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## China in Transition

China this month marked the completion of a months-long, orchestrated leadership transition as new President Xi Jinping took the reins of the world's most populous country. While economic growth near 8 percent is expected this year in China, the story isn't all rosy. The Communist Party's credibility has been damaged by corruption scandals, an income gap between the rich and poor continues to grow and the Chinese people are growing restless over continued environmental degradation and the lack of a free flow of information.

Expectations are high that Xi and his allies will begin to mend social welfare programs and institute other government and economic reform policies. But reform won't be quick, nor will it come easy, according to Ian Bremmer and Nicholas Consonery with Eurasia Group. *OUTLOOK* recently turned to these two experts on China for insight on the historic leadership transition, China's role on a changing global stage and what the future might hold for the country. Ian Bremmer is the president of Eurasia Group, the leading global political risk research and consulting firm. Nicholas Consonery is a senior analyst in Eurasia's Asia practice, specializing in politics and economic policies in China and Taiwan.

***OUTLOOK: Start by telling us why the leadership change in China matters to the American people and to the future of U.S.-China relations.***

**Ian Bremmer:** China's new leaders are walking into an incredibly difficult situation. Over the past five years the global economy has changed in ways that are fundamentally negative for China's economic growth. At the same time global geopolitics have become much more complex in the aftermath of the Arab spring and as the United States focuses more on domestic issues. And internally in China, a growing middle class is demanding more economic reform, and even political reform, from the government. China's new leadership will need to navigate all of these difficult issues simultaneously. The decisions they make will chart the course for China's economic growth, its international role and relationship with the U.S. The variety of potential outcomes is vast.

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### About this article



Ian Bremmer is the president of Eurasia Group, a leading global political risk research and consulting firm that provides financial, corporate, and government clients with information and insight on how political developments move markets.

Bremmer created Wall Street's first global political risk index, and has authored several books, including "Every Nation for Itself: Winners and Losers in a G-Zero World" and "The End of the Free Market: Who Wins the War Between States and Corporations?" Bremmer is a contributor for the *Financial Times* A-List and Reuters.com, and writes "The Call" blog on ForeignPolicy.com. He also has published articles in the *Wall Street Journal*, the *Washington Post*, the *New York Times*, *Newsweek*, *Harvard Business Review*, and *Foreign Affairs*. He appears regularly on CNBC, Fox News Channel, National Public Radio, and other networks.

Bremmer has a doctorate in political science from Stanford University, and was the youngest-ever national fellow at the Hoover Institution. He teaches at Columbia University.

### **OUTLOOK: Describe the transfer of political power in the Chinese system.**

**Nicholas Consonery:** There are three cores of power in the political system in China: the Communist Party, the government structure, and the military. The key institution to watch in terms of political power and power transfer is the Communist Party, because the party leadership essentially controls the other two institutions. Once a new party leadership is chosen, top party officials are then designated leadership roles in the government structure. The military has a more insular process of internal promotions, but the military is ultimately subservient to the party.

This year's transfer of power in China is quite historic. In the past, you essentially had the ascent of strong men, leaders such as Mao Zedong or Deng Xiaoping, who came to power by force of personality. Those individuals designated chosen successors – which meant ordination by default for the next two presidents, Jiang Zemin and Hu Jintao. But this Communist Party leadership turnover has been different. It was the first time new leadership was chosen internally, by an intra-party selection process. It included some level of voting at very high levels of the party but also included negotiations between different factions in the party.

One of the driving forces of personnel appointments in the new administration was mandatory retirement ages. Since Mao, the party has worked to institutionalize mandatory retirement ages and impose term limits on senior officials. The new president, Xi Jinping, for example, will be in control of the party for the next 10 years.

The latest leadership change in China actually began last October. But the full transition in all three cores of power wasn't finalized until this month with the conclusion of The National People's Congress, which is where the new party leadership took control of the government.

