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## The Mystery of Stagnant Wage Growth

At 4.9 percent, the U.S. unemployment rate is now lower than it has been since February 2008. The labor force participation rate has moved off its 38-year low, indicating that more people are coming back into the work force. And in December, the Fed showed its confidence in the economy and the improving labor market by raising the Fed funds rate above near-zero levels for the first time in seven years.

Given all that, one of the biggest mysteries of the current economic recovery is why U.S. wage growth hasn't been able to get out of first gear. Wage growth finally demonstrated some small signs of life in 2015 by growing 2.5 percent, the highest it's been in six years – but that figure is sluggish compared to historical averages. The Federal Reserve considers 3.5 percent annual wage growth to be healthy.

According to Diana Furchtgott-Roth, former chief economist at the U.S. Department of Labor, one reason is that a greater number of lower-skilled jobs are being created, holding the average wage down. Worker productivity is down, too, which also tends to inhibit wage increases. She sees some troubling signs of rough waters ahead and believes that an economic recession is a possibility for 2016. *OUTLOOK* sat down with Furchtgott-Roth to better understand the quandary around wage growth.

***OUTLOOK: It stands to reason that as unemployment falls, wages should rise because there is more competition for each qualified worker. But that hasn't been the case over the past five years. Why is that?***

**Diana Furchtgott-Roth:** Wage growth relies heavily on the mix of workers being hired as the economy picks up. With this recovery, we've seen more low-skill labor coming on line. When you have a greater number of lower-skilled individuals working than higher-skilled workers, then you find that the average wage declines.

We can see this in how the unemployment rates have changed for different age groups. According to the Bureau of Labor Statistics, which tracks unemployment for the U.S. Department of Labor, the unemployment rate in the 20 to 24 age group declined nearly 2 percent – from 10 percent

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### This Month's Expert



Diana Furchtgott-Roth is a senior fellow at the Manhattan Institute and a columnist for MarketWatch.com and other publications. From 2003 to 2005, she was chief economist of the U.S. Department of Labor. She is the author of five books, most recently *Disinherited: How Washington Is Betraying America's Young*, coauthored with Jared Meyer (Encounter Books, 2015). In 2001–02, Furchtgott-Roth was chief of staff of President George W. Bush's Council of Economic Advisers. In 1991–93, she was deputy executive director of the White House Domestic Policy Council and associate director of the Office of Policy Planning under President George H. W. Bush. Furchtgott-Roth was an economist on the staff of President Reagan's Council of Economic Advisers in 1986–87.

Furchtgott-Roth is a frequent guest on Fox Business News and BBC's *Business Matters* and has appeared on numerous other TV and radio shows, including CNBC's *Larry Kudlow Show* and C-SPAN's *Washington Journal*. She holds a B.A. in economics from Swarthmore College and an M.Phil. in economics from Oxford University.

to 8.2 percent – from July 2015 to January 2016. During the same time period, however, unemployment in the 25 to 54 age group decreased by just three-tenths of a percent, to 4.2 percent. In short, the recovery has been much stronger among younger workers, which is why the average wage hasn't been rising.

**OUTLOOK:** *Many economists now think we've reached a tipping point, where wages are poised to start rising again. Do you think that's the case?*

**DFR:** The longer you get into a recovery – and the lower the unemployment rate is – the more likely we are to see upward wage pressure. It's very likely that we'll see wages rise if the recovery continues. But there are many indications that the recovery might not be continuing. We saw that in the fourth quarter 2015 GDP data, when the economy grew at just 0.7 percent. The recovery is slowing, and business and investment is slowing.

**OUTLOOK:** *Aside from pure economic growth, what other factors drive wage growth?*

**DFR:** Wage growth comes from increases in productivity. If productivity is not increasing, we're not really going to see wage growth because there isn't anything more that employers have to pay workers.

And we're not seeing an increase in productivity right now. Usually, productivity increases right as the economy comes out of a recession, which we saw in the 2009–2010 timeframe. But we've seen declining or very slow productivity growth in the last year or so. Productivity in the nonfarm business sector actually decreased at an annual rate of 3 percent in the fourth quarter of 2015. From 2014 to 2015, annual average productivity increased by just 0.6 percent, which is significantly below the 2.2 percent average from 1947 to 2014. This growth also contrasts poorly with the 3.3 percent annual productivity growth we saw in 2009 and 2010 as we were coming out of the recession. If productivity continues to fall, we're not going to see any wage increases either.

