THE MAINSTREET ECONOMY REPORT

July 2018

"A monthly survey of community bank CEO's"

Rural versus Urban Economies: Trade and Fed Policy Divide the Two

Just as the drunk with one hand in the fireplace and the other in the refrigerator is, on average, doing well, the agricultural and energy dependent states have been, on average, doing (performing) well. Currently however, state averages blend healthy growth in urban areas in each state with economic fatigue in the rural areas of the same states.

Between 2009 and 2013, Creighton's Rural Mainstreet survey typically indicated very healthy growth in rural areas that are dependent on agriculture and energy. During this time period, driven by Federal Reserve (Fed) easy money policies that stimulated agriculture and energy exports, our surveys and government data tracked rural areas growing at brisk rates. During the Fed's expansion policies from 2009 to 2013, average yearly export growth in agriculture, food and oil products soared by 12.6 percent.

In 2014, the Fed ended Quantitative Easing, one of its major stimulus programs, which lowered long-term interest rates, and in 2015 began raising short-term interest rates. The end of the Fed interest rate stimulation programs, or easy money policies, raised the value of the U.S. dollar and restrained exports, particularly of agriculture and energy commodities. Thus, urban areas of the region, more dependent on manufacturing and housing, continued to expand while rural areas relying on agriculture and energy moved into negative territory. During the Fed's less accommodative money polices, 2014-17, the average yearly export sales of agriculture, food, and oil products plummeted by 6.3 percent. As a result, employment in urban areas of the region over the past three years expanded by 4.1 percent, while employment in rural areas of the same states contracted by 0.3 percent.

The current trade skirmish/war has the potential to widen the economic performance gap between rural and urban areas. China's retaliatory tariffs on $34 billion worth of U.S. goods are directly aimed at rural regions of the nation that produce soybeans, cotton, rice, sorghum, beef, pork, dairy, nuts and produce. Not surprisingly, soybean prices have tumbled by $2.00 per bushel over the past week. Other ag commodity prices are under downward pressures. Historically, the first casualty of a trade war is agriculture, and agriculturally dependent areas of the nation.

MAINSTREET RESULTS

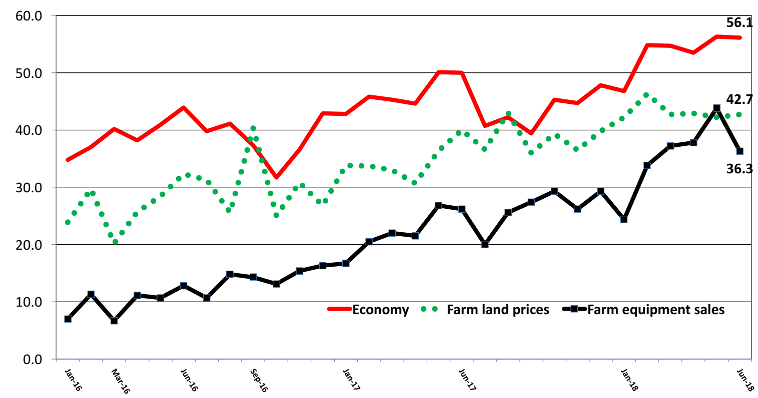
Rural Mainstreet Economy Expands for June:
Rate of Farm Loan Rejections Almost Doubles Among Banks

Survey Results at a Glance:

- For the fifth straight month the overall index rose above growth neutral.
- In reaction to weak farm income, the percentage of banks increasing farm loan rejection rates expanded from 23.9 percent to 42.9 percent over the past year.
- Almost two-thirds of bankers indicated their banks had increased collateral requirements on farm loans in reaction to weak farm income.
- On average, bankers expect farmland prices to decline by 2.1 percent over the next 12 months. This is less than the 3.1 percent projected fall recorded last year at this time.

