Retiring Baby Boomers and Rising Interest Rates-Exploding the Federal Debt

There is at least one thing that Democrats and Republicans agree on—higher federal spending. Since President Trump took office in the first quarter of 2017, federal spending has expanded by a compound annual growth rate (CAGR) of 3.9%, while tax collections have advanced by a more modest 0.9% CAGR. As a result, the federal debt exploded by a CAGR of 4.6% to an estimated $21.6 trillion in the third quarter of 2018, representing 104.8% of the nation's annual output, and the highest since the last quarter of the Obama Administration.

Both Democrats and Republicans signed on to this spending growth with Democrats resisting tax cuts, but embracing spending increases. And it will only get worse. With more than 10,000 baby boomers retiring each day, social security payments are soaring at a CAGR of 4.6%, and Medicare benefits are exploding at a CAGR of 5.0%.

Furthermore, ultra-low interest rates allowed the federal government to borrow needed funds at historically low rates. Since December 2016 to the present, the yield (interest rate) on U.S. Treasury bonds has risen by three-quarters of one percentage point. As a result of rising interest rates and a larger federal debt, interest payments have climbed by a CAGR of 5.0%. Should rates on U.S. Treasury debt rise to the 1990-2007 average, annual federal interest payments would grow by $160 billion to $200 billion, annually.

Without spending restraints, Gen-Xers and Millennials will face higher taxes, elevated interest rates, rising inflation, or all three of these "evils." Former Colorado governor Richard Lamm summed it up quite well saying, "Deficits are when adults tell the government what they want, and the kids pay for it.." Ernie Goss.

MAINSTREET RESULTS

Rural Mainstreet Index Sinks for September: Eight of 10 Bank CEOs Report Negative Tariff Impacts

September Survey Results at a Glance:

- For an eighth straight month, the overall index rose above growth neutral.
- More than eight of 10 bankers reported negative impacts on the local economy from tariffs.
- But only 4 of 10 bankers supported cutting recently enacted tariffs on imported goods.
- Farmland values continued to decline.
- More than one-fifth of bank CEOs support raising Federal Reserve interest rates two or more times in 2018.

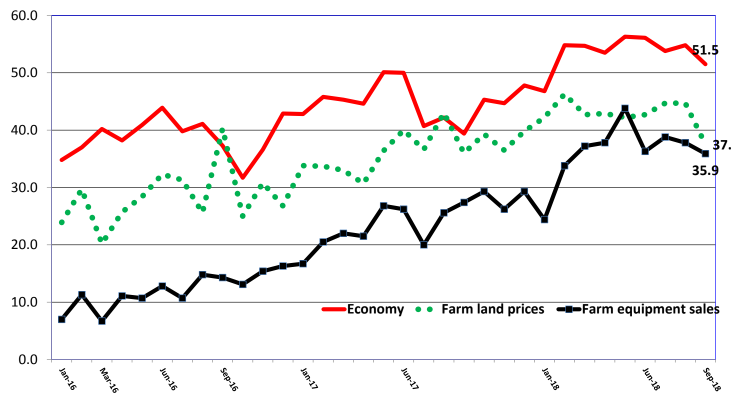
The Creighton University Rural Mainstreet Index climbed above growth neutral in August for a seventh straight month, according to the monthly survey of bank CEOs in rural areas of a 10-state region dependent on agriculture and/or energy.

Overall: The overall index declined to 51.5 from 54.8 in August. The index ranges between 0 and 100 with 50.0 representing growth neutral.

Our surveys over the last several months indicate that the Rural Mainstreet economy is expanding outside of agriculture. However, the negative impacts of recent trade skirmishes have begun to surface, weakening already anemic grain prices.

Table 1: The Mainstreet Economy	Sept 2017	Aug 2018	Sept 2018
Area Economic Index	39.6	54.8	51.5
Loan volume	73.2	72.2	65.3
Checking deposits	51.2	36.0	39.4
Certificate of deposits	46.6	48.8	45.5
Farm land prices	36.0	44.7	37.5
Farm equipment area sales	27.4	37.8	35.9
Home sales	56.0	63.1	54.7
Hiring in the area	55.9	68.7	65.3
Retail Business	41.9	53.5	48.4

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



Farming and ranching: The farmland and ranchland-price index for September sank to 37.5 from 44.7 in August. This is the 58th straight month the index has fallen below growth neutral 50.0.

The September farm equipment-sales index fell to 35.9 from August's 37.8. This marks the 61st consecutive month that the reading has moved below growth neutral 50.0.