## What we're seeing is a very comprehensive reshuffling of leadership in China at all levels of government.

### About this article



Nicholas Consonery is a senior analyst with Eurasia Group's Asia practice. He specializes in the politics and economic policies of China and Taiwan. Consonery is a regular contributor to Bloomberg News, CNBC, and Fox Business, and his research is frequently cited by mainstream media publications, including the *New York Times* and the *Wall Street Journal*.

He has a master's degree in Asian studies from the Elliott School of International Affairs at the George Washington University as well as a bachelor's degree in political science and Asian studies from Furman University.

### **OUTLOOK: What happens throughout the government when a new president takes over?**

**IB:** The turnover at the senior leadership level is paralleled by a very comprehensive turnover throughout the bureaucratic structure in China at all levels – from senior bureaucratic positions in charge of ministries and commissions all the way down to local level officials at province and city levels. What we're seeing is a very comprehensive reshuffling of leadership in China at all levels of government. Even the Chinese ambassador to the U.S. has changed.

In addition, a lot of individuals in government who are seen as up-and-coming officials have been promoted over the past couple of weeks to run some of China's biggest provinces and regulatory bureaucratic institutions. Long story short, it's not just about transfer of power at the top.

### **OUTLOOK: What is the likely posture of the new leadership toward economic liberalization and democratization? What kind of shift will we see?**

**IB:** We're more optimistic about their inclinations regarding economic reform than political reform. It's very difficult to find a senior leader in Beijing, or even a lower-level official in China, who thinks that nothing needs to change on the economic front. In fact, there is a broad consensus within government that the current economic structure is not sustainable. The economy as it exists today is overwhelmingly driven by corporate and government investment, and relatedly by exports to the global marketplace. Household consumption plays a relatively smaller role in growth in China than in many other major economies.

The current set up worked great for China for 30 years, but its utility has been exhausted. It's too vulnerable to external shocks. It's much too resource intensive. The resulting pollution problem is terrible. Plus, the result of all this investment activity, layered with government overreach and corruption, has been an internal distribution of income that is skewed in a way that is great for elites but really disadvantages Chinese families.

We think there's broad agreement within the new government that a comprehensive set of economic reforms need to be pursued over the medium term to address these issues. The problem, however, is that we don't see agreement about what reforms should happen first in order to get the economy to a more sustainable place.

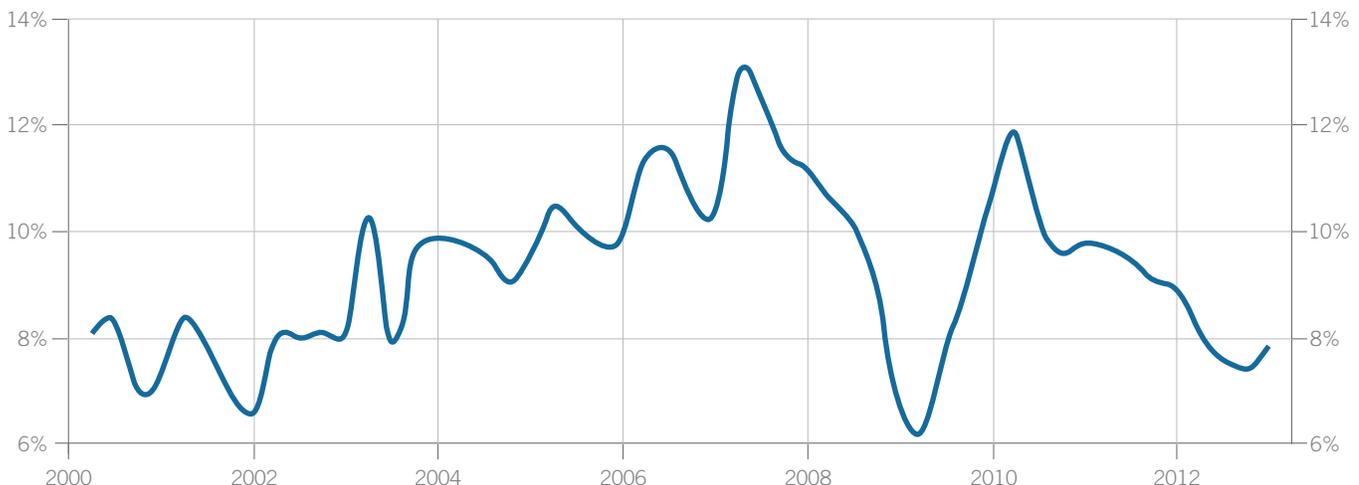
In our view, for the first few years whatever they do agree on will look more like state-led economic reform than pure liberalization of policies. You will see a bigger role for the state in driving industrial policy toward higher value-added manufacturing and new job creation. Changes also could include mandating more wealth transfers from affluent segments of the population and from cash-rich government-connected companies to social welfare networks. We view it as less a liberalization push and more about a government-engineered attempt to redistribute and rebalance.

