

FDIC Presentation on Economic Conditions to the South Dakota Bank Commission

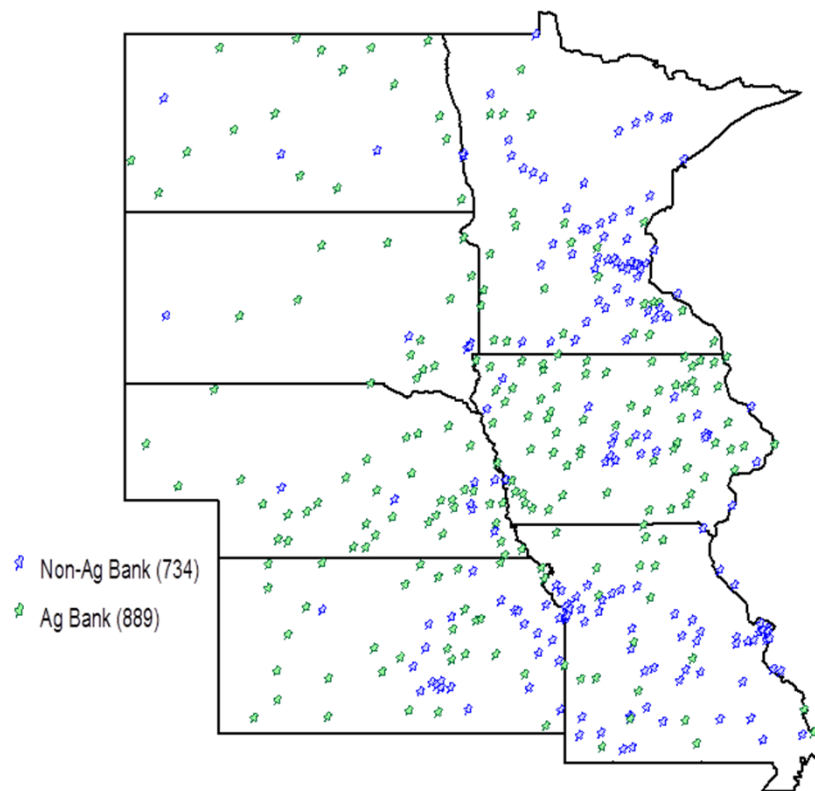
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About the FDIC's Kansas City Region...



- ▶ Most of our economic activity occurs in cities - MSAs and MicroSAs areas account for 84% of all payroll jobs.
- ▶ But most of our banks are local farm banks:
 - ▶ 1,559 IFIs
 - ▶ 889 are farm banks
 - ▶ 948 are in rural counties

