THE MAINSTREET ECONOMY REPORT

April 2013

"A monthly survey of community bank CEO's"

Too Big to Fail Banks Raise Risks and Hurt Economy

At the height of the U.S. financial crisis in 2008, Goldman Sachs and Morgan Stanley, two of the largest in-vestment banking firms in the world, requested a Federal Reserve (Fed) "bailout." A portion of this "relief" consist-ed of classifying Goldman and Morgan as bank holding companies thus allowing both firms to borrow from the Fed discount window with Goldman borrowing $782 billion and Morgan $107 billion. Even foreign banks, such as the Royal Bank of Scotland and Swiss giant UBS AG got into the action, each borrowing over $75 billion from the Fed. The Fed labeled these firms with assets over $50 billion as "too big" to fail. In addition to this Fed policy, the U.S. Congress passed Dodd-Frank in 2010 but emasculated the bill's Volcker Rule. Both actions provide "big" banks with a competitive advantage since the fixed cost required to adhere to Dodd-Frank are a much larger burden for community banks and abandoning the Volcker rule allows big banks with trading operations to undertake speculative investments in hedge funds and private equity rather than traditional lending activity. What have been the unintended consequences of all of this big bank support? Investors have overinvested in these behemoth institutions since their continued life is guaranteed even as they undertake excessive speculative activity. From the beginning of the recession until the end of 2012, the Fed's 34 too big to fail banks grew in size by 14.8 percent while the remaining 1,680 commercial banks actually declined in size by an average of 4.2 percent. Thus, Congressional and Fed actions have actually ballooned systemic risks and undermined community banks that provide a lending lifeline to small businesses and agricultural borrowers.

MAINSTREET RESULTS

Rural Mainstreet Hiring Rate Back to Pre-recession Levels: 2013 Cash Rents Expected to Grow by Almost 10 Percent

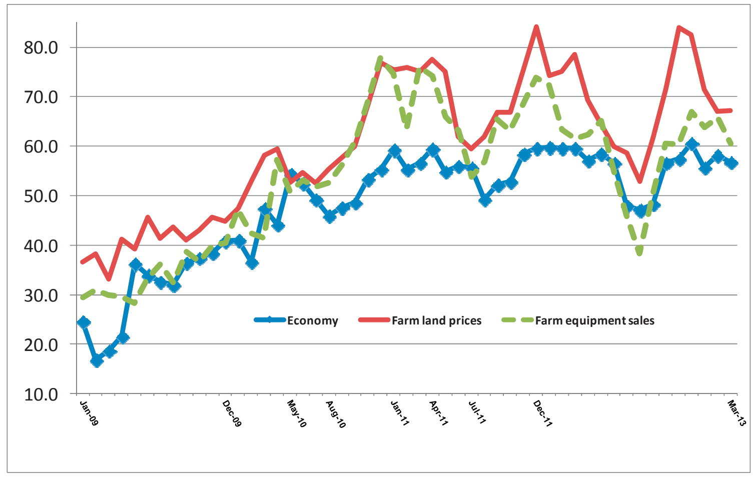
Tables 1 below summarizes the findings from the April survey with an index above 50.0 indicating growth and an index below 50.0 signifying weakness. [Index > 50.0 indicates expansion]

Table 1: The Mainstreet Economy	Mar. 2012	Feb. 2013	Mar. 2013
Area Economic Index	59.8	58.2	56.9
Loan volume	48.4	46.7	51.5
Checking deposits	69.4	67.2	69.4
Certificate of deposits	48.4	47.6	42.4
Farm land prices	78.7	67.0	67.2
Farm equipment area sales	61.5	65.8	60.5
Home sales	60.0	65.0	69.2
Hiring in the area	64.8	54.9	59.4
Retail Business	53.4	46.6	51.6
Economy 6 months from now	63.0	51.7	52.3

March Survey Results at a Glance:

- Rural Mainstreet Index indicates rural economy continues expansion.
- Pace of new hiring back to pre-recession growth rates.
- Bankers expect cash rents for farmland to grow by 9.3 percent this year.
- Agriculture input prices are expected to grow by 6.5 percent from last year.
- More than half of bankers reported an upturn in the percentage of farmland purchases that are bank financed.

Rural Mainstreet, Jan. '09 – March '13



Growth continued for the Rural Mainstreet economy during March according to the latest survey of bank CEOs in a 10-state area. **Overall:** The Rural Mainstreet Index (RMI), which ranges between 0 and 100 with 50.0 representing growth neutral, dipped to a still healthy 56.9 from February's 58.2. Very healthy farm income continues to boost the Rural Mainstreet economy though growth has slowed a bit. However, more and more bankers are concerned about recent strong growth. For example, Dale Bradley, CEO of The Citizens State Bank in Miltonvale, Kan., said, "I still think we are on the bubble."

