THE MAINSTREET ECONOMY REPORT

"A monthly survey of community bank CEO's"

March 2018

Economic Growth Hurts Stock Market? No! The Enemy Is Higher Interest Rates Mr. President.

Just last week President Trump tweeted that "In the old days when good news was reported the stock market would go up." He went on to say that today good news pushes the market down. He asserted this is a "big mistake." But is it? Last week the U.S. Bureau of Labor Statistics reported that year-over-year wages advanced by a solid 2.9% compared to the post-recession growth of 2.2% or less. Good news for the worker and economy, but since that announcement all three major stock indices are down dramatically.

Instead of making a "big mistake", investors are simply assessing the likelihood of higher wages producing higher inflation, and then generating higher interest rates. Higher interest rates encourage inves-tors to move funds from the equity, or stock market, to interest bearing accounts. If investors' fears are borne out and interest rates return to their post-2000 average, how much lower will equity markets likely fall?

Between 2000 and 2009, the ratio of the S&P stock index to corporate profits, as reported by the Bureau of Economic Analysis, was 10.6. However post-2009, the Federal Reserve's (Fed's) unprecedented monetary stimulus helped drive the rate on the 10-year U.S. Treasury to an average 2.44%, and the ratio of the S&P to corporate profits to 11.2. Even after the recent market decline or correction, the ratio is still a high 11.6 on February 15. Thus, if rising inflation, the reversal of the Fed's post-recession stimuli and the expanding federal deficit force the yield on the 10-year U.S. Treasury to its 2000-09 average of 4.48%, investors could see a decline in the S&P by 8.9 percent, other factors unchanged. This estimate assumes a 4.8% increase in corporate profits from Q1, 2017 to Q1, 2018. Higher profit growth, and lower interest rate increases would mean a smaller fall in the S&P. On the other hand, sluggish profit growth, and higher interest rates would generate a larger fall in the S&P.

The next key indicator to watch will be the wage growth number coming from U.S. Bureau of Labor Statistics jobs report, on March 9 (this morning). A year-over-year growth number above 3.0% will put downward pressure on the S&P stock index.

MAINSTREET RESULTS

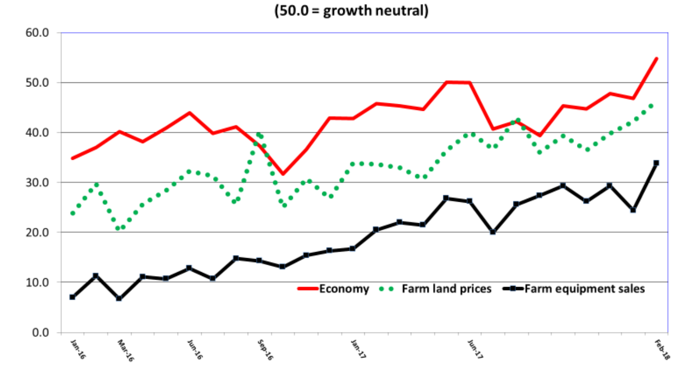
Table 1: Rural Mainstreet Economy Last 2 Months & One Year Ago: (index > 50 indicates expansion)			
	Feb.-17	**Jan. - 18**	**Feb. - 18**
Area economic index	45.8	46.8	54.8
Loan volume	50.1	54.4	53.8
Checking deposits	68.1	57.8	48.8
Certificates of deposit and savings instruments	46.8	43.5	45.2
Farmland prices	33.7	42.2	46.3
Farm equipment sales	20.5	24.4	33.8
Home sales	57.8	51.2	52.4
Hiring	54.3	50.0	58.8
Retail business	45.8	43.5	47.6
Confidence index (area economy six months out)	45.7	46.7	52.4

Rural Mainstreet Index Highest in Almost 4 Years: Bankers Expect 7% 2018 Farm Equipment Sales Decline

February Survey Results at a Glance:

- The overall index from February's survey bounced above growth neutral to its highest reading since May 2014.
- Almost two-thirds of bank CEOs expect farm equipment sales to trend lower for 2018.
- On average bankers expect farm equipment sales to decline by 7 percent in 2018.
- One-third of bankers reported no change in their farm lending practices over the past year, while 45.2 percent indicated that their bank had raised collateral requirements for farm loans.