Table 1: The Mainstreet Economy	June 2017	May 2018	June 2018
Area Economic Index	50.0	56.3	56.1
Loan volume	78.3	74.3	76.3
Checking deposits	48.9	43.9	41.7
Certificate of deposits	41.4	40.9	47.6
Farm land prices	40.0	42.2	42.7
Farm equipment area sales	26.2	43.8	36.3
Home sales	58.8	62.1	60.7
Hiring in the area	58.9	56.0	58.0
Retail Business	41.3	46.9	47.6

Rural Mainstreet, Economic Indicators, Jan. 2016 – June 2018
(50.0 = growth neutral)



The Creighton University Rural Mainstreet Index climbed above growth neutral in June for a fifth straight month, according to the monthly survey of bank CEOs in rural areas of a 10-state region dependent on agriculture and/or energy. This is the first time since July 2015 the survey has recorded five straight months of overall indices above growth neutral.

Overall: The overall index slid slightly to 56.1 from 56.3 in May. The index ranges between 0 and 100 with 50.0 representing growth neutral.

Surveys over the past several months indicate the Rural Mainstreet economy is trending upward with improving, and positive economic growth. However, the negative impacts of recent trade skirmishes have yet to show up in our survey results. While agriculture commodity prices have improved recently, prices remain below breakeven for a large share of grain farmers.

Farming and ranching: The farmland and ranchland-price index for June rose to a weak 42.7 from May's 42.2. This is the 55th straight month the index has fallen below growth neutral 50.0.

Bankers were asked to project the average change in farmland prices in their area over the next 12 months. On average, bankers expect farmland prices to sink by another 2.1 percent over the next year. This is an improvement from last year at this time when a 3.1 percent decline was expected.

The June farm equipment-sales index plummeted to an anemic 36.3 from May's 43.8. This marks the 58th consecutive month the reading has moved below growth neutral 50.0.

Banking: Borrowing by farmers expanded for June as the loan-volume index rose to 76.3 from 74.3 in May. The checking-deposit index slumped to 41.7 from May's 43.9, while the index for certificates of deposit and other savings instruments climbed to a still fragile 47.6, up from 40.9 in May.

Bankers reported their bank's reaction to the continuing weak farm income. Almost two-thirds, or 64.3 percent, indicated their bank had increased collateral requirements on farm loans. Approximately, 40.5 percent indicated that their bank rejected a higher percentage of farm loan applications. This is up significantly from 12 months ago when only 23.9 percent indicated an increase in farm loan rejection rates.

Hiring: The employment gauge improved to a solid 58.0 from May's 56.0. The Rural Mainstreet economy is now experiencing positive year-over-year job growth with added jobs at a 0.9 percent pace over the past 12 months compared to a slightly higher 1.0 percent for urban areas of the region. Both job growth readings are below U.S. job growth over the same period of time.

Confidence: The confidence index, which reflects expectations for the economy six months out, fell to 48.8 from May's 50.0, indicating declining economic optimism among bankers. Just as last month, an unresolved North America Free Trade Agreement (NAFTA) and rising trade tensions with China continue to be a concern.

Dan Coup, CEO of the First National Bank in Hope, Kansas, similar to other Rural Mainstreet bankers said, "Price prospects for grain are a big concern with the trade war talks with China and other countries."

Home and retail sales: The home-sales index moved higher for the Rural Mainstreet economy in remained at a healthy reading with the June index declining slightly to 60.7 from 62.1 in May.

Jim Stanosheck, CEO of State Bank of Odell, Nebraska, echoed many Rural mainstreet communities when he said his community has a low inventory of homes for sale or rent. This supply constraint has boosted prices and reduced sales.

Retail sales dropped for the month, but at a slower rate than in May, with a June reading of 47.6 compared to May's index of 46.9

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, former chairman of the Independent Community Banks of America, created the monthly economic survey in 2005.