**OUTLOOK: What about political reform?**

**NC:** On the political and social reform front, we believe the new leadership is going to be conservative and very risk averse. They understand that things need to change on the economic side, but there's just not as much of a consensus for change on the political and social sides. To be sure, the Chinese government functions in a very fragile space – the government maintains tight controls on public expression and social discourse, and Chinese citizens have little to no influence in selecting their own leaders. But for now the level of public pressure on the government to change its posture is lower on the political front than on the economic front – perhaps in large part because the government immediately stifles any real discussion of political reform.

**CHINA GDP GROWTH**

Percent change in gross domestic product



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com) National Bureau of Statistics of China

In 2013 we think this unwillingness to reform will test the government, because expectations for the new leaders regarding reform are so high. But there are indications that the leadership is more interested in reinforcing the government's capabilities to control the dissemination of information internally than it is in opening up the channels for public discussion. Public discontent with that determination will increase.

To address the shortfall Beijing will attempt to roll out more limited governance and administrative changes to reduce oversight, and it will take its anti-corruption efforts more seriously. These changes could help the government with the public narrative, but they will be more cosmetic than comprehensive.

***OUTLOOK: What will “government-engineered” economic reform in China look like?***

**IB:** In short, we basically see the government doubling down on its state capitalist, economic approach, where Beijing plays an outsized role in driving economic outcomes. The leadership hopes that it can still engineer a rebalancing by spending on different priorities. Rather than driving heavy industry manufacturing, for example, the government has designated seven “emerging strategic industries” in the high-tech space where it hopes to engineer new growth and corporate investment. It is also using tax reform to encourage services sector growth – oriented toward making new jobs for the millions of college graduates the country is generating every year. At the end of the day all of these policies are being rolled out in the hopes of creating new and higher-paying jobs for millions in China, which should then drive higher consumption rates. But again, this is more about government policy than it is about liberalization.

**NC:** One of the most important reforms to the Chinese growth model is to consider comprehensive financial sector reform to reduce the role of the state in shaping the allocation of capital and remove the outsized level of government interference and control of the domestic financial system. But there appears to be a lack of consensus at high levels of government to give up control of the financial system. We view that as one of the big impediments to really being optimistic about the economic liberalization story in China. While some marginal progress is likely, it looks like comprehensive financial reform is not in the cards for the next three to five years.

The Chinese economy in 2013 is expected to grow a little bit more like what I would call old China than the new China – the new economy that the government hopes to create over coming years.

**OUTLOOK: What do we know about Xi Jinping as a man? What are his priorities?**

**NC:** Xi Jinping is emerging as a more charismatic leader than his predecessor, Hu Jintao. He has a broader network of support in those three cores of power – the military, the government and the party. Xi actually spent more time in the military structure earlier in his career, and he is believed to have a much more solid set of internal support networks from the military.

Xi is also different from Hu Jintao in that he is essentially political aristocracy in China. His father was the former governor of Guangdong province, which is now one of the nation's most important manufacturing regions and the most populous province in the country – in large part because of the reforms implemented by Xi's father, Xi Zhongxun. Xi Zhongxun was a known reformer at a time when China was undergoing a very fundamental introspection about the direction of the country and of the economy. He was an integral player in the reform movement of the late 1970s and early 1980s. So not only does Xi have strong support within the bureaucracy and the military, but his political lineages are much stronger and date back to the origins of the founding of the party. He's a member of the elite political class.

