THE MAINSTEET ECONOMY REPORT

"A monthly survey of community bank CEO's"

October 2013

Too Much Politics at the Federal Reserve: Fed Supports DC Overspending

Prior to the September meeting of the Federal Reserve's (Fed) Federal Open Market Committee (FOMC), Fed bank presidents, who are chosen by bankers and business leaders from across each of the 12 Fed regions, indicated in speeches that their stimulus program would likely be reduced beginning at the September FOMC meeting. During this same period of time, presidential appointed Fed governors, who are also members of the FOMC fell mute. Surprisingly, instead of reducing the $85 billion monthly bond buying program, entitled QE3, the FOMC decided to maintain intact this unprecedented economic stimu-lus program. This program, at its current pace, will purchase three-fourths of new federal government borrowing. Thus the Fed, by buying and holding $3-4 trillion of federal debt, is bailing out Washington's overspending by providing a ready buyer for bonds and by holding interest rates at near record low levels. And last month, Congressional Democrats torpedoed President Obama's pick for the next Fed Chair, Lar-ry Summers, in favor of a more compliant Janet Yellen who will likely be on the side of keeping QE3 in place, and potentially even expanding the program, when she assumes the chair position in January 2014. QE3, in this economist's judgment, introduces political uncertainty, punishes savers with low interest rates, produces asset price bubbles, and discourages consumer borrowing. The probability of higher fu-ture interest rates would encourage home buyers to buy and borrow today. The Fed should begin taper-ing QE3 ignoring meddling from politicians. Ernie Goss.

MAINSTREET RESULTS

**Rural Mainstreet Economy Grows:
Bankers Say Farm Bill Passage Important**

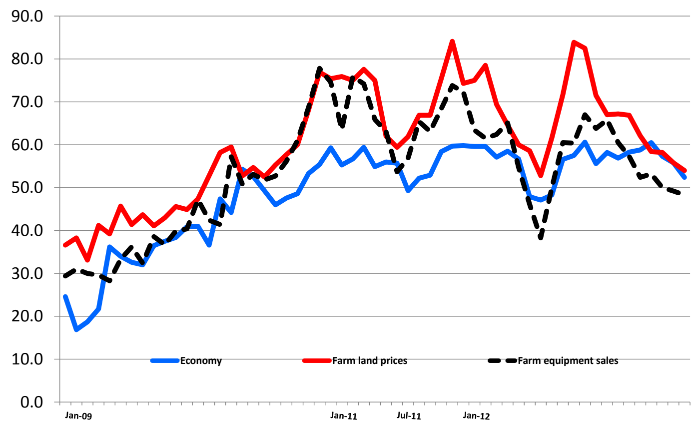
Tables 1 below summarizes the findings from the September survey with an index above 50.0 indicating growth and an index below 50.0 signifying weakness. [Index > 50.0 indicates expansion]

Table 1: The Mainstreet Economy	Sept 2012	August 2013	Sept 2013
Area Economic Index	48.3	55.8	52.4
Loan volume	70.2	70.5	73.5
Checking deposits	48.3	51.7	56.3
Certificate of deposits	38.4	43.5	43.8
Farm land prices	61.6	55.8	54.0
Farm equipment area sales	50.0	49.2	48.3
Home sales	58.8	72.5	60.2
Hiring in the area	50.9	59.2	53.2
Retail Business	42.9	52.6	49.2
Economy 6 months from now	43.0	53.4	46.1

September Survey Results at a Glance:

- Rural Mainstreet Index indicates rural economy advancing at a slower pace.
- Bank CEOs reported that farmland cash rents expanded by 9.9 percent over the past year.
- Farm equipment sales declined below growth neutral for a second straight month for the first time since.
- Economic confidence plunges below growth neutral.
- Farmland price index declined for the ninth time in the past 10 months.

Rural Mainstreet Economy Jan. '09 – September '13



While growth for the Rural Mainstreet economy remains positive, it slowed a bit in September, 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, declined to 52.4 from 55.8 in August. Lower grain prices this year are slowing the growth in the Rural Mainstreet economy. Additionally, 39.4 percent of bankers this month indicated that lower grain prices have encouraged farmers to store grain and hold or higher prices later. This strategy is likely to payoff for the farmer given the Federal Reserve's decision this week to continue their current stimulus program. This $85 billion per month Fed bond program will be supportive of higher agriculture commodity prices.

According to Scott Tewksbury, CEO of Heartland State Bank in Edgeley, N.D."We are looking at reduced production for 2013 due to late season drought, which is why I anticipate economy to be down in next 6 months."