Banking: Borrowing by farmers expanded for September, but at a slower pace than in August, as the loan-volume index declined to 65.3 from 72.2 in August. The checking-deposit index increased to 39.4 from August's 36.0, while the index for certificates of deposit and other savings instruments fell to 45.5 from 48.8 in August.

Hiring: The employment gauge dipped to a strong 65.3 from August's 68.7. The Rural Mainstreet economy is now experiencing positive job growth. Over the past 12 months, the Rural Mainstreet economy added jobs at a 2.3 percent pace compared to a lower 1.7 percent for urban areas of the same 10 states.

Confidence: The confidence index, which reflects expectations for the economy six months out, rose to a weak 49.5 from August's 46.5, indicating a pessimistic economic outlook among bankers.

Just as last month, tariffs and trade tensions weakened the economic outlook of bank CEOs.

Bankers were asked their position on recently implemented and proposed tariffs on imported goods. More than eight of 10 bankers, or 81.9 percent, reported negative impacts on the local economy from tariffs. Despite this, fewer than half, or 42.4 percent, support cutting or eliminating those tariffs. Approximately 45.5 percent support continuing current tariffs and trade policy, while 12.1 percent endorse pursuing a more hawkish approach by raising tariffs.

Home and retail sales: The home-sales index decreased to a still solid 54.7 from 63.1 in August. Retail sales sank for the month with an index of 48.4 from August's 53.5.

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 for September climbed to 56.1 from 55.8 in August. The farmland and ranchland-price index slumped to 38.0 from 45.1 in August. Colorado's hiring index for September slipped to 68.1 from August's 69.5. Colorado's Rural Mainstreet economy added jobs at a 1.5 percent pace over the past 12 months.

ILLINOIS
The September RMI for Illinois declined to 52.4 from 54.1 in August. The farmland-price index rose to 45.5 from August's 45.0. The state's new-hiring index fell to 65.9 from last month's 68.4. According to Jim Eckert, president of Anchor State Bank in Anchor, "Harvest is underway in our area. Corn yields are 10 percent (or more) less than last year. Not too many soybeans have been harvested yet, but early fields are disappointing." Illinois's Rural Mainstreet economy added jobs at a 1.9 percent pace over the past 12 months.

IOWA
The September RMI for Iowa sank to 51.2 from August's 56.8. Iowa's farmland-price index for September sank to 37.3 from August's 44.1. Iowa's new-hiring index for September jumped to 61.1 from August's 59.1. Iowa's Rural Mainstreet economy added jobs at a 1.3 percent pace over the past 12 months.

KANSAS
The Kansas RMI for September slipped to 53.2 from August's 56.3. The state's farmland-price index sank to 38.1 from 45.3 in August. The new-hiring index for Kansas declined to 69.0 from 71.7 in August. Kansas's Rural Mainstreet economy added jobs at a 2.1 percent pace over the past 12 months.

MINNESOTA
The September RMI for Minnesota fell to 50.0 from August's 53.1. Minnesota's farmland-price index slumped to 37.2 from 44.0 in August. The new-hiring index dipped to 58.8 from August's 59.0. Minnesota's Rural Mainstreet economy added jobs at a 1.4 percent pace over the past 12 months.

MISSOURI
The September RMI for Missouri fell to 52.7 from 56.4 in August. The farmland-price index for the state sank to 37.9 from August's 45.3. Missouri's new-hiring index for September declined to 67.1 from August's 72.0. Missouri's Rural Mainstreet economy added jobs at a 1.5 percent pace over the past 12 months.

NEBRASKA
The Nebraska RMI for September sank to 52.0 from 55.2 in August. The state's farmland-price index fell to 37.6 from last month's 44.9. Nebraska's new-hiring index declined to 64.2 from 67.4 in August. Nebraska's Rural Mainstreet economy added jobs at a 1.2 percent pace over the past 12 months.

NORTH DAKOTA
The North Dakota RMI for September declined to 50.5 from August's 52.4. The state's farmland-price index moved lower to 37.1 from 43.8 in August. The state's new-hiring index increased to 58.4 from 56.1 in August. North Dakota's Rural Mainstreet economy added jobs at a 0.8 percent pace over the past 12 months.

SOUTH DAKOTA
The September RMI for South Dakota remained above growth neutral, but fell to 52.8 from August's 55.4. The state's farmland-price index declined to 38.0 from August's 44.9. South Dakota's new-hiring index dipped to 67.5 from 67.8 in August. South Dakota's Rural Mainstreet economy added jobs at a 3.0 percent pace over the past 12 months.