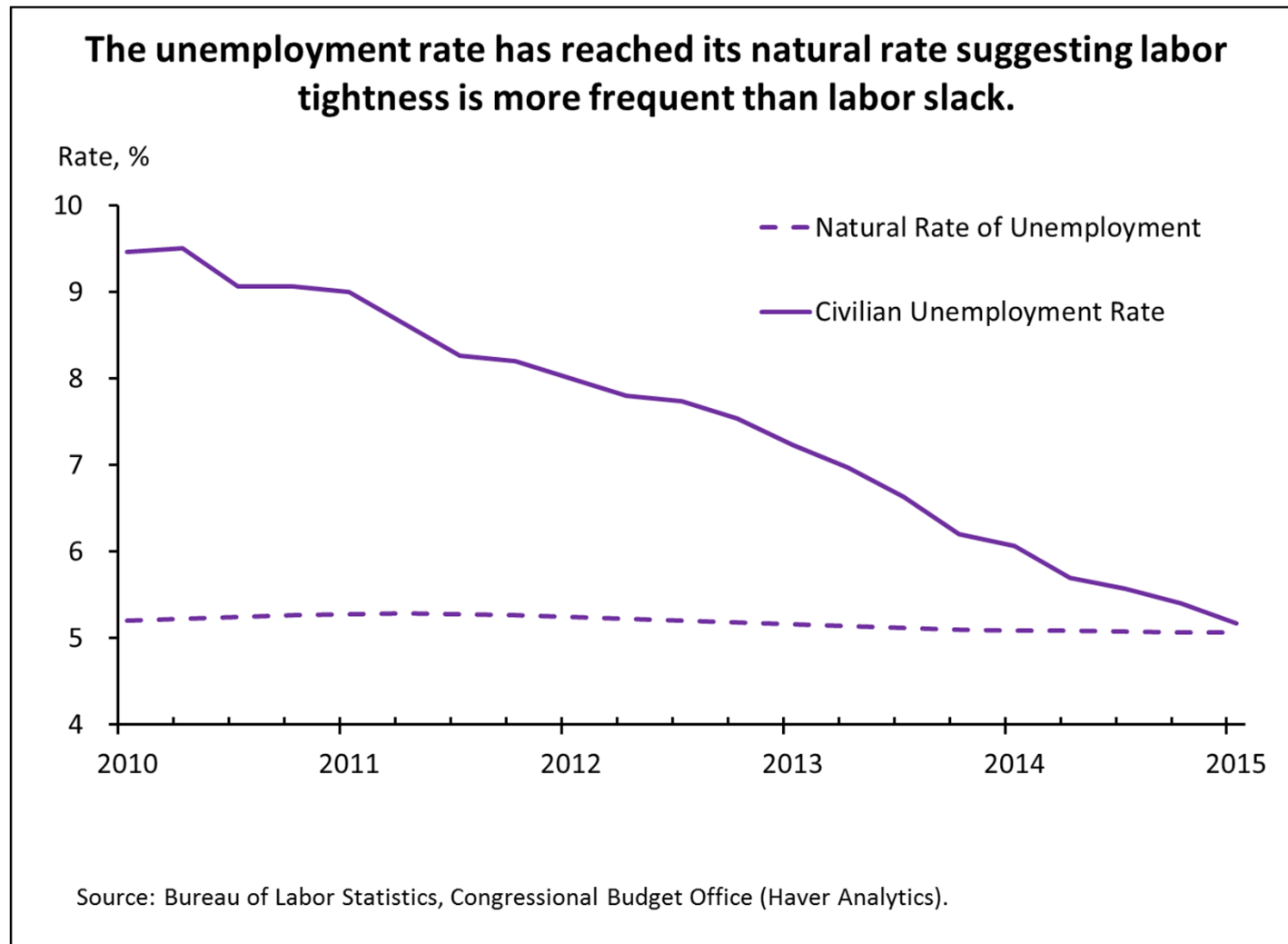
U.S. Economy Overview



Slow & Steady: U.S. Economy Continues to Move Ahead

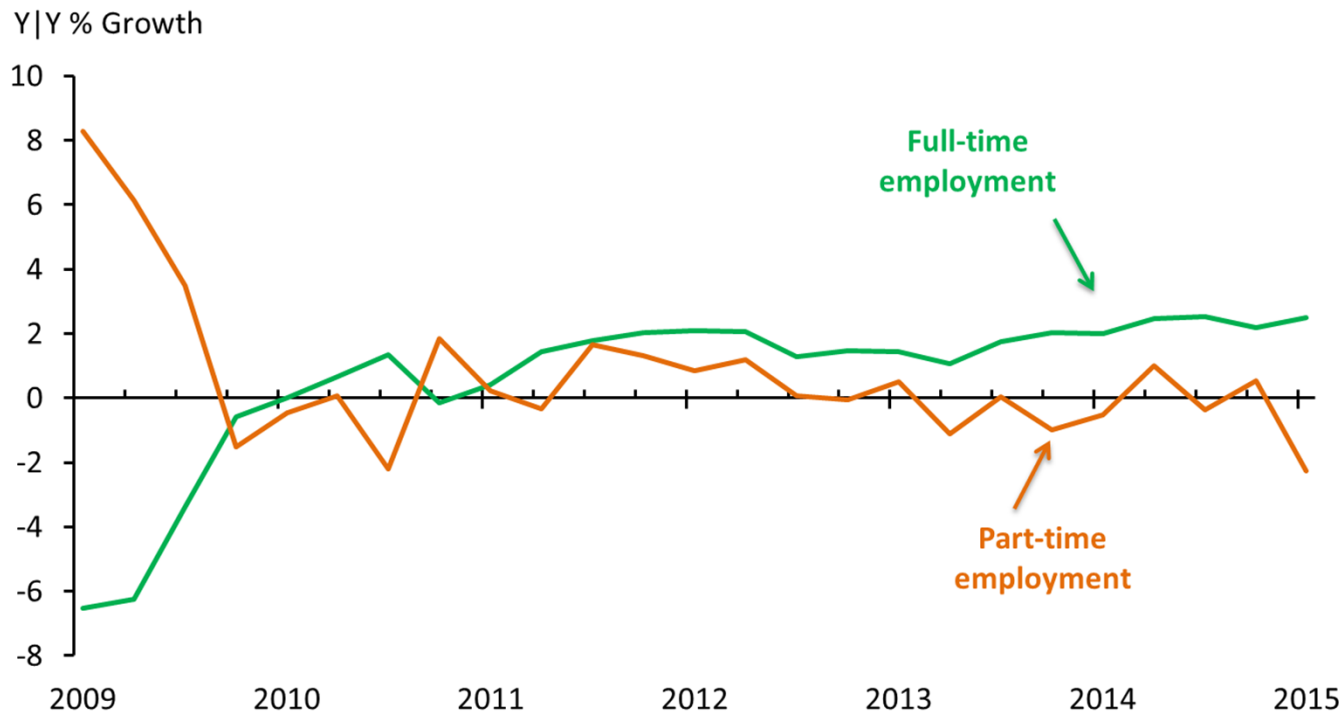
- ▶ Job growth continues at a > 200k /month pace
 - ▶ Nearly all net new jobs since 2010 have been full-time
- ▶ Unemployment rates continue to decline
 - ▶ Nearing its natural rate and creating a tight labor market
- ▶ Wages and incomes
 - ▶ Showing signs of stable improvement?
- ▶ Manufacturing headwinds
 - ▶ New orders and exports hit by strong dollar and weak global economy
- ▶ Interest rates
 - ▶ Still low, still compressed - what will the Fed do?