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



The Creighton University Rural Mainstreet Index sprang higher in February from January's below growth neutral reading. This is the first time since July 2015 the overall index has advanced above growth neutral, according to the latest monthly survey of bank CEOs in rural areas of a 10-state region dependent on agriculture and/or energy.

Overall: The overall index soared to 54.8 from 46.8 in January, the highest reading for the overall index since May 2014. The index ranges between 0 and 100 with 50.0 representing growth neutral.

Given that fewer than one in four, or 23.9 percent, of bankers reported economic growth in their area, the solid February reading surprised me. However, weak agriculture commodity prices continue to weigh on the rural economy.

Jim Eckert, president of Anchor State Bank in Anchor, Illinois, reported, "We are seeing farmers with somewhat reduced income and moderate operating loan carryovers. However, without rain prior to planting, 2018 could be a bad year."

Farming and ranching: The farmland and ranchland-price index for January rose to 42.2 from 39.8 in December. This is the 50th straight month the index has fallen below growth neutral 50.0.

The February farm equipment-sales index jumped to 33.8 from January's very weak 24.4. This marks the 54th consecutive month the reading has remained below growth neutral, 50.0.

Almost two-thirds, or 63.5 percent of bankers, project that agriculture equipment sales will decline fur-ther in 2018. Only 4.9 percent of bank CEOs expect farm equipment sales to expand in 2018. Even so, these projections are an improvement from February 2017, when 73.9 percent of bank CEOs expected a slump in farm equipment sales for the year, and 4.3 percent anticipated an increase in equipment sales. On average, a decline of seven percent is expected for 2018.

Banking: Borrowing by farmers sank for February, as the loan-volume index stood at 53.8 from 54.4 in January. The checking-deposit index fell to 48.8 from January's 57.8, while the index for certificates of deposit and other savings instruments advanced to 45.2 from 43.5 in January.

Bank CEOs were asked how their banks were dealing with weak farm income. More than four in 10, or 45.2 percent, reported increasing collateral requirements, 21.4 percent indicated rejecting a higher percent of loan applications, and 11.9 percent reported reducing the average size of farm loans.

On the other hand, one third reported no change in their farm lending practices. As stated by Jeffrey Gerhart, chairman of Bank of Newman Grove, Newman Grove, Nebraska, "Our response to a weak farm economy is to continue working closely with our customers to get them through the tough times, just like we've always done."

Hiring: The employment gauge climbed to 58.8 from January's 50.0. The Rural Mainstreet economy experi-enced year-over-year job growth of only 0.4 percent compared to 1.3 percent for urban areas of the states.

Confidence: The confidence index, which reflects expectations for the economy six months out, rose to 52.4 from 46.7 in January indicating rising economic optimism among bankers. "However, an unresolved North America Free Trade Agreement, a weak USDA 2018 farm income projection, and anemic agriculture commodity prices continue to undermine economic optimism," said Goss.

Home and retail sales: The home-sales index moved slightly higher for the Rural Mainstreet economy in February, rising to 52.4 from January's 51.2. The February retail-sales index improved to a below growth neutral 47.6 from January's 43.5.

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 Inde-pendent Community Banks of America, created the monthly economic survey in 2005.