**IB:** Xi Jinping and his new cohort of administrators also are generally more patriotic and nationalistic in their foreign policy inclinations. They're expected to take China into a next phase of foreign policy and global engagement, and it's going to be characterized by China being more forceful and advocating for its domestic and international interests. But at this point there is very little we know about Xi's personal inclinations on foreign policy.

**OUTLOOK: Give us an overview of where the Chinese economy is today.**

**NC:** The Chinese economy in 2013 is expected to grow a little bit more like what I would call old China than the new China – the new economy that the government hopes to create over coming years. The economy is still very reliant on domestic investments and exports for economic growth. Because there's a new government this year, they're looking for a positive growth story and they have the fiscal capacity to get there. They're going to spend a lot more money on fiscal outlays, especially on infrastructure and social welfare, which are priorities of the incoming premier.

The offsetting issue that is going to restrain the government on the fiscal side, and on the monetary side as well, is inflation. Overall, it appears that inflation will become a bigger headache for the government this year because of the excess capital in the global financial markets and the potential for that to bleed into China. Plus, China has its own issues with the excess liquidity domestically.

***OUTLOOK: What level of growth do you expect for China in 2013?***

**NC:** We're expecting 7.5 percent plus this year. We don't have an explicit growth forecast, but that seems to be the consensus. This new administration is going to need to prove their bona fides on economic management. This year is really going to be one where the government prioritizes stability, and hopefully makes progress on laying the foundation for broader economic reform efforts down the road. So given an expectation of slow progress on reform, the end result will be a government that is incentivized to lean a little bit more toward pure growth promotion this year.

***OUTLOOK: You've said the new leadership wants to invest in a social welfare agenda. What does that look like?***

**NC:** They have essentially promised universal healthcare to the entire population by 2020. There's an expectation there's going to be a massive level of new expenditures on health care and on the highly state-involved network of health care clinics and hospitals in China.

Plus, the country's pension system is a big fragmented mess and the government knows it needs to remedy this. They're trying to get a nationwide pension system in place that will allow people to move from place to place internally and be able to transfer the money they've already paid into that system to other locales.

A third piece of it is affordable housing. The government wants to build 36 million units of affordable housing by 2015. The rapid increase in housing prices – a result of the government's stimulus response to the financial crisis – has become a real domestic vulnerability and an issue of extreme political pressure on the government.

***OUTLOOK: Earlier you talked about the government investing in infrastructure. What does that look like?***

**NC:** China has very aggressive domestic infrastructure investment plans, rail being at the forefront. Obviously, there's the public transportation component but more importantly it's about logistics - the transfer of manufactured goods and raw materials like coal. Coal bottlenecks have been a big issue driving price increases in domestic energy costs for years. They're going to spend a lot more money not just on rail, but on roads, ports, airports. They just have billions and billions of dollars of spending plans on all those kinds of priorities.

***OUTLOOK: You believe there's some room for reform when it comes to energy. Are those environmental reforms? Or reforms in how energy is delivered? Both?***

**NC:** The government has a couple of overarching goals for what they want to do with the energy sector. They want to reduce the energy intensity of growth; they want to reduce the carbon intensity of growth; and they want to diversify the overall energy mix away from fossil fuels. Clearly, these priorities are driven by a realization that their current model of growth is just plain unsustainable – resources are too scarce, and the environmental costs are extreme. Resource scarcity is becoming a much bigger complication to economic growth, and one that drives price inflation.

***OUTLOOK: Is there a demand in China for energy imports?***

**NC:** Absolutely. Big increases are expected in natural gas imports in particular as they try to move away from coal. We've also seen massive imports in coal over the past couple of years, driven partly by pricing in the global coal market. Oil is obviously another big one. They are 55 to 60 percent import reliant on petroleum.