Farming: The farmland price index expanded slightly to a strong 67.2 from February's 67.0. This is the 40th consecutive month that the farmland-price index has been above growth neutral. Current readings are consistent with farmland price growth between 12 and 16 percent. The farm equipment-sales index declined to 60.5 from 65.8 in February. The Federal Reserve's cheap money policies continue to bolster farm commodity prices, farm income, farmland prices and farm equipment sales. The Fed has indicated little change in this pro-agriculture money policy for 2013, which means we will likely continue to see healthy growth in farmland prices and farm equipment sales.

This month bankers were asked several questions related to agriculture conditions in the region. First, they were asked how much they expected the cost of farm/ranch inputs, such as fertilizer, to increase for 2013. On average, bankers anticipate growth of 6.5 percent from last year's levels. Jeff Bonnett president of Havana National Bank in Havana, Ill., said he and his bank officers were expecting a 9 percent growth from 2012 levels.

Second, bankers were asked how much growth they expected in agriculture land rents for 2013. A 9.3 percent increase in cash rents for farmland is expected for 2013.

Finally, bankers were asked to gauge the growth in the financing of farmland purchases over the past two to five years. Approximately 3.2 percent of bank CEOs indicated they were seeing the highest expansion in the financing of farmland in decades. Approximately 52.4 percent of bankers indicated an increase in the financing of farmland. Another 19 percent reported no change in the percentage of farmland purchases that were financed, while 28.6 percent indicated a reduction in financing of farmland sales (i.e. an increase in cash sales).

According to Michael Flahaven, president of Wenona State Bank in Wenona, Ill., "Farmland financing has increased at our bank. However, after talking with other bankers, I think we are the exception."

Banking: The loan-volume index moved above growth neutral for the month. The index rose to a tepid 51.5 from February's weak 46.7. The checking-deposit index advanced to a robust 70.5 from 67.2 in February, while the index for certificates of deposit and other savings instruments sank to 42.4 from last month's 47.6. Banking data continue to reflect healthy farm income and an expanding Rural Mainstreet economy.

Hiring: March's hiring index slipped to 59.4 from 54.9 in February but higher than January's 52.4. The growth rate in new hiring has been trending upward. Since the beginning of 2011, Rural Mainstreet companies have been adding new workers. However, the pace of that new hiring began to increase in October of 2012.

Confidence: The confidence index, which reflects expectations for the economy six months out, strengthened a bit to 52.3 from 51.7 in February. The failure of Washington to pass a new farm bill continues to weigh on the Rural Mainstreet economic outlook.

Additionally, weather concerns remain an issue. David Callies, CEO of Miner County Bank in Howard, S.D., reported, "Continued drought (is) still the biggest concern."

Home and retail sales: For a second straight month the homes-sales index took a large positive jump. The March home-sales index soared to 69.2 from February's 65.0. The March retail-sales index advanced to 51.6 from 46.6 in February and January's 44.5. Rural Mainstreet consumers remain very cautious in terms of their retail purchases.

Each month, community bank presidents and CEOs in nonurban, agriculturally and energy-dependent portions of a 10-state area are surveyed regarding current economic conditions in their communities and their projected economic outlooks six months down the road. Bankers from Colorado, Illinois, Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, South Dakota and Wyoming are included.

This survey represents an early snapshot of the economy of rural, agriculturally and energy-dependent portions of the nation. The Rural Mainstreet Index (RMI) is a unique index covering 10 regional states, focusing on approximately 200 rural communities with an average population of 1,300. It gives the most current real-time analysis of the rural economy. Goss and Bill McQuillan, president of CNB Community Bank of Greeley, Neb., created the monthly economic survey in 2005.

MAIN$TREET ON YOUR $TREET

COLORADO

For a sixth straight month, Colorado's Rural Mainstreet Index (RMI) moved above 50.0. The March RMI rocketed to 75.2 from 61.1 in February. The farmland and ranchland price index expanded to 71.2 from February's 70.2. Colorado's hiring index for March expanded to 67.8 from 54.6 in February.

ILLINOIS

While the RMI for Illinois declined in March it remained above growth neutral for the sixth consecutive month. The March index declined to 56.9 from February's 61.4. Farmland prices declined to 68.1 from February's 71.2. The state's new-hiring index increased to 57.1 from last month's 55.3. In contrast, Jim Eckert, president of Anchor State Bank in Anchor said, "Area small towns are in decline and small businesses are not doing well. Reduction of hours at rural post offices has affected the ability to do business and caused additional declines in customer traffic."

IOWA

The March RMI for Iowa advanced to 65.2 from February's 59.8. The farmland-price index declined to 66.7 from 70.4 in February. Iowa's new-hiring index for March improved to 61.3 from February's 54.7.

KANSAS

The Kansas RMI for March rose to 52.8 from 47.2 in February. The farmland-price index climbed to 69.1 from February's 60.0. The state's new-hiring index expanded to 57.8 from 47.8 in February.

