global pandemic appears to be slowly receding and becoming less disruptive to global supply chains, travel, and labor markets. However, the Russian invasion of Ukraine has created uncertainty in the financial markets, supply chain concerns in several key industries, and caused prices to spike for a number of commodities including oil, natural gas, and wheat, creating a new set of economic concerns and inflationary pressure. The Federal Reserve noted the increased inflation risks in the June 15th FOMC statement.

<u>Federal Reserve FOMC Statement June 15, 2022:</u>
"The invasion of Ukraine by Russia is causing tremendous human and economic hardship. The invasion and related events are creating additional upward pressure on inflation and are weighing on global economic activity. In addition, COVID-related lockdowns in China are likely to exacerbate supply chain disruptions. The Committee is highly attentive to inflation risks."

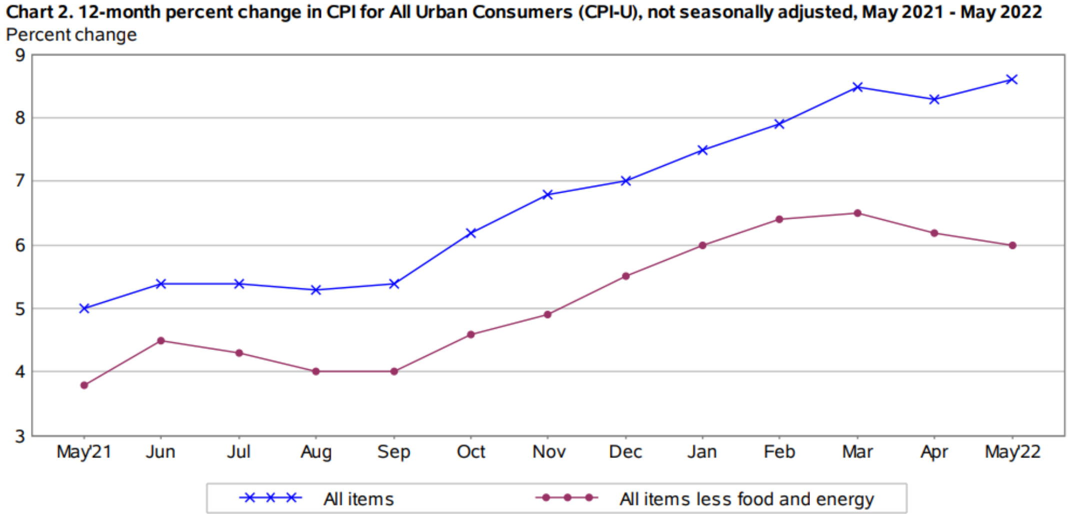
INFLATION:
The U.S. Bureau of Labor Statistics reported that the Consumer Price Index for All Urban Consumers (CPI-U) increased 1.0% in May after rising 0.3% in April. The all-items index increased 8.6% for the 12 months ending May, the largest 12-month increase since December 1981. The all items less food and energy index rose 6.0% over the last 12 months.



The energy index rose 34.6% over the last year, the largest 12-month increase since September 2005. The gasoline index increased 48.7% over last 12 months. The index for fuel oil more than doubled, increasing 106.7%, which represents the largest increase in the history of the series dating back to 1935. The index for natural gas increased 30.2% over the last 12 months, the largest such increase since the period ending July 2008.

The food index increased 10.1% for the 12-months ending May, the first increase of 10% or more since March 1981. The index for meats, poultry, fish, and eggs increased the most at 14%, with the index for eggs increasing 32.2%. The remaining groups saw increases ranging from 8.2% (fruits and vegetables) to 12.6% (other food at home). The index for food away from home rose 7.4% over the last year, the largest 12-month change since November 1981. The index for food at employee sites and schools fell 30.5% over the last 12 months, reflecting widespread free lunch programs.