The demand for agricultural product consumption in China is going to grow dramatically over coming years as the population becomes more affluent and turns toward consumption of more meat and organic products.

***OUTLOOK: Given the growing economy, what is the demand in China for agricultural imports?***

**NC:** Well, we have to be careful how we talk about China's ag imports. Without a doubt, the demand for agricultural product consumption in China is going to grow dramatically over coming years as the population becomes more affluent and turns toward consumption of more meat and organic products.

The import story is more nuanced. The Chinese government maintains aggressive food security goals, and historically has been unwilling to allow too much overreliance on foreign sources for its basic foodstuffs. But the past couple of years have shown that's an increasingly difficult strategy to maintain because of the outsized consumer demand and the diminishing levels of clean water and arable land within China.

The end result over the next few years is that the government might be forced to walk away from its self-sufficiency aspirations. As it happens, that will be a bright spot for the U.S.-China story, as agricultural producers here increasingly step up to satisfy Chinese demand.

***OUTLOOK: Tell us about the risks China faces in terms of economic growth.***

**NC:** Inflation is a near-term risk. It could force the government toward a less accommodative growth policy or, in market terms, a more neutral monetary policy position and away from the expansionary approach they have right now. I don't see inflation in the near-term as a really outsized risk though. The government has the instruments to address the issue if they need to. It wouldn't be good for this year's growth story, but it is unlikely to be more broadly destabilizing.

**IB:** As far as outsized risk, we focus first on the domestic financial sector where we see a proliferation of arbitrage in the financial system and explosion of unregulated financial products that in some cases are quite risky and potentially expose the balance sheets of the big financial institutions to a higher level of risk than they currently have. The government has the tools and money to recapitalize bank balance sheets if it needs to, but the process could generate a sharper downside growth outcome in China than the market currently expects.

The second risk, and one potentially much harder for the government to control, is on the political and social front. At Eurasia Group we flagged this kind of risk as our number two on our top 10 global risks list for 2013. This year we called it “China Vs. Information,” which is essentially the government’s determination to maintain its information control policies and the growing potential for the Chinese population to really push back against that. The government’s ability to maintain control over domestic narratives has significantly eroded, so the potential for an emergence of an online social movement that is counter to the government’s discourse is high. That’s going to be a medium-term, persistent risk for the government until they walk away from that oversight.

**OUTLOOK: What about the Chinese real estate market?**

**NC:** At the end of 2010, in the post-stimulus period, the government was really cognizant that it had a big problem with price inflation in the real estate market. Beijing tried to stop the rapid increases in prices by restricting how many households individual investors could buy as investment properties. They made it more difficult for people from one city to invest in another city and they increased the level of down payment and mortgage interest requirements – all with the goal of trying to put a freeze on growth and prices in the market. Two years later, we have to say that that push has been

**INFLATION IN CHINA**

Annual Change on Consumer Price Index



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com) National Bureau of Statistics of China

The Chinese government has not yet come to terms with how to shape its foreign policy doctrine. What it needs is a new narrative for the 21st century – one that accommodates China’s role in the world and strengthens its hand in shaping economic and strategic outcomes.

pretty successful. The sense I get from the developers in China is that while we’re having a rebound in pricing in the market now, the growth is actually healthier and much less speculative in many city markets.

Does that mean that the bubble concerns in Chinese real estate have gone away? Definitely not. And what we’re starting to see now is the government trying to move in on a more discreet, city-by-city basis to control the potential for speculation in some of the big markets where price growth has been more worrying. I think the policy story for this year will be one of cautious refinement of regulation by the government – stepping in to try to slow worrying price growth, but hesitant to freeze the nationwide market, which would risk a broader slowdown in economic growth.

**OUTLOOK: Talk a little bit about what the political changeover means in terms of foreign policy.**

**IB:** I think that’s the big story. We’re talking about a government that is increasingly trying to cope with its newfound power and influence. The weight of the country, the influence of the country has increased dramatically in recent years – on not just global financial markets, but in global geo-politics as well.