MINNESOTA

The March RMI for Minnesota declined to a strong 66.8 from February's 73.4. Minnesota's farmland-price index sank to 72.1 from February's 83.3. The new-hiring index fell to 59.8 from February's 63.3.

MISSOURI

The March RMI for Missouri decreased to 56.3 from February's 64.5. The farmland-price index for March climbed to 74.1 from February's 67.5. Missouri's new-hiring soared to 61.1 from 52.8 in February.

NEBRASKA

After moving below growth neutral for January, Nebraska's Rural Mainstreet index broke above growth neutral for two straight months. The March RMI expanded to 54.9 from February's 52.7. The farmland-price index advanced to 65.4 from 60.7 in February. Nebraska's new-hiring index increased to 58.0 from February's weak 48.3. Said Bill McQuillan, president of CNB Community Bank of Greeley, "Our pastures were 75 percent moisture deficient from our average rainfall during 2012 because of the drought. We will need at least 20 inches of rain this year before we will be able to utilize our livestock pastures."

NORTH DAKOTA

The North Dakota RMI for March decreased to 61.2 from February's regional high of 78.9. The farmland-price index declined to a robust 79.8 from 86.4 in February. North Dakota's new-hiring index decreased to 63.4 from 75.1 in February.

SOUTH DAKOTA

The March RMI for South Dakota improved to 58.8 from February's 54.1. The farmland price index decreased to 62.4 from 65.0 in February. South Dakota's new-hiring index for March advanced to 58.4 from 51.1 in February.

WYOMING

The March RMI for Wyoming declined to 52.8 from 54.1 in February. The March farmland and ranchland price index decreased to 61.8 from 64.6 in February. Wyoming's new-hiring index climbed above growth neutral with a March reading of 53.9, which was up from February 's 51.9.

THE BULLISH NEWS

- The Case-Shiller U.S. home price index rose 8.1 percent over the past year with the index growing at its fastest pace since 2006, a year before the housing collapse.
- The U.S. trade deficit narrowed in February as exports climbed to near a record level.. The volume of imported crude oil fell to its lowest level in 17 years for February.
- The Conference Board Leading Economic Indicator rose

for both January and February.

- U.S. February retail sales expanded by 1.1% from the previous month. Anything above 0.5% is healthy.

THE BEARISH NEWS

- The March employment report was not good with employment expanding by only 88,000 jobs. The unemployment rate declined to 7.6% but only because almost 500,000 unemployed left the workforce.
- The Conference Board's Consumer Confidence Index which improved in February declined in March.
- The National PMIs for March weakened significantly while Creighton's regional PMIs expanded for the month.

WHAT TO WATCH

- **Purchasing Management Indices:** On May 1, Creighton releases its regional leading economic indicator (PMI) and the national Institute for Supply Management releases its national PMI for April. Another decline in the national reading would be very bearish for the economy.
- **Jobs:** On Friday May 3, the U.S. Bureau of Labor Statistics (BLS) will release the employment report for April. Another lousy report will like March's will dampen the stock market and push interest rates lower.
- **Gross Domestic Product (GDP):** On April 26, the U.S. Bureau of Economic Analysis will release GDP estimates for Quarter I, 2013. Annualized growth of 2% - 3% is expected. Anything outside this range will have significant influence on markets.

THE OUTLOOK

FROM GOSS:

- I am getting weak knees regarding my recent long-term interest rate forecast. Due to recent weakness in the economy, I expect long-term interest rates to remain low but rising by less than a quarter percentage point by the end of summer.
- The Fed's ultra-cheap money policies will not end this year. This will put a floor underneath somewhat weaker agriculture and energy commodity prices. Investors have to remain bullish on agriculture.

OTHER FORECASTS:

- The Conference Board (April 2013). "The labor market had some reasonable momentum over the past several months, but with just 88,000 job gains in March, once again we see a disappointing seasonal slowdown unfold as we head into spring. What is even more troubling about the most recent slowdown is that it takes place even before the sequester cuts materially hit the economy. This reinforces our view that the estimated 3.5 percent real GDP growth in Q1 is not likely to be sustained. Instead, we see the overall economy, led by the consumer, downshifting significantly in the second quarter, struggling to get close to 1 percent real growth. The sticky point throughout the nearly four years since the official end of the reces-sion has been revving up in the "core" service sector (which excludes health and education). While jobs were finally beginning to open up there, the impact of the sequester likely blunts that job growth a bit and leads to further contraction in government sector jobs, and will likely continue to keep growth on the slow boil throughout the spring and into the summer."

GOSS EGGS (RECENT DUMB ECONOMIC MOVES)

- President Obama called on lenders to make more home loans to applicants with less than stellar credit profiles. Has the Administration forgotten that expanding home ownership to those with poor credit was one of the prime factors that ushered in the financial collapse? Hasn't the federal government done enough to damage the housing sector and delay its full recovery?

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