Overall, the U.S. job market moves from slack to tight as the economy expands.



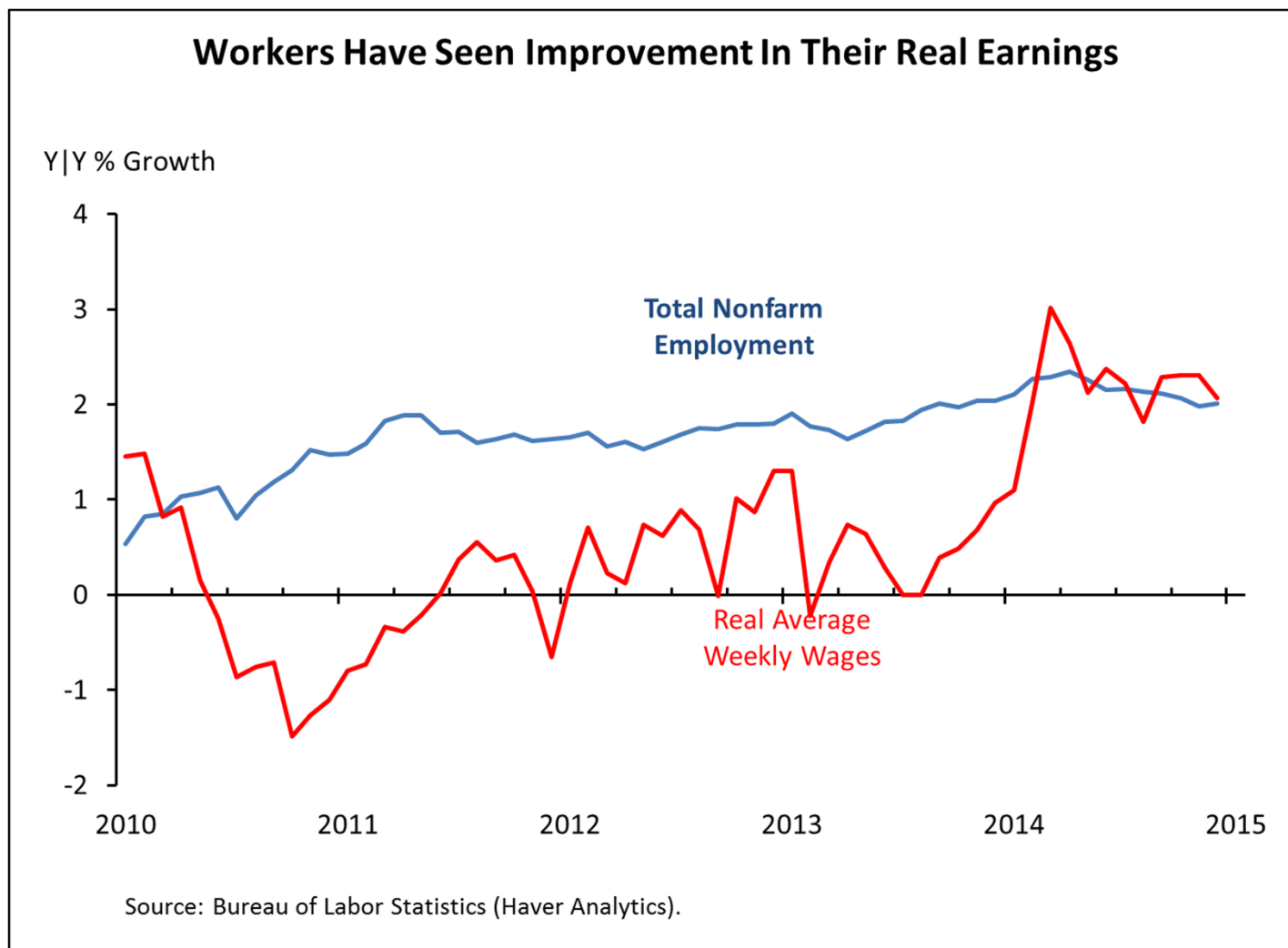
...and households are seeing better employment opportunities.