Chart 2. 12-month percent change in CPI for All Urban Consumers (CPI-U), not seasonally adjusted, May 2021 - May 2022

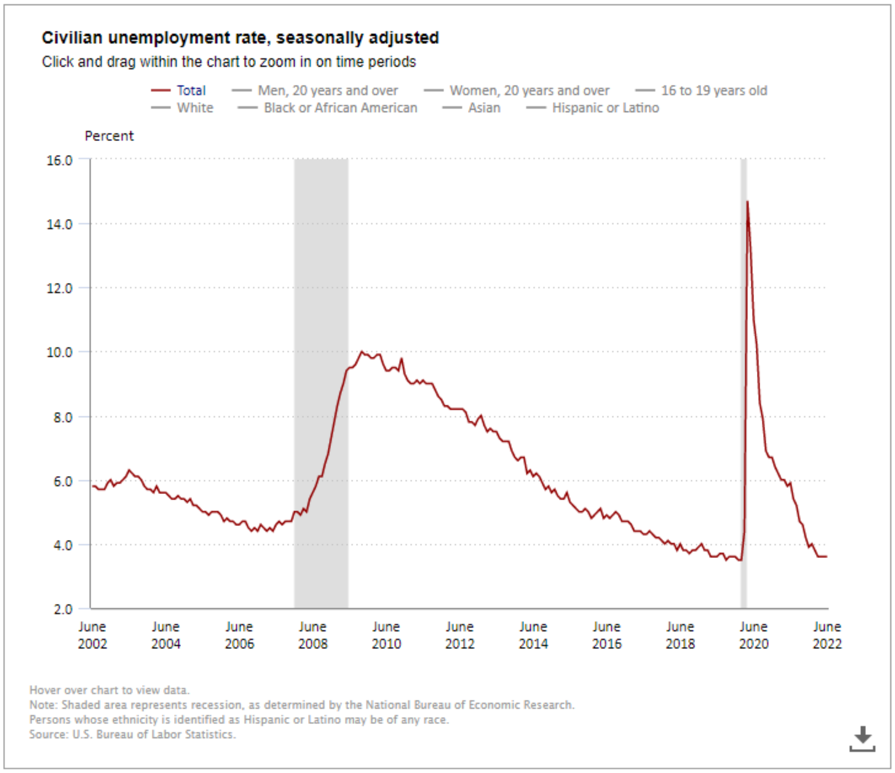


The Federal Reserve has shifted their stance on inflation from transitory inflation caused by supply and demand imbalances created by the pandemic to systemic inflationary pressures, namely oil prices, caused by the Russian invasion of Ukraine and continued supply chain disruptions. In a second quarter 2022 survey conducted by the Philadelphia Federal Reserve, professional forecasters estimated that second quarter headline CPI inflation will average 7.1% at an annual rate, which is up from their forecast of 3.8% in the last survey. Moody's Baseline forecast second quarter 2022 CPI at 7.9%.

<u>Federal Reserve Governor Michelle W. Bowman "The Outlook for Inflation and Monetary Policy" June 23, 2022</u>
"The inflation data show that, after moderating slightly for a short time, price increases for motor vehicles have picked up again, energy prices rose sharply in May, and prices for food have risen more than 10 percent from a year ago. The inflationary effect from the invasion of Ukraine has proven to be lasting for both energy and food commodity prices, with little prospect of the conflict or those price pressures abating very soon."

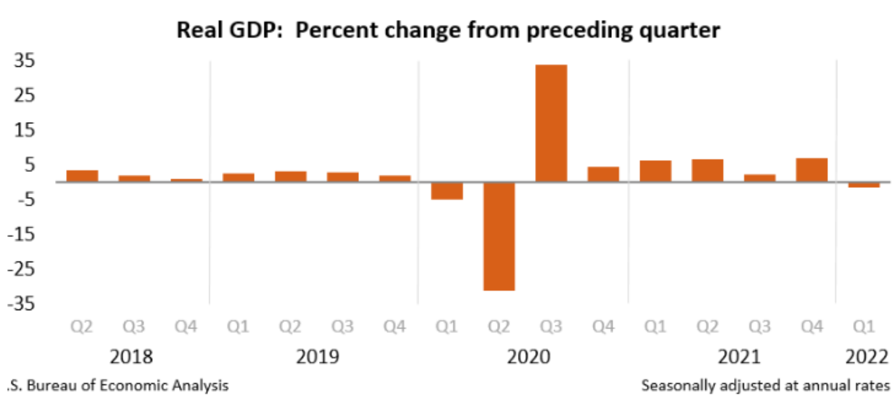
EMPLOYMENT:
Total nonfarm employment rose by 372,000 in June, the unemployment rate remained at 3.6%, and the number of unemployed remained unchanged at 5.9 million. In February 2020, prior to the COVID-19 pandemic, the unemployment rate was 3.5%, and 5.7 million were unemployed. The labor force participation rate was little changed at 62.2% in June but still remains lower than the 63.4% witnessed in