Farming: The farmland-price index declined for the ninth time in the past ten months. The September index fell to 54.0 from 55.8 in August. Our farmland-price index has been above growth neutral since February 2010. However, lower farm commodity prices are slowing growth in farmland prices. The Federal Reserve's decision to make no changes to their expansionary monetary policy is definitely bullish for agriculture. Most economists including me expected the Fed to begin tapering QE3. Thus, the Fed's lack of September action will be supportive of agriculture commodity prices, farm income and farmland prices.

As indicated by Jeff Bonnett, president of Havana National Bank in Havana, Illinois, "We do anticipate a significant in-crease in stored/deferred grain sales from this year's harvest."

This month bankers were asked to how much farmland cash rents expanded in their area over the last year. On average, bankers reported that cash rents grew by 9.9 percent over the past year. Farm equipment sales for September once again declined. The index slumped to 48.3 from 49.2 in August. Lower agriculture commodity prices are weighing on farmer confidence and their willingness to purchase big ticket items such as agriculture equipment.

Banking: The loan-volume index remained above growth neutral for the month at 73.5 from 70.5 in August. The checking-deposit index advanced to 56.3 from August's 51.7

while the index for certificates of deposit and other savings instruments increased to a very weak 43.8 from August's 43.5.

Hiring: September's hiring index plunged to 53.2 from August's strong 59.2. Despite recent healthy job growth, Rural Mainstreet employment is down by 1.2 percent from pre-recession levels. Solid farm and manufacturing productivity have allowed businesses to grow their sales with little job growth.

Confidence: The confidence index, which reflects expectations for the economy six months out, slumped to 46.1 from 53.4 in August. The farm economy continues to grow but is trending lower as agriculture commodity prices have moved lower. This and the uncertainty surrounding passage of the Farm Bill and potential Congressional budget impasses pushed confidence below growth neutral.

Bankers remain concerned about the lack of a farm bill. According to Dale Bradley, CEO of The Citizens State Bank in Miltonvale, Kansas, "A good farm bill is important to most farmers!"

Home and retail sales: The September home-sales index declined to a still strong 60.2 from 72.5 in August. The September retail-sales index declined to 49.2 from 52.6 in August. Higher interest rates brought housing sales down to a still healthy rate of increase.

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 the 12th straight month, Colorado's Rural Mainstreet Index (RMI) remained above 50.0. The September RMI declined to a still healthy 57.2 from 63.4 in August. The farmland and ranchland price index fell to a still strong 67.7 from last month's 70.3. Colorado's hiring index for September fell to 62.4. Compared to its pre-recession level, Colorado's Rural Mainstreet employment is currently down by 3.1 percent.

ILLINOIS

The RMI for Illinois advanced to 52.2 from growth neutral 50.0 in August. The RMI has now remained at or above growth neutral for 12 straight months. Farmland prices slumped to 46.2 from 51.2 in August. The state's new-hiring index dipped to 47.7 from August's 52.4. Compared to its pre-recession level, Rural Mainstreet employment in Illinois is currently down by 4.6 percent. However good weather is boosting the outlook. According to Jim Ashworth, Jim Ashworth, vice chairman of CNB Bank & Trust in Carlinville, "(I am) expecting good corn and bean yields; growing season precipitation was generally "normal" for first time in five years."

IOWA

The August RMI for Iowa sank to 53.4 from 56.9 in August. The farmland-price index for September was unchanged from 53.2 in August. Iowa's new-hiring index for rose to 52.7 from August's 52.4. Compared to its pre-recession level, Rural Mainstreet employment in Iowa is currently down by 2.1 percent.

KANSAS

The Kansas RMI for September decreased to 51.7 from 56.4 in August. The farmland-price index for Sep-tember was unchanged from August's 48.2. The state's new-hiring index declined to 49.4 from 53.7 in August. Compared to its pre-recession level, Rural Mainstreet employment in Kansas is 2.0 percent higher.

MINNESOTA

The September RMI for Minnesota fell to 51.8 from August's 54.8. Minnesota's farmland-price index fell to 39.5 from 40.7 in August. The new-hiring index declined to 43.6 from 48.7 in August. Compared to its pre-recession level, Rural Mainstreet employment in Minnesota is currently down by 2.7 percent. Some portions of the state are being negatively affected by the drought. For example, Pete Haddeland, CEO of First National Bank in Mahnomen, "Some crops in our area have been affected by the drought." Bryan Grove, CEO of American State Bank in Grygla, summarized what many bankers reported for the month, "However, soybeans and corn appear stressed within a few miles of Grygla, depending on earlier timely rains. Some areas to our south have had little moisture since early July."

MISSOURI

The September RMI for Missouri declined to a still solid 56.8 from August's 61.4. The farmland-price index for September declined to a regional high of 81.0 from 85.2 in August. Missouri's new-hiring index sank to 71.3 from August's 78.4. Compared to its pre-recession level, Rural Mainstreet employment in Missouri is currently down by 9.3 percent.