But the government has not yet come to terms with how to shape its own foreign policy doctrine. What it needs is a new narrative for the 21st century – one that accommodates China’s role in the world and strengthens its hand in shaping economic and strategic outcomes. China’s old doctrines – like “peaceful rise” and “non-interference in the domestic affairs of foreign countries” are just plain insufficient at this point. But the creation of a new narrative is just in its infancy. Formulating it will be the main foreign policy task for the new administration over the coming years.

Without a doubt, this young administration is going to be more inclined toward foreign policy positions that it views as more accommodative of China’s own internal interests. But the key question is how Beijing ascertains what its interests really are. The end result could lead to conciliatory positions as well as to confrontational ones. For example, in the lead-up to the political

transition in China we saw a more aggressive foreign policy posture from Beijing, especially regarding territorial disputes with Japan and Vietnam. At the time, Beijing saw an interest in building internal support by generating nationalistic or patriotic sentiment against those governments.

But over the medium-term Beijing has a genuine interest in maintaining stable economic and political relations in its region. Over the past few weeks we are starting to see indications that the leadership is leaning more toward that interest, and consciously attempting to walk away from tension in the relationship with Tokyo. So the decisions that the new government makes about its interests will be crucially important – they will drive China’s foreign policy behavior across the board.

Managing key relationships won’t be easy for this new government, especially as China becomes more influential. In Asia, you have concerns among governments across the region about how to balance against China’s growing influence. In that context the door really has been opened for the Obama administration to get the U.S. more engaged in Asia on both strategic and economic fronts. But those moves are perceived with skepticism and even suspicion in Beijing. The result will be that the U.S.-China relationship becomes more complex and difficult over the next couple of years as the administration in D.C. really doubles down on its intentions to refocus attention on the Asia region.

### CHINA’S TOP 10 AGRICULTURAL IMPORTS FOR 2012

IMPORTS
Oilseeds
Food and Livestock for Food
Soybeans
Cotton
Animal and Vegetable Oils, Fats and Waxes
Fixed Vegetable Fats & Oils, Crude, Refined
Edible Vegetable Oils
Vegetable and Fruits
Fish & Aquatic Invertebrates & Preparations
Cereals

Source: CEIC

**OUTLOOK:** *Go into that a little deeper. What is the status of the strategic relationship between the U.S. and China today and what changes might we see with new leadership?*

**NC:** On the economic front, we have a very high potential for a more balanced U.S.-China relationship in the context of growing import demand from China and relatedly, huge expectations about U.S. export growth into the Chinese market. There’s also much more interest from Chinese companies and Chinese investors about investing directly into the United States markets and to get manufacturing capabilities in place to serve U.S. consumer demand. That story will drive job growth in the U.S. and could turn out to be a very, very positive economic story.

The hope is that the economic benefits will continue to underpin a certain level of diplomatic and strategic stability in the relationship, which has certainly been the story of U.S.-China relations since at least the mid-90s.