MAIN$TREET ON YOUR $TREET

COLORADO

Colorado's Rural Mainstreet Index (RMI) for June expanded to 59.5 from 58.8 in May. The farmland and ranchland-price index advanced to 44.0 from May's 42.8. Colorado's hiring index for June declined to 60.1 from May's 60.6. Colorado's Rural Mainstreet job growth over the last 12 months was 6.8 percent.

ILLINOIS

The June RMI for Illinois declined slightly to 57.0 from 57.2 in May. The farmland-price index increased to 43.0 from 42.5 in May. The state's new-hiring index rose to 59.4 from last month's 57.7. Jim Eckert, president of Anchor State Bank in Anchor, reported, "Central Illinois was very dry in April and May, however 3"-6" of general rains came last week. Crops look good, but subsoil is low and we will require timely rains to insure a good crop." Illinois' Rural job growth over the last 12 months was 1.8 percent.

IOWA

The June RMI for Iowa climbed to 55.9 from 54.0 in May. Iowa's farmland-price index for June increased to 42.6 from May's 42.1. Iowa's new-hiring index for June expanded to 54.8 from May's 53.5. Iowa's Rural Mainstreet job growth over the last 12 months was minus 0.7 percent.

KANSAS

The Kansas RMI for June climbed to 56.4 from May's 56.2. The state's farmland-price index decreased to 41.2 from 42.1 in May. The new-hiring index for Kansas improved to 58.9 from 53.9 in May. Dan Coup, CEO of the First National Bank in Hope, Kansas, reported that, "Continued dry weather is having a big impact on our farm economy. We had a very poor wheat harvest, grass hay being cut is 15 to 20 percent of normal, and pasture conditions are causing cattle to be pulled off grass early." Kansas's Rural Mainstreet job growth over the last 12 months was 1.3 percent.

MINNESOTA

The June RMI for Minnesota dipped to 55.3 from May's 56.0. Minnesota's farmland-price index increased to 42.3 from 42.1 in May. The new-hiring index fell to 52.6 from May's 53.1. Pete Haddeland, CEO of the First National Bank in Mahnomen said, "Crops look great." Minnesota's rural Mainstreet Job grow over the last 12 months is minus 2.6 percent.

MISSOURI

The June RMI for Missouri jumped to 59.4 from 59.0 in May. The farmland-price index grew to 44.0 from 43.2 in May. Missouri's new-hiring index for June bounced to 68.8 from May's 64.9. Missouri's Rural Mainstreet job growth over the last 12 months was 3.4 percent.

NEBRASKA

The Nebraska RMI for June decreased to 55.9 from May's 56.0. The state's farmland-price index increased to 42.6 from last month's 42.0. Nebraska's new-hiring index rose to 55.0 from 52.8 in May. Nebraska's Rural Mainstreet job growth over the last 12 months was minus 0.3 percent.

NORTH DAKOTA

The North Dakota RMI for June slipped to 51.0 from May's 52.3. The state's farmland-price index moved slightly higher to 40.6 from 40.5 in May. The state's new-hiring index plummeted to 35.2 from 38.0 in May. North Dakota's Rural Mainstreet job growth over the last 12 months was minus 5.5 percent.

SOUTH DAKOTA

The June RMI for South Dakota remained above growth neutral, but was down at 56.2 from May's 56.5. The state's farmland-price index increased to 42.7 from May's 42.2. South Dakota's new-hiring index climbed to 56.2 from 54.9 in May. South Dakota's

Rural Mainstreet job growth over the last 12 months was 0.6 percent.

WYOMING

The June RMI for Wyoming rose to 58.2 from May's 57.5. The June farmland and ranchland-price index increased to 43.2 from 42.7 in May. Wyoming's new-hiring index improved slightly to 59.4 from May's 59.0. Wyoming's Rural Mainstreet job growth over the last 12 months was minus 1.2 percent.