WYOMING
The September RMI for Wyoming sank to 53.5 from August's 56.4. The September farmland and ranchland-price index moved lower to 38.4 from August's 45.4. Wyoming's new-hiring index slipped to a very healthy 70.4 from 72.1 in August. Wyoming's Rural Mainstreet economy added jobs at a 3.5 percent pace over the past 12 months

THE BULLISH NEWS

- The nation added 134,000 jobs in September and the unemployment rate fell to 3.7%, its lowest level in almost 50 years.
- U.S. consumer prices rose by 0.2%, less than expected in August. Increases in gas prices and rents were offset by declines in health care and apparel costs.

THE BEARISH NEWS

- Home prices rose by 6% annually in July, down from 6.2% in June as the rate of gains continues to slow, as potential homebuyers hit an affordability wall and sellers ratchet down their demands.
- The nation's budget deficit widened by 31.4% between Q2, 2017 and Q2, 2018.
- The U.S. trade deficit widened in August by $53.24 billion as Americans stepped up their purchases of foreign automobiles.

WHAT TO WATCH

- **GDP growth for Q3, 2018:** The Bureau of Economic Analysis will release 3rd Quarter 2018 on October 26. Annualized and inflation adjusted growth below 3% will be bearish for stocks and bullish for bonds.

- **Inverted yield:** Every recession since 1980 has been preceded by 2-year rates exceeding, or approximating, 10-year rates (termed an inverted yield). Currently 34 basis points (0.34%), but up from 24 basis points last month.

- **Wage Data for July**: On November, the U.S. Bureau of Labor Statistics will release wage data for October. Year-over-year growth above 3.0% will be a strong inflation signal and push the Fed to raise short-term interest rates at their December 19 meeting.

STATISTIC OF THE MONTH

- Black teenage employment declined to 19.3% in September, the lowest reading on record.

THE OUTLOOK

FROM GOSS:

- I expect **the Federal Reserve to raise rates on December 19 (0.25% or 25 basis points); **GDP growth to slow in the second half of 2018, but remain above 3.3% annualized. ***annualized growth in the consumer price index (CPI) to exceed 3% in Q4, 2018.

OTHER FORECASTS:

- **NABE Business Conditions Survey (October 2018) High lights:** "Despite concerns over trade policy, NABE Outlook panelists are slightly more optimistic about the U.S. economy in 2018 than they were three months ago, especially regarding prospects for the industrial sector of the economy," said NABE Vice President Kevin Swift, CBE, chief economist, American Chemistry Council. "Other indicators of real economic activity show light vehicle sales remaining elevated and housing continuing to improve. Trade issues are clearly influencing panelists' views," added Survey Chair David Altig, executive vice president and director of research, Federal Reserve Bank of Atlanta. "Half of survey respondents have moderately increased their inflation forecasts as a result of trade policy changes. Over half of the survey respondents indicate that they had reduced their GDP growth forecasts for 2018 and nearly 80% did so for 2019. Nonetheless, the percentage of panelists expecting a recession in 2019 fell relative to that in the June survey. One-third of respondents expects that we will not see a recession until 2021 or later."

GOSS EGGS (RECENT DUMB ECONOMIC MOVES)

- The Arizona education-industrial complex drafted an initiative for the November election to nearly double the top income tax rate of 4.54% to pay for higher teacher pay. A new 8% tax bracket would begin at $250,000 and a 9% rate for incomes over $500,000. If passed, Arizona would surpass New York and New Jersey in digging into the pockets of taxpayers. Florida, with no income tax, is salivating for passage. Fortunately, Arizona's Supreme Court tossed the initiative due to sloppy writing by the teachers.

BANKER READING ROOM

"The Role of Community Banks in the U.S. Economy," Federal Reserve Bank of Kansas City.

The U.S. banking system is unusual in consisting not only of some very large banks but also a large number of relatively small community banks. This bifurcated banking structure resulted largely from a legal framework that, in the past, restricted banks' abilities to diversify geographically. This institutional structure, in turn, reflected a long-standing concern in the United States about the concentration of banking power in a few very large institutions located far away from many of the customers they serve.

https://www.kansascityfed.org/Publicat/ECONREV/Pdf/2q03keet.pdf

FOLLOW ERNIE

Follow Ernie Goss on Twitter www.twitter.com/erniegoss

For historical data and forecasts, visit our website at: http://www.creighton.edu/instituteforeconomicinquiry/economicoutlook/

For ongoing commentary on recent economic developments, visit our blog at: www.economictrends.blogspot.com