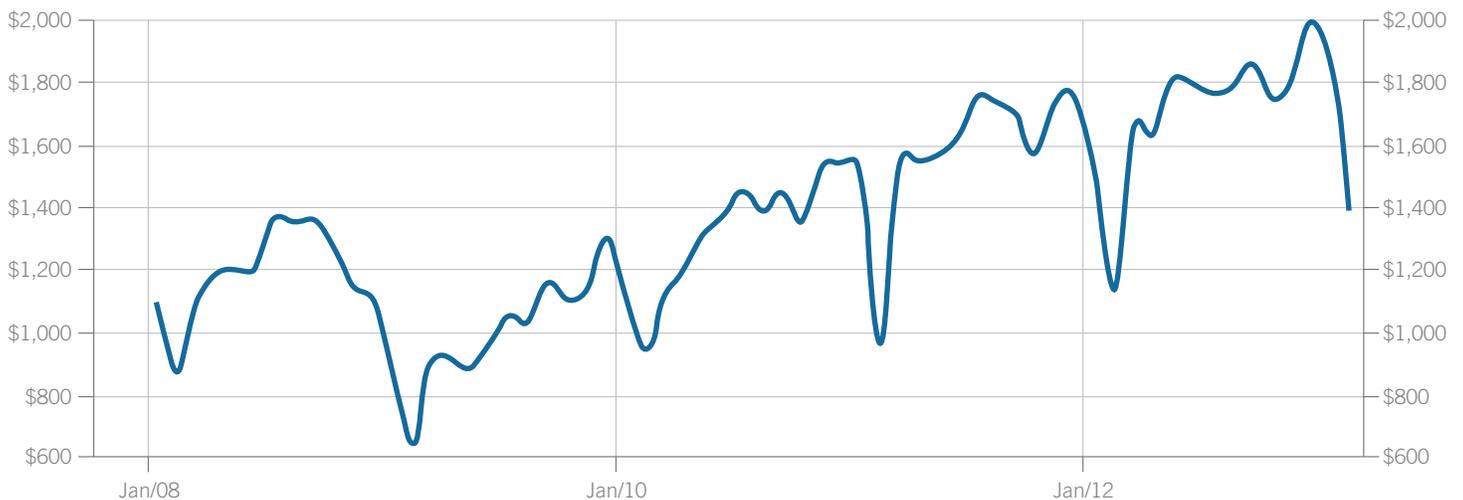
**IB:** True, but the big risk over the medium-term is that concerns on the strategic side outweigh and even threaten to undermine the economic story. That would be the more negative trajectory that I certainly hope the two governments can avoid. So far, it seems that both the new administration in China and the Obama administration in the U.S. are committed to avoiding this outcome.

**OUTLOOK:** *What should the U.S. be doing policy-wise with regard to China? What should we do to nurture this most important global relationship?*

**IB:** The relationship needs the direct involvement of Presidents Barack Obama and Xi Jinping. Only a top-level dialogue on the scale of the summits that brought together President Ronald Reagan and Soviet leader Mikhail Gorbachev can give U.S.-Chinese relations the urgency they deserve.

## CHINA'S EXPORTS

Exports By Month (USD Hundred Million)



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com) General Administration of Customs



## U.S. officials must stop trying to negotiate with the China they want and engage China as it is.

Moreover, the U.S. must stop asking for things that Beijing can't provide. For example, in 2009 President Obama asked China to join in a G2-style global partnership, one that would require Beijing to take on new costs and risks in international politics. China's leaders refused, insisting that China remains a developing country.

In fact, China is *not* ready to be part of a G2. The domestic reform challenges China has to meet over the next 10 to 20 years are far more pressing for the new leadership.

The key focus has to be on finding as many areas as possible where the two sides can work together – while ensuring that competition in one area doesn't derail partnership in another.

Finally, let's be honest – hedging should remain a part of U.S. strategy, because even the most serious attempt to build better relations might simply fail. But hedging without a sincere attempt at high-level engagement increases the risk that competition will stoke conflict – generating public anger in both countries that political officials can't ignore.

### ***OUTLOOK: What mistakes should we avoid?***

**IB:** U.S. officials must stop trying to negotiate with the China they want and engage China as it is. That country's leaders won't accept another approach, and the United States doesn't have the power to force them to. ■

# Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 2/28/13. 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

Source: Insight Economics, LLC and Blue Chip Economic Indicators

### US Treasury Securities

2013	GDP	CPI	Funds	2-year	10-year
Q1	2.00%	1.40%	0.15%	0.26%	1.87%
Q2	2.20%	1.80%	0.14%	0.30%	2.00%
Q3	2.60%	2.20%	0.14%	0.36%	2.14%
Q4	2.80%	2.10%	0.15%	0.43%	2.30%
2014	GDP	CPI	Funds	2-year	10-year
Q1	2.70%	2.10%	0.16%	0.54%	2.51%