Households continue to add full-time jobs at a steady rate while part-time jobs are on the decline

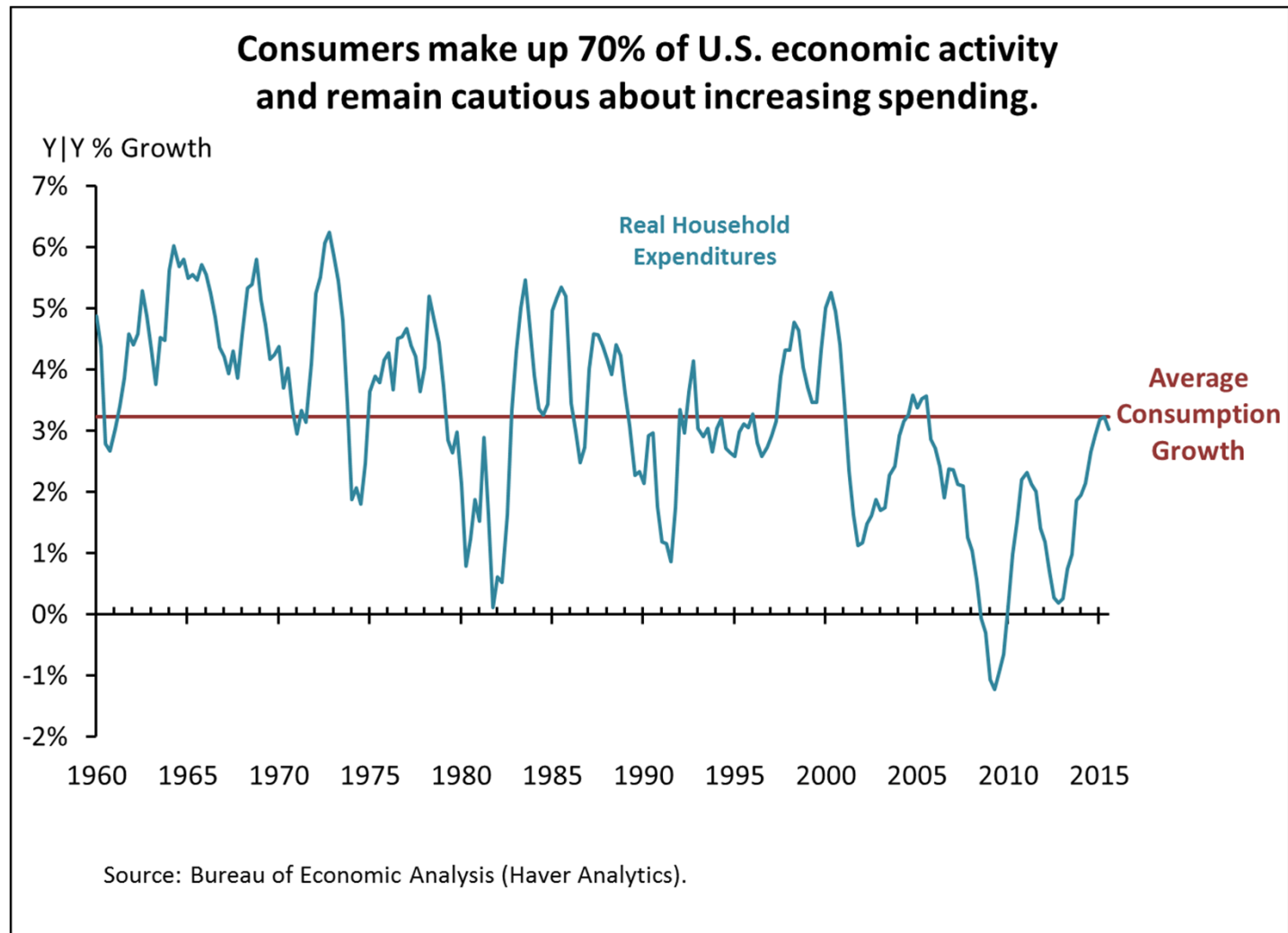


Source: Bureau of Labor Statistics (Haver Analytics).