**OUTLOOK:** *What factors drive increases in productivity?*

**DFR:** Productivity is driven by increasing use of technology, more efficient use of manpower and by innovation. All these things drive productivity in an economy. Instead, we have seen several factors that basically reduce innovation, reduce the use of technology and keep businesses out of the United States. These factors include a restrictive immigration policy that prevents foreign start-ups from locating here; a high corporate tax rate that discourages businesses from repatriating funds; and excessive regulation of cutting-edge sectors, such as the Internet, pharmaceuticals and finance.

If we can see better economic performance, more people are going to be drawn back into the labor force. They're going to find that it's more worthwhile working than not working.

***OUTLOOK: Beyond growth and productivity, what other factors are most likely to affect wage growth in the next three to five years?***

**DFR:** The U.S. government's corporate tax policy will be significant. We have more than \$2 trillion in corporate earnings sitting outside the United States because we have the highest corporate tax rate in the world – around 39 percent between federal and state tax combined. The global average is about 25 percent.

The current corporate tax policy is, in fact, forcing more companies out of the country. We just saw that Johnson Controls and Tyco – two very large manufacturers – are merging to become an Irish company under Tyco's name. We also saw the merger of two trash companies – one in Texas and one in Canada – to become a Canadian company. This is disturbing for the obvious reason that trash collection is a highly localized business. When even your trash company is off-shoring, that's really bad.

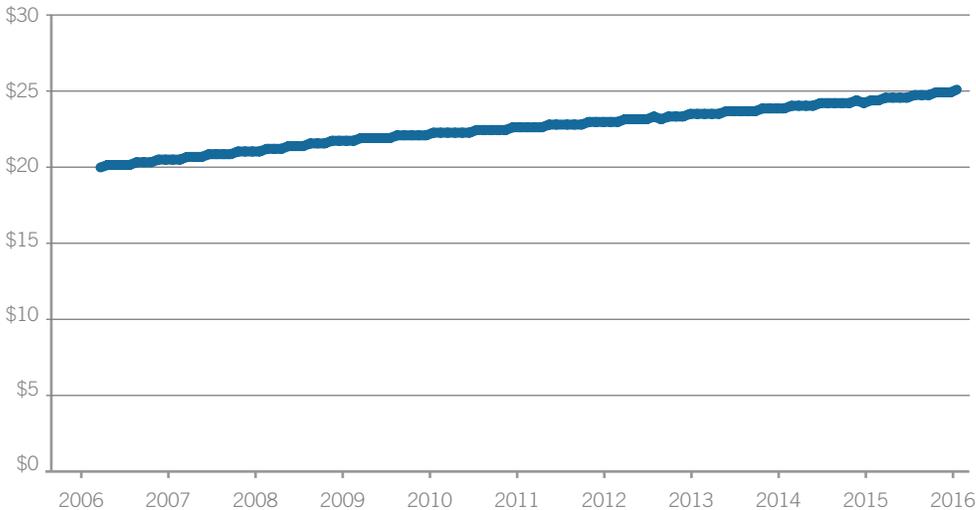
***OUTLOOK: Where do you see the labor participation rate going from here? Do you think it will have an impact on wages?***

**DFR:** There is generally a correlation between labor force participation and economic growth. Rising labor participation rates will help the economy by making more labor available; labor force participation will rise as the economy improves. The labor force participation rate has been improving over the last few months – going from 62.4 percent to 62.7. If we can see better economic performance, more people are going to be drawn back into the labor force. They're going to find that it's more worthwhile working than not working.

Interestingly, we haven't been seeing declines in the labor force participation rate of people 55 and over, as we would expect from an aging population. To the contrary, the 55-and-over labor force participation rate has been increasing. While many people thought the labor force participation rate would decline as these Baby Boomers drop out of the labor force, they're staying to work in higher percentages than in previous generations. What is troubling, however, is that we're seeing a decline in the 25 – 54 age group. This is a group that should be in the labor force. They are not retired and they are generally not in school.

## GROWTH IN WAGES

AVERAGE HOURLY EARNINGS 2006-2016



Source: Bureau of Labor Statistics

**OUTLOOK:** Typically, what percentage of a business owner's expenses are spent on wages?

**DFR:** There is a substantial variation depending on which industry we're talking about. According to the U.S. Bureau of Economic Analysis, farms spend only 16.9 percent of their expenses on wages. Hospitals are among the highest at 88.7 percent. Manufacturing is at 46.3 percent, retail is about 55 percent and construction is 63 percent.

**OUTLOOK:** What are the effects of wage growth on small businesses, which fuel much of the economy's growth?

**DFR:** Wage growth means that people will have more money to spend. This should increase the demand for small businesses' products. Businesses need to see productivity growth in order to justify raising wages in their firms. As with all averages, some businesses will raise wages, and others will keep wages the same – it depends on the occupation. Wages have been rising faster in high-tech than in leisure and hospitality.

