THE MAINSTEET ECONOMY REPORT

"A monthly survey of community bank CEO's"

AUGUST 2013

Give the Poor a Fish or a Fishing Pole: Which Solution Works Best?

Pope Francis and President Obama find themselves in the unusual position of "agreement." Both have highlighted the need to assist the poor (although Obama uses the euphemism "middle class"). Everyone ranging from Bernie Madoff to Mother Teresa agree that economically aiding the poor is a worthy goal. Disagreements surface in the method, the impact, and the costs of such efforts. The two opposing camps could be labeled as, the "give them a fish" and the "give them a fishing pole." The 50 U.S. states provide a laboratory to test which approach works best. States were categorized into quintiles according to the percentage of GDP to support the poor between 1990 and 1999. Financial support included: food stamps, social security income, unemployment compensation and other welfare support. The states were then ranked according to how they fared economically from 2000 to 2012. The "give them a fish" states, or the ten states providing the most generous welfare benefits between 1990 and 1999 at 2.2 percent of GDP suffered the slowest GDP growth between 2000 and 2012 at 55.7 percent, had the highest 2013 unemployment rate at 7.7 percent, and had the greatest degree of income disparity with a 2010 Gini coefficient of .468. The quintile of states providing the least generous welfare benefits at only 0.95 percent of GDP between 1990 and 1999 experienced the top economic outcomes from 2000 to 2012 with GDP growth of 73.7 percent, had the lowest 2013 unemployment rate at 5.3 percent, and had the lowest degree of income inequality with a 2010 Gini coefficient of .440. The lowest welfare spending states included New Hampshire, Delaware, Nebraska, Nevada, Virginia, Wyoming, Colorado, South Dakota, Indiana, the District of Columbia, and Utah. The "give them a fish" or most generous welfare spending states were: California, New York, Rhode Island, West Virginia, Mississippi, Maine, Arkansas, Kentucky, Louisiana, and Alabama. For all 50 states and D.C., there was a strong negative correlation between 1990 and 1999 welfare spending and subsequent economic performance. This data provide at least superficial support for the hypothesis that overly generous welfare benefits serve neither the poor, nor the broader economy . Ernie Goss

MAINSTREET RESULTS

Rural Mainstreet Economy Grows: Bankers Say Farm Bill Passage Important

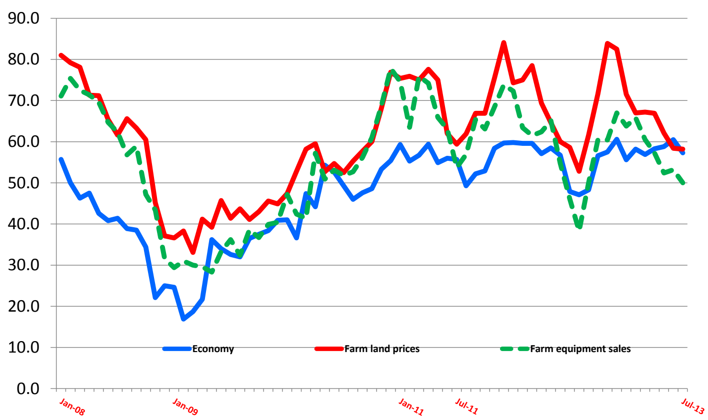
Tables 1 below summarizes the findings from the July survey with an index above 50.0 indicating growth and an index below 50.0 signifying weakness. [Index > 50.0 indicates expansion]

Table 1: The Mainstreet Economy	July 2012	June 2013	July 2013
Area Economic Index	47.9	60.5	57.3
Loan volume	65.3	66.7	75.7
Checking deposits	47.9	48.5	53.7
Certificate of deposits	41.7	33.6	42.0
Farm land prices	58.6	58.4	58.2
Farm equipment area sales	46.1	53.2	50.0
Home sales	58.6	78.1	76.6
Hiring in the area	52.8	61.4	60.7
Retail Business	44.4	53.9	53.1
Economy 6 months from now	40.9	60.0	56.6

July Survey Results at a Glance:

- Rural Mainstreet Index indicates rural economy expansion continues at healthy pace.
- On average, bankers expect farm income this year to be down by 3 percent from last year.
- More than one-third of bankers report impacts from federal spending sequestration.
- More than three fourths of bankers consider passage of a new farm bill as very important to the Rural Mainstreet economy.
- Farmland price growth slowed for the seventh time in past eight months.

Rural Mainstreet Economy Jan. '08 – July '13



While growth for the Rural Mainstreet economy remains healthy, it slowed a bit in July, according to the monthly 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, slipped to 57.3 from June's 60.5, but was well ahead of last July's 47.3. Last year at this time, the drought was having a significant negative impact on the Rural Mainstreet economy. This year, ample moisture has boosted the rural economy and the banker's economic outlook.