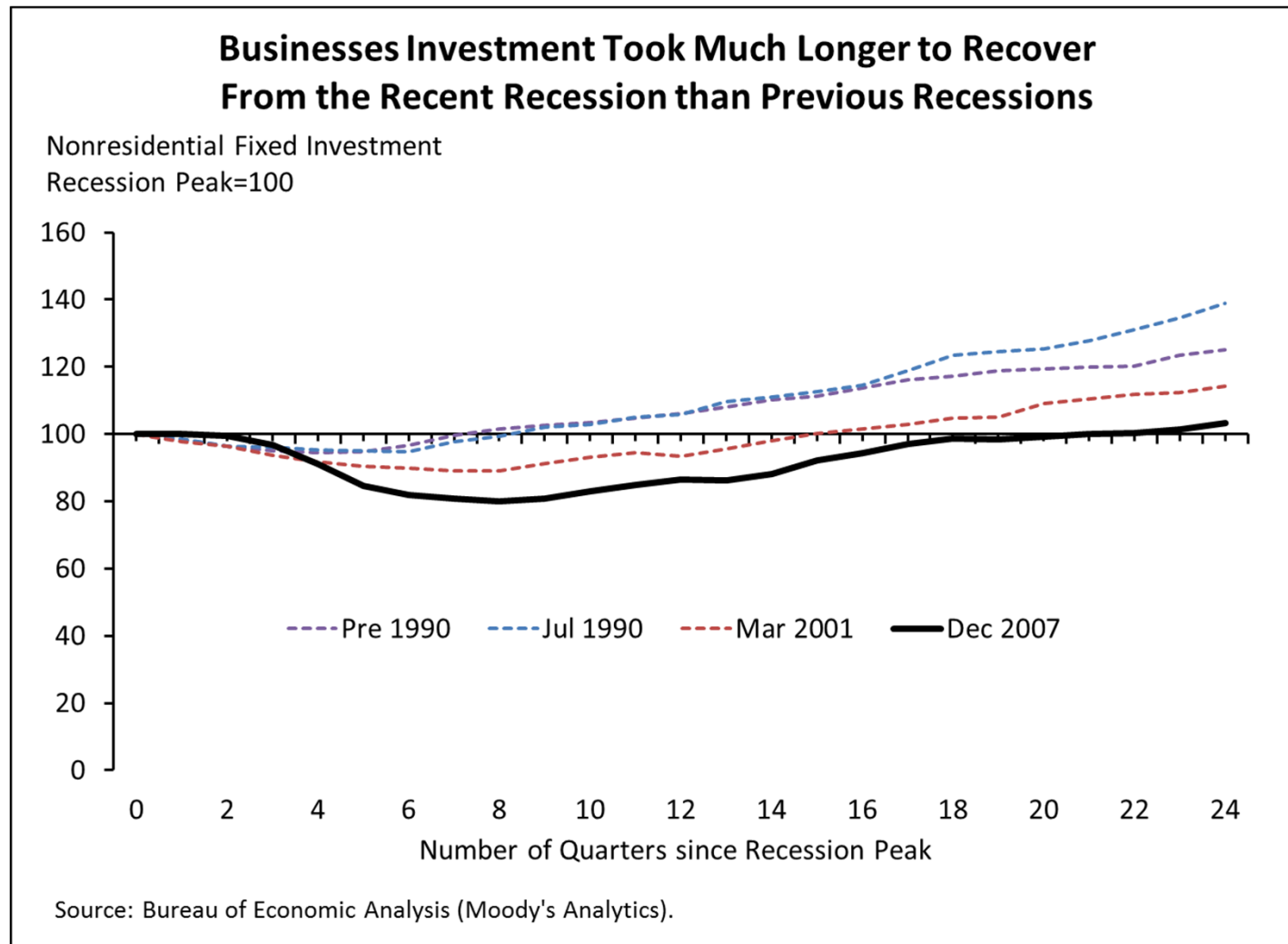
The job market and economic conditions are improving worker purchasing power...