February 2020. Moody's anticipates that full employment, defined as 3.5% unemployment rate and 62.5% labor force participation rate, will be achieved in the summer of 2022.



GROSS DOMESTIC PRODUCT:

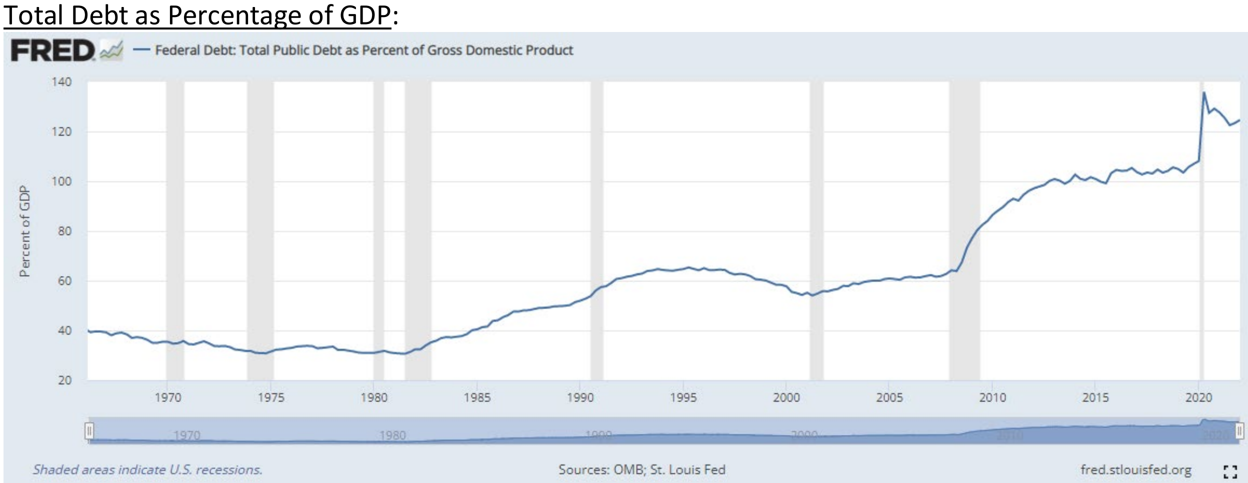
After the sharp decline in GDP during the second quarter of 2020, GDP growth rebounded quickly and continued to grow until the first quarter of 2022. After an increase of 6.9% in the fourth quarter of 2021, GDP decreased at an annual rate of 1.6% in the first quarter of 2022. In the first quarter, there was a resurgence of COVID-19 cases and decreases in government pandemic assistance payments. The decrease was revised down 0.1 percentage point based on the latest estimate released in May. The chart below displays the trend in quarterly GDP growth over the last five years. Moody's June Baseline forecasts 2022 GDP growth at 2.7%, which is close to the Bloomberg consensus of 2.6%. Moody's also expects GDP growth of 2.6% in 2023, which is slightly higher than the Bloomberg consensus of 2%.



FISCAL POLICY:
Fiscal support since the beginning of the pandemic will ultimately total more than $5 trillion, equivalent to nearly 25% of 2019 GDP and approximately three times the support provided during the global financial crisis. The highly expansionary, deficit-financed discretionary fiscal policy will continue to provide a boost to the economy. Moody's no longer expects lawmakers to pass the $600 billion legislation that the Biden administration named "Building a Better America." However, lawmakers did pass a $550 billion, 10-year public infrastructure package in late 2021 that is early in process of being allocated and eventually spent on infrastructure projects.