**OUTLOOK:** Would a higher minimum wage necessarily have a disproportionate effect on small businesses?

**DFR:** Not necessarily. There would be a disproportionate effect on leisure and hospitality, and the retail trade. Most minimum wage jobs are retail or leisure and hospitality – the hotel industry, the restaurant industry. But there are other small businesses – such as law firms, financial planning firms, software developing companies – that wouldn't be affected. It depends more on the skill level.

For example, Marriott, which is a large business that hires many hotel maids and kitchen workers, is going to be affected more than a small business that does financial management. It's more about the sector rather than the size of the business.

Data shows that most immigrants don't have a downward pressure on wages. In fact, they help create jobs for native-born Americans and raise their wages.

***OUTLOOK: How does the immigration issue – both legal and illegal – play into wage growth?***

**DFR:** The extent to which immigrants affect wages is somewhat misunderstood. Data shows that most immigrants don't have a downward pressure on wages. In fact, they help create jobs for native-born Americans and raise their wages. Immigration does not have a negative effect on wages.

The availability of immigrants, both high- and low-skill, makes it easier for native-born Americans to start firms. This increases jobs for native-born Americans. If a company can hire an immigrant to design a new kind of computer chip, the company will have more jobs for Americans marketing the chip and its applications. More construction companies will be started if there are additional immigrant construction workers.

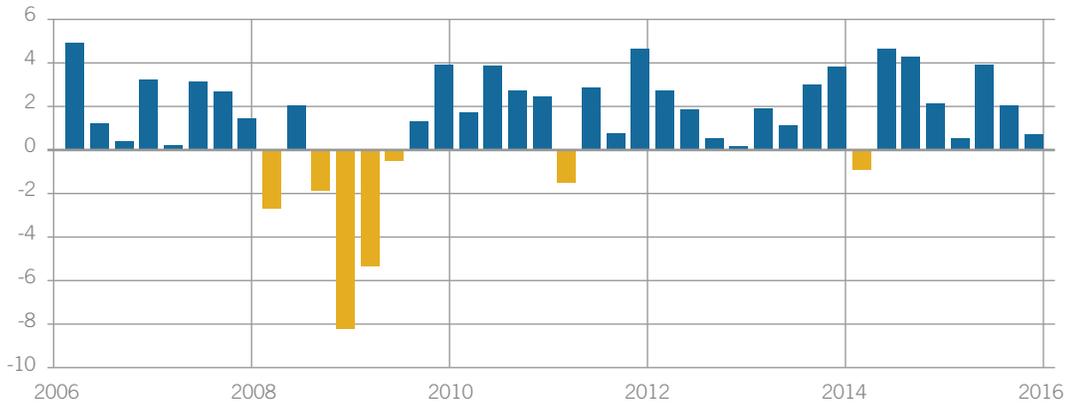
***OUTLOOK: Is the current availability of visas helping or hurting the issue?***

**DFR:** We need more legal visas. Of course, with our security concerns we need to know who is coming into the country, but we need more legal visas to get a more consistent supply of legal immigrants. And if it's easier to get a legal visa – both to come in and come out – we're going to have fewer illegal immigrants, because it will be easier to actually get the documentation you need, whereas right now it's extraordinary difficult.

This issue is especially acute in agriculture. If farms cannot get labor, they may be forced to shut down. If food processing companies aren't getting enough crop production or food supply domestically because of lack of labor, they may turn to other countries, such as Mexico, where there is ample labor. Having a supply of immigrants to do certain jobs – even low wage jobs – affects these American businesses with great consequence.

## US GDP GROWTH RATE

Percent Change In Gross Domestic Product



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com),  
US Bureau of Economic Analysis

**OUTLOOK:** *The so-called quit rate – the number of people who quit their jobs in any given month – has been rising lately. Is that a positive indicator?*

**DFR:** It is, and it's been one of the brightest signs in the labor market recently. In December 2015, nearly 3.1 million people voluntarily quit their jobs. It was the largest number

of people quitting since December of 2006. The number was up and down throughout the year, but it rose appreciably at year-end. A rising quit rate is very positive because it shows that people have alternatives to their current jobs. We've also seen that the job opening rate in the same data set has risen, and that's also very positive.

The hiring rate, on the other hand, has been somewhat flat, so we're hoping that is going to pick up. But the quit rate is a very important measure of how well people think the economy is doing. When the economy is doing badly and they don't feel like they have a better job alternative, then they don't quit. They just stay in their current job.

What we want, ideally, is a higher quit rate. We want people to feel confident. That's how we get upward mobility – when people move from one job to another. However, the labor market is a lagging indicator, so a higher quit rate may not reflect the slowdown in economic growth.