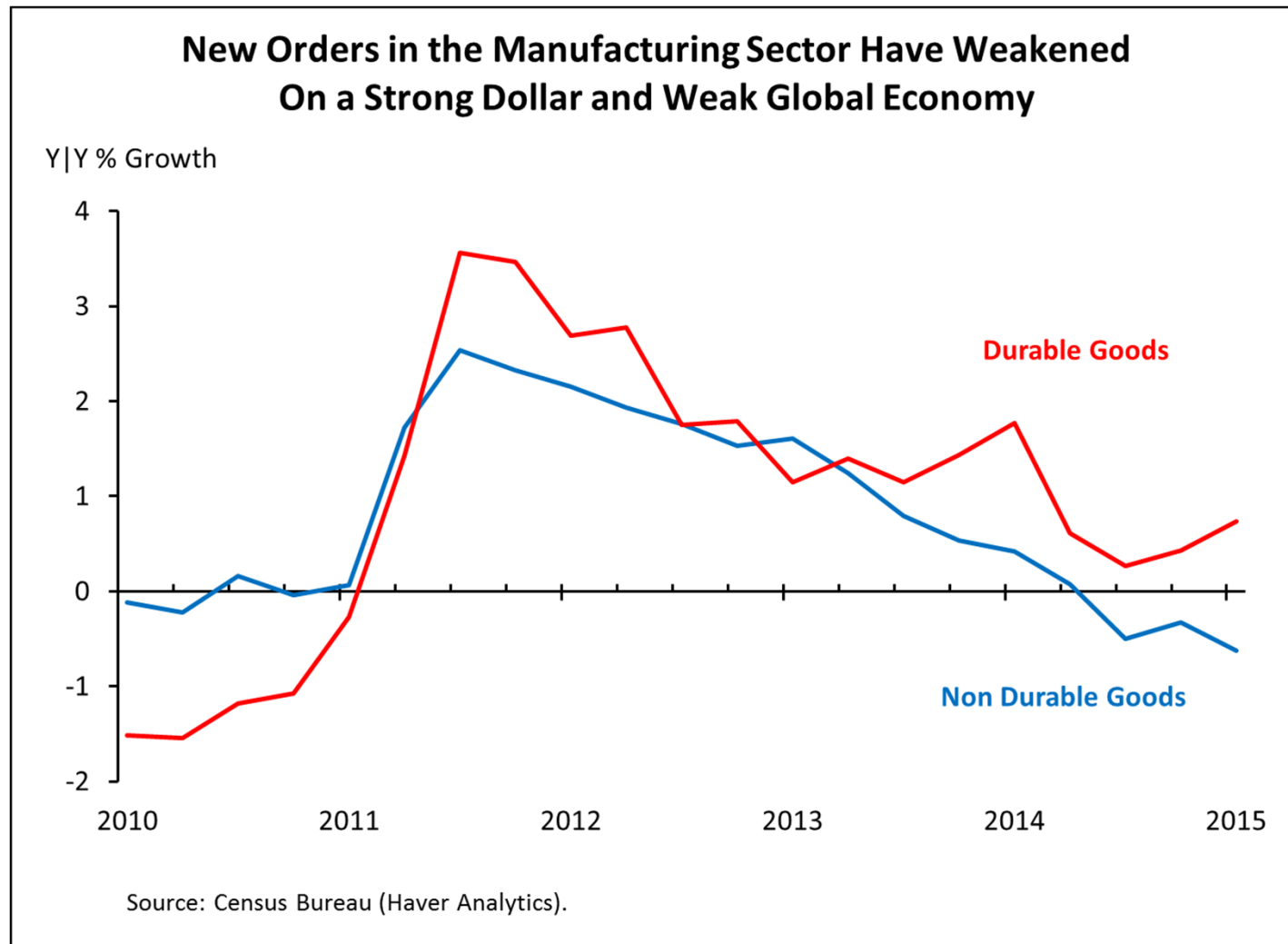
...but consumers have been slow to put their 'pay increase' back into the economy.



Weak consumer demand has contributed to weak post-recession business investment

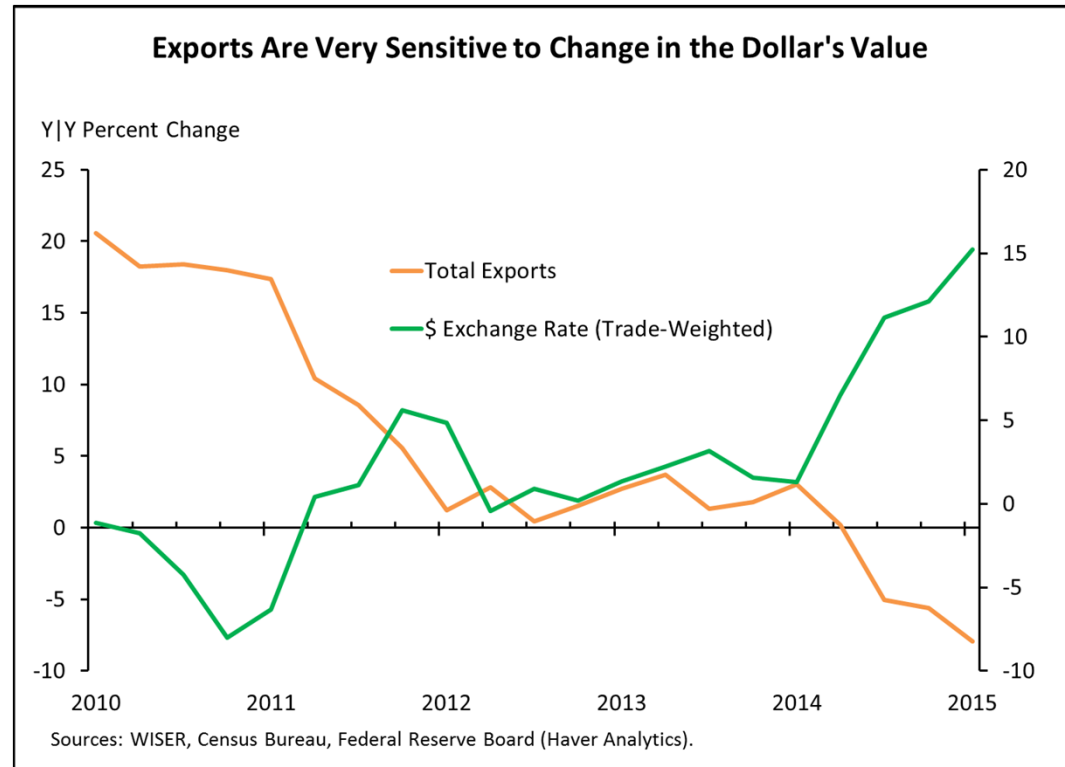


The strong U.S. dollar continues to weigh on manufacturing...



