Economists Whisper the “R” Word:
Watch Yield Curve for Clues of Recession

Seven years of the weakest economic growth since 1937 and 2015 ending with economic growth close to zero have pushed some economists to issue 2016 recession alerts for the U.S. However, economic signals are truly mixed.

Recession harbingers: the national and Creighton regional ISM readings for manufacturing have been below growth neutral for three straight months; the U.S. stock market as measured by the S&P 500 index is down by 10.3% over the past six months signaling weak corporate profits; Fourth quarter 2015, U.S. worker productivity fell by 3%, GDP expanded by an anemic 0.7% and exports declined by $0.5 billion; the percentage of the U.S. population in the labor market is at its lowest level since 1978;

Growth signs: U.S. economy added 1,137,000 jobs over the past six months and the unemployment rate declined to its lowest level in 8 years; Average weekly earnings expanded by 2.5% over the past year (not great, but not bad); consumer spending rose by 2.2% in Q4, 2015.

However, the most telling statistic is the yield curve—the difference between the yield on the 10-year U.S. Treasury bond and the 2-year U.S. Treasury bond. When the short term bond yield rises significantly due Federal Reserve rate hikes and the long term bond yield declines due to investor’s pessimistic outlook, the economy is likely to slow. Six months before the beginning of the last 3 recessions, the difference between these two bond yields sank into negative territory. While the difference in yields has been trending lower, it currently stands at 1.0%. Thus at this point in time, this important indicator is not signaling a 2016 recession, but keep an eye on it. Ernie Goss.

MAINSTREET RESULTS

Lowest Rural Mainstreet Index Since August 2009: Growing Regulatory Burdens Hurt Bank Outlook

Table 1: The Mainstreet Economy

<table>
<thead>
<tr>
<th>Area Economic Index</th>
<th>Jan 2015</th>
<th>Dec 2015</th>
<th>Jan 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan volume</td>
<td>62.1</td>
<td>61.0</td>
<td>55.4</td>
</tr>
<tr>
<td>Checking deposits</td>
<td>64.8</td>
<td>64.7</td>
<td>55.5</td>
</tr>
<tr>
<td>Certificate of deposits</td>
<td>42.6</td>
<td>46.4</td>
<td>42.3</td>
</tr>
<tr>
<td>Farm land prices</td>
<td>39.4</td>
<td>28.8</td>
<td>23.9</td>
</tr>
<tr>
<td>Farm equipment area sales</td>
<td>29.5</td>
<td>8.8</td>
<td>7.0</td>
</tr>
<tr>
<td>Home sales</td>
<td>45.3</td>
<td>55.0</td>
<td>43.3</td>
</tr>
<tr>
<td>Hiring in the area</td>
<td>52.8</td>
<td>54.9</td>
<td>51.2</td>
</tr>
<tr>
<td>Retail Business</td>
<td>48.1</td>
<td>51.2</td>
<td>32.7</td>
</tr>
<tr>
<td>Economy 6 months from now</td>
<td>43.6</td>
<td>39.8</td>
<td>29.4</td>
</tr>
</tbody>
</table>

Survey Results at a Glance:

- For a fifth straight month, the Rural Mainstreet Index fell below growth neutral.
- Farm equipment sales declined to another record low level.
- Approximately one-fifth of bankers report cuts in ethanol production in their area.
- Half of the bankers judge rising regulator costs as the top 2016 threat to community banks.

The Creighton University Rural Mainstreet Index for January fell from December’s weak reading, according to the monthly survey of bank CEOs in rural areas of a 10-state region dependent on agriculture and/or energy.

Overall: The Rural Mainstreet Index (RMI), which ranges between 0 and 100, sank to 34.8 from December’s 41.5.

This is the fifth straight month the overall index has declined, and the lowest reading since August 2009. Recent declines are the result of lower agriculture and energy commodity prices and downturns in manufacturing. Over the last 12 months, prices for farm products have fallen by approximately 15 percent and for fuels by roughly 20 percent.

Sinking prices for grain and fuel have had only moderate impacts on the region’s ethanol industry. Approximately one-fifth of the bank CEOs reported that ethanol plants in their area had reduced production, while seven of ten bankers indicated that ethanol plants had made no changes to their production levels.

Farming and ranching: The farmland and ranchland price index for January sank to 23.9 from December’s 28.8. This is the 26th straight month the index has moved below growth neutral. But, as in previous months, there is a great deal of variation across the region in the direction and magnitude of farmland prices with prices growing in some portions of the region.