Additionally, energy production has taken on an increasingly important role for the rural economy. As reported by Jim Stanosheck, CEO of State Bank of Odell in Odell, Neb., "The area has about 45 wind generators being built in the next six months. This activity should spur the rural economy for next six to seven months."

Farming: The farmland-price index declined for the seventh time in eight months. The July index fell to 58.2 from June's 58.4. Our farmland-price index has been above growth neutral since February 2010. However, lower farm commodity prices and expected declines in farm income are slowing growth in farmland prices. I expect farmland price growth to continue to weaken as a stronger U.S. dollar weighs on agriculture commodity prices.

This month bankers were asked to project farm income for 2013. On average, bankers expect farm income to be down by 3 percent from 2012. Approximately 59.6 percent of bank CEOs expect farm income to be down from 2012, while only 19.5 percent anticipate an increase in farm income and the remaining 20.9 percent expected no change. Farm equipment sales also softened for July with an index of 50.0, down from June's 53.2. Farmers are getting increasingly cautious regarding economic conditions. This has been reflected in declines in our equipment-sales index and in the stock prices of agriculture equipment producers.

Banking: The loan-volume index moved above growth neutral for the month. The index soared to 75.7 from June's 66.7. The checking-deposit index advanced to 53.7 from June's 48.5, while the index for certificates of deposit and other savings instruments increased to a very weak 42.0 from 33.6 in June. Community bankers are more upbeat that Congress will address the increasing concentration of U.S. banking. As reported by Pete Haddeland, CEO of the First National Bank in Mahnomen, Minn., "TBTF (too big to fail) is gaining some traction (in D.C.)."

This month bankers were also asked about the impacts of the federal spending sequester. Only 1.5 percent reported significant impacts, while 34.3 percent indicated moderate impacts with the remaining 64.2 percent detailing no impacts from the spending sequestration.

Hiring: July's hiring index declined to a strong 60.7 from June's 61.4. Readings over the past several months are consistent with an annualized growth rate in jobs of 1 percent. Businesses linked to agriculture and energy continue to add jobs at this slow, but positive pace.

Confidence: The confidence index, which reflects expectations for the economy six months out, fell to 56.6 from 60.0 in June. While healthy crop conditions have fortified the economic outlook, recent weaker expected agriculture commodity prices have lowered that outlook. More than three-fourths, or 77.9 percent, of bankers think that Congressional passage of a new farm bill is important or crucial to the Rural Mainstreet economy.

Home and retail sales: The July home-sales index slipped to 76.6 from June's record high of 78.1. The July retail-sales index slipped to 53.1 from 53.9 in June. Slightly higher mortgage rates failed to slow the rapidly improving Rural Mainstreet housing sector.

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 tenth straight month, Colorado's Rural Mainstreet Index (RMI) remained above 50.0. The July RMI declined to a still robust 70.5 from June's 81.2. The farmland and ranchland price index declined to a strong 75.5 from June's 80.3. Colorado's hiring index for July slipped to 73.0 from June's 75.7. Bankers reported problems for certain segments of the rural economy. According to Fred Bauer, CEO of Farmers Bank in Ault, "Dairies are still struggling with (high) feed costs."

ILLINOIS
While the RMI for Illinois declined in July to 57.6 from June's 61.6, it has remained above growth neutral for 10 straight months. Farmland prices sank to 49.1 from 49.4 in June. The state's new-hiring index dipped to 54.3 from June's 55.2.

IOWA
The July RMI for Iowa expanded slightly to 62.3 from June's 62.2. The farmland-price advanced to 54.6 from 49.6 in June. Iowa's new-hiring index for July improved to 58.0 from June's 55.3. As reported by Steven Lane, CEO of Security Savings Bank in Farnhamville, "Most of the crops in our area were planted late. It's now up to mother nature to see if it amounts to much."

KANSAS
The Kansas RMI for July decreased 59.2 from 60.5 in June. The farmland-price index sank to 46.6 from June's 49.6. The state's new-hiring index decreased to 52.7 from 56.7 in June. Bankers in the state remain hopeful, but cautious regarding the farm economy.

MINNESOTA
The July RMI for Minnesota tumbled to a 53.4 from June's 59.7. Minnesota's farmland-price index fell to 51.3 from 58.5 in June. The new-hiring index declined to 55.8 from last month's 61.2. Pete Haddeland, CEO of the First National Bank in Mahnomen, said, "Our crops look great."

MISSOURI
The July RMI for Missouri rocketed to regional high of 81.2 from 59.2 in June. The farmland-price index for July remained strong at 78.9, though it was down from June's 81.5. Missouri's new-hiring index rose to 84.2 from June's 76.7.