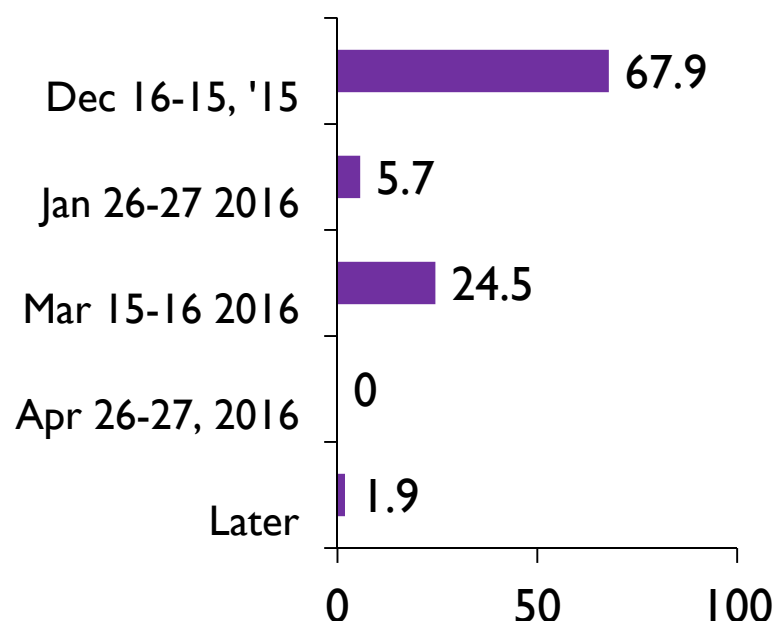
... and exports to the rest of the world.

- ▶ An interest rate increase likely to cause further \$ appreciation and declines in exports.
- ▶ A strong \$ compared to our major trading partners makes exports more expensive and imports cheaper.



Economists expect the Fed to begin raising interest rates this month

When do you think the FOMC will first hike its target for the federal funds rate?



Source: Special Question in the Nov. 10, 2015 *Blue Chip Economic Indicators*, Aspen Publishing.

- ▶ Such a move by the Fed would run counter to what many other key central bankers are currently doing or considering – lower rates and/or quantitative easing (mkt. interventions)

Regional & South Dakota Economy

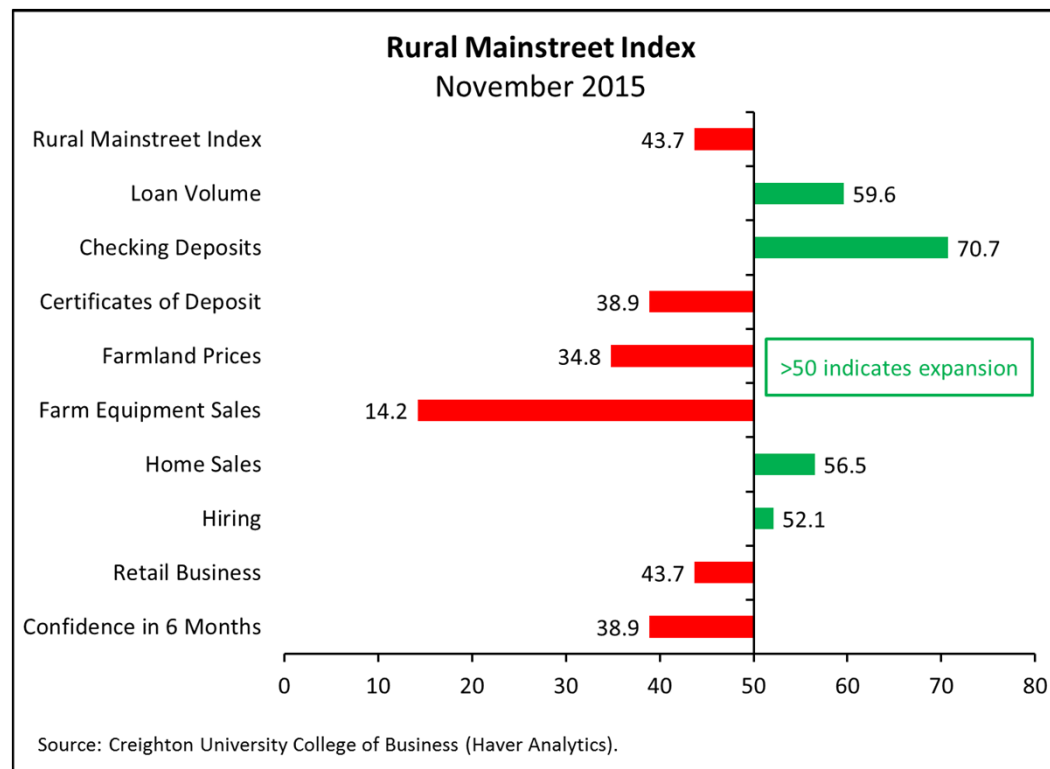


KC Region's Economy Is Doing a '180'

- ▶ Surveys suggest that the region's strong rural economy continues its transition of its agricultural cycle peak with bankers bearish on many fronts.
- ▶ Meanwhile, the region's metro areas are seeing building booms in multi-family and commercial space as well as some movement in 1-4 family home construction.
- ▶ Agriculture sector continues to see low commodity prices, but thus far most producers have been able to weather the storm.