The federal government posted a deficit of $2.8 trillion in fiscal 2021 and is expected to post a $1.2 trillion deficit in fiscal 2022. The publicly traded Debt-to-GDP ratio is near 100% and will soon breach the all-time high of 106% reached briefly after World War II.

Total Debt as Percentage of GDP:



MONETARY POLICY:
The Federal Reserve no longer considers inflation to be transitory and is now aggressively tightening monetary policy. At the most recent FOMC meeting on June 15th, the committee raised the federal funds rate by 0.75% for a target of 1.5-2.0%. In addition to raising the fed funds rate, the committee will continue reducing its holdings of Treasury securities, agency debt, and agency mortgage-backed securities, as described in the May 2022 plan for reducing the size of the Federal Reserve's balance sheet. Moody's Analytics expects the Fed to increase the funds rate 50 basis points at the July meeting of the Federal Open Market Committee and follow with more rate hikes, bringing the funds rate to its long-run equilibrium, of 2.5% by year's end, and to 2.75% by this time next year. The chart below provides a complete view of the current market (Chicago Mercantile Exchange) probabilities across all scheduled FOMC meetings and possible Federal Funds rate outcomes. The market is expecting a 75-100 basis point increase to the Federal Funds rate at the July 2022 meeting.

Federal Funds Rate Probabilities:

FedWatch Tool

Target Rate: Current | Compare | Probabilities
Historical: Historical | Downloads | Prior Hikes
Dot Plot: Chart | Table

FED FUND FUTURES												
ZQN2	ZQQ2	ZQU2	ZQV2	ZQX2	ZQZ2	ZQF3	ZQG3	ZQH3	ZQJ3	ZQK3	ZQM3	ZQN3
98.3213	97.6725	97.5025	97.0925	96.7575	96.6475	96.5825	96.5475	96.5525	96.5625	96.6250	96.6850	96.7475

MEETING PROBABILITIES

MEETING DATE	225-250	250-275	275-300	300-325	325-350	350-375	375-400	400-425	425-450
7/27/2022	90.6%	9.4%	0.0%						
9/21/2022	0.0%	0.0%	61.6%	35.4%	3.0%	0.0%	0.0%	0.0%	
11/2/2022	0.0%	0.0%	0.0%	35.7%	46.4%	16.6%	1.3%	0.0%	0.0%
12/14/2022	0.0%	0.0%	0.0%	13.6%	39.8%	35.1%	10.8%	0.8%	0.0%
2/1/2023	0.0%	0.0%	0.0%	11.3%	35.4%	35.9%	14.9%	2.5%	0.1%
3/15/2023	0.0%	0.0%	1.0%	13.4%	35.4%	34.0%	13.8%	2.3%	0.1%
5/3/2023	0.0%	0.3%	4.4%	19.4%	35.0%	28.6%	10.7%	1.7%	0.1%
6/14/2023	0.1%	1.9%	10.2%	25.4%	32.5%	21.6%	7.2%	1.1%	0.1%
7/26/2023	0.8%	5.4%	16.6%	28.4%	27.9%	15.5%	4.6%	0.6%	0.0%