THE BULLISH NEWS

- The nation added 213,000 jobs for May as 601,000 formerly discouraged workers entered the labor market. This caused the unemployment rate to increase from 3.8% to 4.0%.
- The U.S. trade deficit slid to a 19-month low of $43.1 billion for May. Exports rose 1.9% to a record $215.3 billion for the month. Watch for declines in exports in the months ahead.
- The Case-Shiller home price index for April rose 6.4% from a year earlier. Home price growth continues to outstrip income growth. How much longer can this go on?

THE BEARISH NEWS

- Average hourly earnings increased 5 cents to $26.98, keeping the annual increase unchanged at 2.7%. Low unemployment rates have yet to boost average hourly pay.
- This year, for the first time since 1982, social security payments will exceed receipts as baby boomers retire.
- The nation's labor force participation rate for May stood at an unacceptably low 62.7%

WHAT TO WATCH

- **Inflation, Inflation, Inflation:** The Bureau of Labor Statistics will release the inflation gauge for June on July 12. An annualized increase above 2.5% will be bearish for bond prices (rising yields, falling prices).
- **Inverted Yield:** Marketwatch.com provides contemporaneous yields on the 2-year and 10-year U.S. Treasury bonds. Every recession since 1980 has been preceded by 2-year rates exceeding 10-year rates (termed an inverted yield)
- **Wage Data for June**: On July 6, the U.S. Bureau of Labor Statistics will release wage data for June. Year over year growth approaching 3.0% will be a strong inflation signal (more interest rate increases from the Fed).
- **Trade Balance**: On July 6, the U.S. Bureau of Economic Analysis will release May exports and imports for the nation. A widening trade deficit will push the President and Congress to undertake even more aggressive, and wrong-headed trade restrictions.

STATISTIC OF THE MONTH

- 10.29% (29 basis points). The gap between the yield on the 10-year U.S. Treasury bond (2.83%) and the 2-year U.S. Treasury bond (2.54%) sank to its lowest level since the 2008-09 recession. A signal of a slowing U.S. economy.

THE OUTLOOK

FROM GOSS:

- I expect **the next Federal Reserve rate hike on September 26 (0.25% or 25 basis points); **mortgage rates to climb by another ¼% by the end of 2018. ***GDP growth to slow in the second half of 2018.

OTHER FORECASTS:

- **NABE Business Conditions Survey (July 2018):** "The median forecast for growth in inflation-adjusted gross domestic product (real GDP) from the fourth quarter (Q4) of 2017 to Q4 2018 is 2.8%. The median forecast for real GDP growth from Q4 2018 to Q4 2019 calls for a moderation to 2.5%—unchanged from the March 2018 NABE Outlook Survey. Overall, the panel continues to expect economic growth in 2018 to be stronger than the actual 2.3% annual real GDP growth rate in 2017. On an annual basis, real GDP growth in 2018 is also expected to be 2.8%, compared with 2.9% in the March survey, and the median forecast for average annual real GDP growth in 2019 is 2.7%. The panel has shifted its sentiment regarding the risks to the outlook since the previous survey, with more than half of survey respondents—57%—currently indicating that the balance of risks to real GDP growth through 2019 is weighted to the downside. Thirty-one percent of panelists indicate the balance of risks is weighted to the upside. This is in stark contrast to results in the March 2018 survey, which reflected over 75% of the panel stating risks were largely weighted to the upside for 2018. Note that the March survey was conducted when economic policy proposals were focused on tax cuts and fiscal policy in the near term. Since then, the discussion of economic policy has been dominated by tariffs and potential trade wars."

GOSS EGGS (RECENT DUMB ECONOMIC MOVES)

- In 2017, Harley-Davidson sold 39,775 motorcycles in Europe which were built in the U.S. Due to recent European tariffs of 31% on imported cycles, Harley is moving production to Europe. Like boxers in the ring, all sides get bloodied from ill-advised trade wars and skirmishes. Smart for Harley; dumb for U.S. and Europe.

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