**OUTLOOK:** *What is your expectation for wage growth in 2016?*

**DFR:** At this point, the economic prospects for 2016 are very uncertain, which is also going to negatively affect increases in wages. If we should be so unfortunate as to go into a recession in 2016, we're not going to see much wage growth. A recession technically involves two consecutive quarters of negative growth, so we're not there yet, but the fourth quarter reading of just 0.7 percent growth is very troubling. ■

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.

# Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 1/31/16. 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

	2016	GDP	CPI	Funds	2-year	10-year
Q1	2.50%	1.20%	0.39%	1.07%	2.27%	
Q2	2.60%	2.20%	0.45%	1.29%	2.46%	
Q3	2.60%	2.30%	0.49%	1.49%	2.57%	
Q4	2.50%	2.30%	0.58%	1.65%	2.69%	
<b>2017</b>	<b>GDP</b>	<b>CPI</b>	<b>Funds</b>	<b>2-year</b>	<b>10-year</b>	
Q1	2.40%	2.20%	0.65%	1.82%	2.83%	

## 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	0.62%	0.71%	1.03%	1.32%	1.56%	1.83%
0.25	0.68%	0.77%	1.11%	1.39%	1.62%	1.85%
0.50	0.73%	0.84%	1.19%	1.46%	1.69%	1.92%
0.75	0.80%	0.93%	1.27%	1.53%	1.75%	1.97%
1.00	0.87%	1.03%	1.34%	1.60%	1.81%	2.02%
1.50	1.08%	1.21%	1.49%	1.73%	1.92%	2.11%
2.00	1.23%	1.39%	1.64%	1.84%	2.02%	2.19%
2.50	1.37%	1.51%	1.76%	1.95%	2.11%	2.25%
3.00	1.51%	1.62%	1.88%	2.07%	2.19%	2.30%
4.00	1.77%	1.90%	2.10%	2.24%	2.34%	2.43%
5.00	1.98%	2.12%	2.25%	2.38%	2.46%	2.52%

## 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

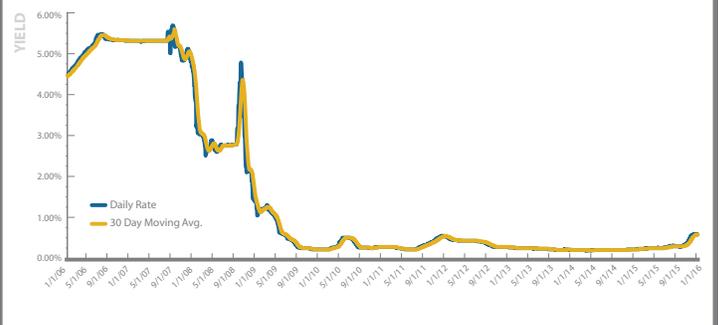
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	8	9	8	8
90	14	16	14	14
180	18	24	22	22
365	39	46	42	39

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.

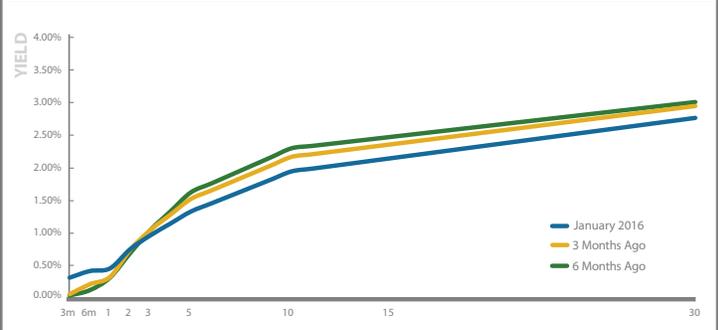
## 3-MONTH LIBOR



## 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 \$110 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 farmers, 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).

## CoBank Announces 2016 Customer Meetings

CoBank’s 2016 customer meeting program is underway, featuring presentations from leading experts on the economy, politics and business leadership. The meetings take place at locations around the country and are an opportunity for managers and directors of all CoBank’s customer and partner organizations to receive valuable knowledge, insight and information they can use every day in their business and personal lives.

LOCATION	DATE
Pacific West: Napa, California	March 8–9
Central: Normal, Illinois	March 10–11
Western Plains: Wichita, Kansas	March 16–17
Minnesota: Minneapolis	March 23–24
North Dakota: Moorhead, Minnesota	March 31–April 1
Southwest: Austin, Texas	April 6–7
Southeast: Amelia Island, Florida	April 13–14

Information about speakers, registration and venues is available at [www.cobank.com/meetings](http://www.cobank.com/meetings). There is no charge to attend the conference beyond travel and hotel expenses. For more information, contact your CoBank relationship manager or the bank’s Corporate Communications Division at 303-740-6442. ■