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, June 2022

Percent

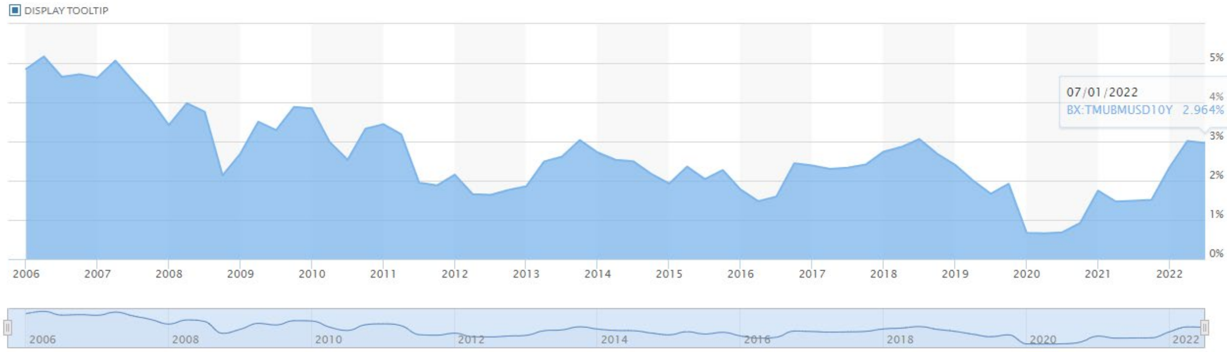
Variable	Median[1]				Central Tendency[2]				Range[3]			
	2022	2023	2024	Longer run	2022	2023	2024	Longer run	2022	2023	2024	Longer run
Change in real GDP	1.7	1.7	1.9	1.8	1.5–1.9	1.3–2.0	1.5–2.0	1.8–2.0	1.0–2.0	0.8–2.5	1.0–2.2	1.6–2.2
March projection	2.8	2.2	2.0	1.8	2.5–3.0	2.1–2.5	1.8–2.0	1.8–2.0	2.1–3.3	2.0–2.9	1.5–2.5	1.6–2.2
Unemployment rate	3.7	3.9	4.1	4.0	3.6–3.8	3.8–4.1	3.9–4.1	3.5–4.2	3.2–4.0	3.2–4.5	3.2–4.3	3.5–4.3
March projection	3.5	3.5	3.6	4.0	3.4–3.6	3.3–3.6	3.2–3.7	3.5–4.2	3.1–4.0	3.1–4.0	3.1–4.0	3.5–4.3
PCE inflation	5.2	2.6	2.2	2.0	5.0–5.3	2.4–3.0	2.0–2.5	2.0	4.8–6.2	2.3–4.0	2.0–3.0	2.0
March projection	4.3	2.7	2.3	2.0	4.1–4.7	2.3–3.0	2.1–2.4	2.0	3.7–5.5	2.2–3.5	2.0–3.0	2.0
Core PCE inflation[4]	4.3	2.7	2.3		4.2–4.5	2.5–3.2	2.1–2.5		4.1–5.0	2.5–3.5	2.0–2.8	
March projection	4.1	2.6	2.3		3.9–4.4	2.4–3.0	2.1–2.4		3.6–4.5	2.1–3.5	2.0–3.0	
Memo: Projected appropriate policy path												
Federal funds rate	3.4	3.8	3.4	2.5	3.1–3.6	3.6–4.1	2.9–3.6	2.3–2.5	3.1–3.9	2.9–4.4	2.1–4.1	2.0–3.0
March projection	1.9	2.8	2.8	2.4	1.6–2.4	2.4–3.1	2.4–3.4	2.3–2.5	1.4–3.1	2.1–3.6	2.1–3.6	2.0–3.0

- The chart Above displays the Federal Reserve's projections for each of the major economic variables and their longer-run expectations.

Federal Reserve FOMC Statement June 15, 2022:

"The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. In support of these goals, the Committee decided to raise the target range for the federal funds rate to 1-1/2 to 1-3/4 percent and anticipates that ongoing increases in the target range will be appropriate. In addition, the Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities, as described in the Plans for Reducing the Size of the Federal Reserve's Balance Sheet that were issued in May. The Committee is strongly committed to returning inflation to its 2 percent objective."

US 10 Year Treasury Yield:



- The closely watched 10-year treasury yield has reached 3% and is expected to rise to 3.5% by the end of 2022. The 10-year serves as a barometer for the economy and is watched closely by investors. Moody's expects the 10-year treasury yield to steadily increase over the next few years, reaching its estimated long-run equilibrium of 4% by mid-decade.

CONCLUSION:
The economy has rebounded from the pandemic-related disruptions but is now faced with new inflation headwinds partially created by the Russian/Ukraine conflict. Now that we are at or near full unemployment, and inflation is above expectations, the question is will the FOMC be able to increase rates enough to lower inflation while avoiding a recession?

SOURCES:

1. Moody's Analytics March 2022 US Macroeconomic Outlook
2. https://covid.cdc.gov/covid-data-tracker/#cases_totalcases
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