MAIN$TREET ON YOUR $TREET

COLORADO

Colorado's Rural Mainstreet Index (RMI) increased to 59.6 from 51.7 in January. The farmland and ranchland-price index expanded to 47.7 from January's 43.7. Colorado's hiring index for February rock-eted to 68.6 from January's 60.8

ILLINOIS

The February RMI for Illinois climbed to 54.4 from 46.4 in January. The farmland-price index rose to 46.1 from 42.1 in January. The state's new-hiring index advanced to 58.1 from last month's 50.2

IOWA

The February RMI for Iowa expanded to a solid 55.3 from 47.3 in January. Iowa's farmland-price index for February increased to 46.4 from January's 42.4. Iowa's new-hiring index for February soared to 60.0 from January's 52.1.

KANSAS

The Kansas RMI for February jumped to 51.1 from January's 43.1. The state's farmland-price index rose to 45.1 from 41.1 in January. The new-hiring index for Kansas climbed to 51.5 from January's 43.6.

MINNESOTA

The February RMI for Minnesota expanded to 52.9 from January's 46.5. Minnesota's farmland-price index rose to 45.1 from 41.1 in January. The new-hiring index for the state climbed to 51.4 from Janu-ary's 43.6. Pete Haddeland, CEO of the First National Bank in Mahnomen, said "Farm cash flow projections for 2018 are very difficult to work (at this time)."

MISSOURI

The February RMI for Missouri soared to 59.6 from 51.6 in January. The farmland-price index slipped to 42.3 from 43.6 in January. Missouri's new-hiring index shot up to 68.5 from 60.6 in January.

NEBRASKA

The Nebraska RMI for February climbed to 54.3 from January's 46.3. The state's farmland-price index climbed to 46.1 from last month's 42.1. Nebraska's new-hiring index fell to a still solid 57.9 from 60.6 in January.

NORTH DAKOTA

The Nebraska RMI for February climbed to 54.3 from January's 46.3. The state's farmland-price index climbed to 46.1 from last month's 42.1. Nebraska's new-hiring index fell to a still solid 57.9 from 60.6 in January.

SOUTH DAKOTA

The February RMI for South Dakota remained below growth neutral, but was up for February to 48.2 from 40.2 in January. The state's farmland-price index dipped slightly to 40.0 from 40.2 in January. South Dakota's new-hiring index expanded to 45.8 from January's 37.9.

WYOMING

The February RMI for Wyoming rose to 52.3 from January's 44.3. The February farmland and ranch-land-price index climbed to 48.9 from 41.5 in January. Wyoming's new-hiring index expanded to 53.9 from January's 50.2.

Table 2: The Rural Mainstreet Economy, February 2018

	Percentage of bankers reporting				
	Recession	Modest Downturn	No Growth	Modest Upturn	Strong Growth
How would you describe the economy in your area?	2.4%	38.1%	35.6%	19.1%	4.8%

	Percentage of bankers reporting				
	Greater than 15% decline	1% - 5% reduction	No change	1% to 5% increase	Greater than 15% increase
In terms of agriculture equipment sales for dealers in your area for the next year, what do you expect?	22.0%	41.5%	41.6%	4.9%	0.0%

	Percentage of bankers reporting				
	Little or no change	Increased collateral	Reduced average farm loan size	Increased interest rates	Increased Loan rejections
Which of the following has been your bank's response to weak farm income? (click all that apply)	33.3%	45.2%	11.9%	40.5%	21.4%

THE BULLISH NEWS

- U.S. home prices rose 7.0% in December from one year earlier. This reflects supply an almost severe shortage of homes for sale in certain many parts of the nation. Growth in home prices cannot continue to outstrip income growth by such huge margin. A bubble for sure.
- According to ADP, private-sector jobs grew by 235,000 in February.

Threats/The Bad News (Dangers)

- The U.S. trade deficit rose to nearly a 6-year high in November driven by imports. (note: a larger trade deficit is a by-product of an expanding U.S. economy).
- According to the U.S. Census Bureau, retail sales for January 2018 fell 0.3% from December. Over the 12 months, retail sales expanded by a low 3.6%.