## 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	0.29%	0.31%	0.51%	0.95%	1.44%	2.01%
0.25	0.28%	0.33%	0.58%	1.06%	1.55%	2.10%
0.50	0.31%	0.36%	0.66%	1.16%	1.65%	2.19%
0.75	0.33%	0.40%	0.75%	1.28%	1.76%	2.28%
1.00	0.37%	0.45%	0.85%	1.39%	1.87%	2.37%
1.50	0.47%	0.59%	1.09%	1.64%	2.08%	2.54%
2.00	0.63%	0.79%	1.34%	1.90%	2.24%	2.72%
2.50	0.90%	1.06%	1.64%	2.15%	2.48%	2.88%
3.00	1.17%	1.33%	1.93%	2.40%	2.72%	3.04%
4.00	1.79%	1.95%	2.44%	2.84%	3.10%	3.32%
5.00	2.38%	2.55%	2.94%	3.15%	3.40%	3.55%

## 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

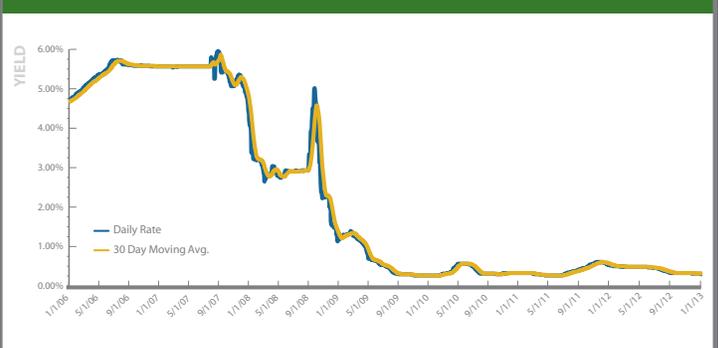
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	5	5	5	5
90	5	10	12	12
180	6	16	21	21
365	18	35	43	41

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.

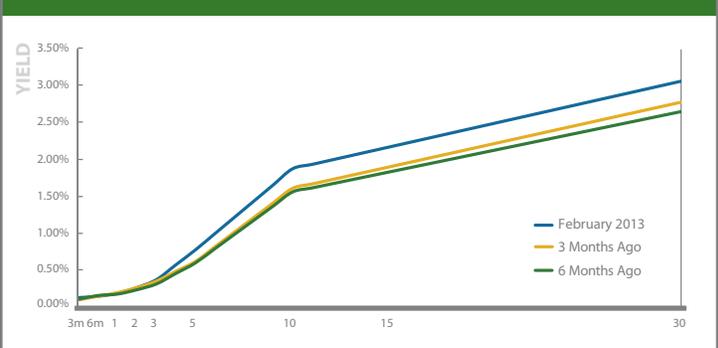
## 3-MONTH LIBOR



## RELATION OF INTEREST RATE TO MATURITY

The yield curve is 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





### About CoBank

CoBank is a \$92 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 approximately 70,000 farmers and 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 and the nation's rural economy.

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 the bank's web site at [www.cobank.com](http://www.cobank.com).

*Commentary in Outlook is for general information only and does not necessarily reflect the opinion of CoBank. The information was obtained from sources that CoBank believes to be reliable but is not intended to provide specific advice.*

## Follow CoBank on Social Media

CoBank has recently launched corporate pages on the major social platforms – Facebook, Twitter, LinkedIn and YouTube. Each platform has a slightly different feel and focus, but all are being used as alternative distribution channels for news and information about the bank and supplement other channels we currently use, including email and the corporate web site.

If you would like to follow CoBank on any of our corporate social sites, please do so using the links below:

- **Facebook:** [www.facebook.com/cobankacb](http://www.facebook.com/cobankacb)
- **Twitter:** [www.twitter.com/cobank](http://www.twitter.com/cobank)
- **LinkedIn:** [www.linkedin.com/company/cobank](http://www.linkedin.com/company/cobank)
- **YouTube:** [www.youtube.com/cobank](http://www.youtube.com/cobank)

If you have questions about CoBank's use of social media or our policies, please email us at [connect@cobank.com](mailto:connect@cobank.com). ■