NEBRASKA

After moving below growth neutral for January, Nebraska's Rural Mainstreet Index has been above growth neutral for eight straight months. The September RMI declined to 53.0 from 56.2 in August. The farmland-price index for September rose to 48.1 from August's 47.7. Nebraska's new-hiring index stood at 49.3, down from 53.4 in August. Compared to its pre-recession level, Rural Mainstreet employment in Nebraska is currently down by 1.3 percent.

NORTH DAKOTA

The North Dakota RMI for September fell to 56.0 from 58.9 in August. The farmland-price index declined to 70.0 from August's 73.2. North Dakota's new-hiring index declined to a still very strong 63.9 from Au-gust's 70.4. Compared to its pre-recession level, Rural Mainstreet employment in North Dakota is currently up by 51.8 percent.

SOUTH DAKOTA

The September RMI for South Dakota slipped to 53.8 from August's 56.8. The farmland-price index for the state increased to 52.2 from August's 51.2. South Dakota's new-hiring index for September sank to 52.2 from 55.7 in August. Compared to its pre-recession level, Rural Mainstreet employment in South Dakota is currently up by 1.2 percent. Drought conditions are hurting some areas of the state. According to David Callies, CEO of Miner County Bank in Howard, "Dry weather has hurt crop yields in our area."

WYOMING
The September RMI for Wyoming expanded to 53.2 from 53.0 in August. The September farmland and ranchland price index grew to 46.2 from 41.9 in August. Wyoming's new-hiring index slumped to 48.0 from August's 49.6. Compared to its pre-recession level, Rural Mainstreet employment in Wyoming is currently up by 0.3 percent.

THE BULLISH NEWS

- Purchasing management indices (PMIs) from the national survey of supply managers and Creighton's regional sur-veys point to an expanding economy for the fourth quarter of 2013.
- The Case-Shiller home price index advanced by more than 1.8 percent for July and was up by 12.4% over the past 12 months.
- The Consumer Price Index (CPI) increased 0.1% in August. Over the last 12 months, the CPI increased just 1.5%. This is below the Fed's target.

THE BEARISH NEWS

- US retail sales rose 0.2% month-on-month in August. This is a troubling signal after July numbers were also weak. Annual growth is only slightly above inflation.
- Total private employment expanded by a weak 166,000 in September according to ADP, a private payroll services provider. Too weak!
- Vampire foreclosures. According to RealtyTrac, an estimated 47 percent of bank-owned homes across the nation are still occupied by the previous owner.

WHAT TO WATCH

- **PMIs:** On Nov. 1, Creighton University and the Institute for Supply Management will release purchasing management indices (PMI) for October. This is the first economic data released in November. Keep and eye on the overall index and the prices-paid index. Any significant upturn could push the Federal Reserve to be begin QE3 taper in December. This will mean higher long-term interest rates.
- **Jobs:** On Friday Nov. 1, the U.S. Bureau of Labor Statistics (BLS) will release the employment report for October (assuming government shutdown ends). A very weak private sector reading will be negative signal for the Christmas buying season.
- **Retail Sales:** Around the middle of November, depending on shutdown, the U.S. Census Bureau releases its retail sales numbers for October. This will be get a read on the impact of the shutdown and on the Christmas buying season.

THE OUTLOOK

FROM GOSS:

- I expect Christmas buying to be reasonably strong this year with growth of 4% from last year.
- The 2013 Farm Bill will be passed but it will contain SNAP food stamps despite Republican efforts exclude them.
- Long term interest rates will continue to head higher after Washington gets beyond the shutdown and debt limit deliberations.

OTHER FORECASTS:

- National Association of Business Economics (September 2013 survey). The NABE panel forecasts a gradual acceleration in economic expansion, from a 2.3% rate of growth in inflation-adjusted gross domestic product in the third quarter of 2013 to 3.0% in the spring through the autumn quarters of 2014," said Dr. Nayantara Hensel, chair of the NABE Outlook Survey. "The panelists suggest that there is an 80% probability that the Federal Reserve will reduce its asset purchase program in 2014 and that there is a 45% probability that the Fed will reduce both the monthly purchases of mortgage-backed securities and Treasurys in 2013. The panelists suggest that Treasury yields are likely to rise, which may be due to the potential that the Fed may reduce asset purchases. Inflation is expected to remain slow and the labor market is expected to show improvement.

GOSS EGGS (RECENT DUMB ECONOMIC MOVES)

- Ohio Republican and former U.S. trade representative Rob Portman is backing a bizarre and economically wrong-headed proposal to ban currency manipulation by our trading partners. This proposal is backed by labor unions and other protectionists who seek to raise the prices of U.S. imported goods. How do you define manipulation? According to most definitions, the U.S. Federal Reserve is manipulating the U.S. dollar making foreign goods less competitively priced in the U.S. and U.S. goods more competitively prices abroad.

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