The January farm equipment-sales index plummeted to a record low 7.0 from December’s record low 8.8. The strengthening U.S. dollar and global economic weakness have pushed grain prices down by 8 percent, and slaughter cattle prices 28 percent lower over the past 12 months. These weaker prices have discouraged farmers from buying additional agriculture equipment, and have negatively affected the agriculture equipment dealers and manufacturers in the region.

According to Jim Eckert, president of Anchor State Bank in Anchor, Ill., “Recent weakness in grain prices and increases in inputs have caused area farmers to “pull in their horns.”

Banking: The January loan-volume index decreased to 55.4 from last month’s 61.0. The checking-deposit index declined...
to 55.5 from December's 64.7, while the index for certificates of deposit and other savings instruments dipped to 42.3 from 46.4 in December.

Hiring: Despite weaker crop prices and pullbacks from businesses with close ties to agriculture and energy, Rural Mainstreet businesses continue to add workers to their payrolls but at a slower pace. The hiring index decreased to 51.2 from 54.9 in December. Rural Mainstreet businesses hired additional workers for the month as non-farm and non-energy related businesses continue to expand.

Confidence: The confidence index, which reflects expectations for the economy six months out, slumped to 29.4 from 39.8 in December, indicating a very pessimistic outlook among bankers. Bankers see few factors pointing to an improving Rural Mainstreet economy.

This month bankers were asked to identify the greatest economic threat to community banks for 2016. Half of the bank CEOs identified rising regulatory costs as the biggest challenge to community banks over the next year. Furthermore, only 28.3 percent of bankers expect an additional Federal Reserve rate hike in the first half of 2016 and 15.3 percent anticipate no additional Fed rate hikes in 2016.

According to Pete Haddeland, CEO of the First national Bank in Mahnomen, Minn., “Our regulatory costs now exceed $200,000 per year for compliance/audit.”

Home and retail sales: The January home-sales index plummeted to 43.3 from 55.0 in December. The January retail-sales index plunged to 32.7 from 51.2 last month. “Much like national home market and retail sales, the Rural Mainstreet housing market experienced a very tough month,” said Goss.

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. The survey is supported by a grant from Security State Bank in Ansley, Neb.

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.

THE BULLISH NEWS

• The U.S. added 151,000 jobs for January and the unemployment rate fell to its lowest level in 8 years.
• According to the latest Case-Shiller index, U.S. home prices advanced by 0.9% in November.

THE BEARISH NEWS

• U.S. gross domestic product (GDP) expanded at an annualized 0.7% rate in the fourth quarter of 2015. Nation’s economy should be growing at 5-6% rates this pace.
• Both the U.S. and Creighton survey of supply managers indicate that the economy is slowing down with little inflationary pressures at the wholesale level.

THE MAINSTEET ECONOMY REPORT
“A monthly survey of community bank CEOs”

February 2016

THE BULLISH NEWS

• The U.S. trade deficit widened in December as a strong dollar and weak global demand continued to weigh on exports.

WHAT TO WATCH

• CPI: On Feb. 9 and March 16, the BLS will release the consumer price indices for January and February, respectively. The core CPI, which excludes food and energy, increased 2.1% between December 2013 and 2014. This is getting uncomfortably higher for the Fed.
• Federal Reserve: The Fed’s interest rate meeting is March 15-16. The likelihood of a rate hike is at 12% right now. That is much, much too low. Even if there is no hike, listen for any hawkish language.
• The Jobs Report: On March 4 the Bureau of Labor Statistics will report February jobs report. A very strong report (200,000 jobs and unemployment rate of 4.8%) will push the Federal Reserve to raise rates late in the month.

FROM GOSS:

• I put the likelihood of a March Federal Reserve rate hike at 40% which is well above the consensus 12%.
• I also expect the core inflation rate to move a bit higher in the months ahead. This will push the Fed to raise short term rates sooner, rather than later.

OTHER FORECASTS:

• National Association of Business Economics (Feb. 2016) "The panel’s median forecast is for the economy to grow at 2.5% forecasted in the October 2015 survey. Growth will push the Federal Reserve to raise short term rates sooner, rather than later.

• The Environmental Protection Agency is proposing to make it illegal to modify your road-going car for racing, and could even prohibit the sale of aftermarket parts that mess with emission control devices. To paraphrase Charlton Heston, “I’ll give you my carbarator when you pry it from my cold, dead hands.”