NEBRASKA
After moving below growth neutral for January, Nebraska's Rural Mainstreet index has now moved above growth neutral for six straight months. The July RMI climbed to 58.0 from 56.5 in June. The farmland-price index for July fell to 48.5 from June's 59.2. Nebraska's new-hiring index stood at 53.9, down slightly from June's 53.7. Weather remains a problem for some parts of the state. According to Bill McQuillan, president of CNB Community Bank of Greeley, "Pasture conditions continue to deteriorate because of the lack of moisture in the last 30 days."

NORTH DAKOTA
The North Dakota RMI for July dipped to a 78.4 from 81.8 in June. The farmland-price index declined to 82.4 from June's 87.6. North Dakota's new-hiring index declined to a still very strong 76.5 from June's 80.6.

SOUTH DAKOTA
The July RMI for South Dakota slipped to 59.9 from 60.5 in June. The farmland price index slumped to 50.8 from June's 51.5. South Dakota's new-hiring index for July decreased to 55.5 from June's 56.5. As in other areas of the region, farm conditions are up significantly from last year. According to David Callies, CEO of Miner County Bank in Howard, "Crops are doing very well."

WYOMING
The July RMI for Wyoming expanded to 53.0 from 52.6 in June. The July farmland and ranchland price index grew to 41.9 in July from 40.8 in June. Wyoming's new-hiring index increased to 49.6 from June's 49.4.

THE BULLISH NEWS

- The Case-Shiller home price index advanced by one percent for May and was up by more than 12% over the past 12 months.
- The U.S. trade deficit shrank by 22% in June. There was a $2 billion decline in oil imports. The U.S. is rapidly losing its heavy dependence on foreign oil.
- Both the non-manufacturing and non-manufacturing ISM numbers were up strongly for July.
- Retail sales continue to expand at a solid pace despite little growth in income.

THE BEARISH NEWS

- The U.S. economy added 162,000 jobs and the unemployment rate dipped to 7.4% in July. However, a large share of the jobs were part-time and the size of the labor market shrank due to more of the unemployed became discour-aged and chose to sit at home and watch re-runs of Golden Girls instead of looking for a job.
- Annualized GDP growth for the second quarter of 2013 declined to 1.7%. It should be more than double this rate.

WHAT TO WATCH

- **Retail Sales:** On Sept. 13, the U.S. Census Bureau releases its retail sales numbers for August. We will get a glimpse of consumer "back to school" shopping. Year over year sales growth of more than 5% will be another incentive for the Fed to begin allowing long-term interest rates to rise.
- **Jobs:** On Friday Sept. 6, the U.S. Bureau of Labor Statistics (BLS) will release the employment report for August. A very positive report (jobs added over 200,000 and unemployment down) will be another factor encouraging the Fed to begin raising long term rates (i.e. reducing bond purchases) in September.
- **Consumer Price Index (CPI):** On Aug. 15 and Sept. 17, the U.S. Bureau of Labor Statistics releases the CPI. Annualized readings above 2.0% will push the Federal Reserve to begin reducing its QE3 stimulus program at its Sept. 17-18 meetings.

THE OUTLOOK

FROM GOSS:

- Over the next 6 months, I expect short term interest rates (less than 2 years) to remain at their current low levels while long term rates will continue to rise but by less than one-half of one percentage point.
- The President will win the budget battles with Congress in September. This will mean that the debt ceiling will be raised with only token resistance. Republicans cannot win this battle so they should not take it on.

OTHER FORECASTS:

- The Conference Board. "U.S. economy looks poised to strengthen as private sector strength offsets fiscal drag The upside potential to our previous base case forecast that we pointed out to be a possibility in the past month appears to be unfolding. The U.S. private domestic sector of the economy continues to exhibit underlying strength and improved health following several years of major structural adjustments. This improved strength appears to be offsetting the fiscal drag from the spending sequester cuts. After a sluggish 1% growth performance in Q2, we forecast an acceleration in economic activity to 2.4% in Q3 and 2.7% in Q4 (vs. our previous forecasts of 1.7% and 2.5%, respectively in Q3 and Q4). The ongoing revival in the housing and automotive sector leads the rebound in the overall economy, but importantly we also anticipate increases in personal income and consumers' increasing comfort to borrow again to underpin firmer and more sustainable real consumer spending in the quarters ahead."

GOSS EGGS (RECENT DUMB ECONOMIC MOVES)

- The Obama Administration is gutting its own healthcare bill by pushing the employer mandate out one year and by exempting Congressional staffers from the more onerous portions of the bill. Also the government will not verify the income of individuals applying for health insurance coverage through the exchanges, thus inviting abuse and higher taxpayer costs.

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