WHAT TO WATCH

- **Inflation, Inflation, Inflation.** The Bureau of Labor Statistics will release the inflation gauge for February on March 13. An annualized increase above 2.5% will be bullish for stock prices and bearish for bond prices (rising yields, falling prices).
- **Wage Growth.** On March 9 (today), the U.S. Bureau of Economic Analysis releases its February jobs report. Focus on the wage growth number. Year-over-year growth over 2.8% will be viewed as a signal of budding inflation with higher interest rates to follow.
- **Home Prices.** On the last Tuesday of the month, March 27. S&P Corelogic will release its Case-Shiller home price index for January. Home prices have been rising by over 5.0% (annualized) since November 2015. Air will continue to inflate this bubble with too little housing supply.

STATISTIC OF THE MONTH

Of the more than 40 million Americans who have student debt, 5.9 million owe more than $50,000. That's nearly triple the percentage who owed that amount in 2000, and it's a share that's continuing to grow.

BANKER READING ROOM

For Community Banks, Big Business From Small Business Credit Cards. "Think small, goes the saying, to effect big change. For community banks serving small- to mid-sized businesses (SMBs), training an eye on credit cards can translate into additional revenue streams and tap into an unmet need for those SMBs. There's a lot of runway here. As noted in a whitepaper commissioned by ICBA Bancard and Visa, surveying more than 3,400 SMBs, A.T. Kearney found 26 percent of small business cardholders have community banking relationships in place. Only 3 percent of them, however, have their credit cards with those community banks."

"In an interview with PYMNTS, ICBA Bancard president and CEO Tina Giorgio said community banks should proactively offer cards to those clients, as community banks historically provide approximate-ly 60 percent of all small business loans in the United States. With such a significant share of lending ac-tivity in place, a credit card is a logical extension of that community bank-SMB relationship, particularly since the underwriting has already occurred." https://www.pymnts.com/news/digital-banking/2018/icba-bancard-community-banks-smb/

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THE OUTLOOK

NABE Business Conditions Survey (February 2018). "A majority of the NABE Policy Survey panel considers current fiscal policy 'too stimulative,' a depar-ture from the view in August 2017 that the policy was 'about right,'" said NABE Vice President Kevin Swift, CBE, chief economist, American Chemistry Council. "Overall, the panel expects the deficit to grow as a percentage of the economy in the longer term. Survey respondents are more supportive of cur-rent monetary policy, with more than six in ten reporting that the Federal Reserve's policy is 'about right.' Indeed, the percentage holding that view is the highest in eight years." "Regarding the impact of the recently enacted Tax Cuts and Jobs Act on equity and efficiency, two-thirds of panelists deem it 'far better' or
'somewhat better' than the previous corporate tax system, but nearly half regards the individ-ual tax provisions as worse than before," added Survey Chair Jim Diffley, CBE, executive director, IHS Markit. "The panel expects near-term boosts in economic growth, but is less optimistic about longer-term results.

Goss (March 2018): I expect **four more Federal Reserve rate hikes by the end of 2018 (1.0% or 100 basis points); **the nation's consumer prices to expand by 2.9% in 2018; wage growth to pick up in 2018 with hourly wages growing by 3.3% in 2018. ***the nation's trade deficit to worsen for all of 2018. A rapidly expanding U.S. economy boosts imports more than exports.

GOSS EGGS (RECENT DUMB ECONOMIC MOVES)

President Trump's decision to place tariffs of 25% and 10% on imported steel and aluminum, respectively could almost undo all of his otherwise stellar economic actions. The good from tariffs: a positive for wages, salaries, and profits for steel and aluminum companies. The bad and ugly: invites retaliation and potential trade wars; increases costs for steel and aluminum users reducing their wages, and profits, while increasing their prices; tends to raise U.S. infla-tion and interest rates; in the end, this action will actually raise the U.S. trade deficit as a share of GDP. This repre-sents the worst presidential economic policy action since Nixon's wage and price controls al-most 50 years ago.

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This month's survey results will be released on the third Thursday of the month, March15th.