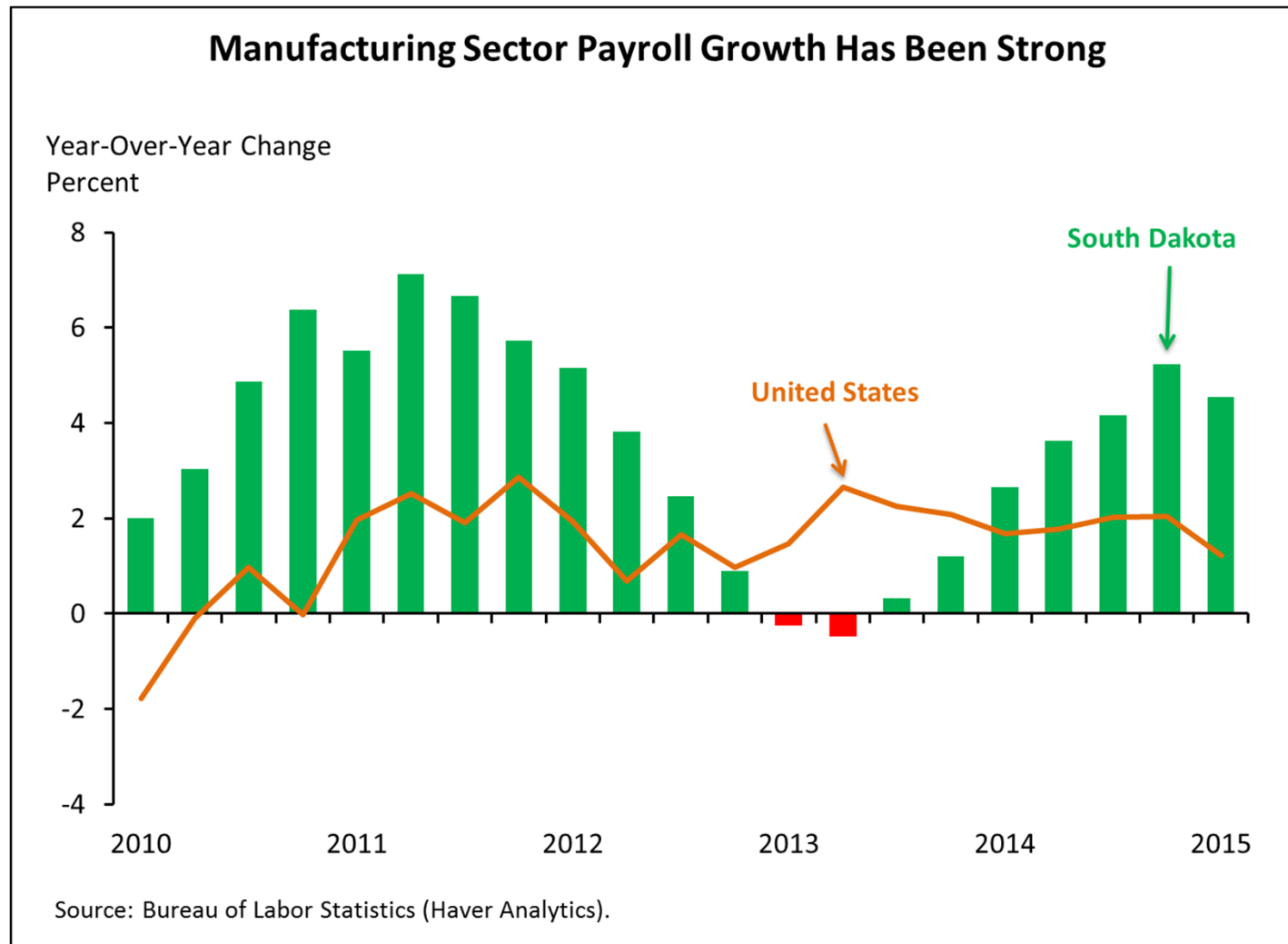
Economic Conditions Show Continued Economic Strain in Rural America

- ▶ Rural bankers continue to see agriculture as a headwind to economic growth
- ▶ Rural bankers have turned bearish on economic prospects going into the fall



Lower ag prices => lower incomes => more loans

South Dakota's manufacturing sector has been a solid performer...

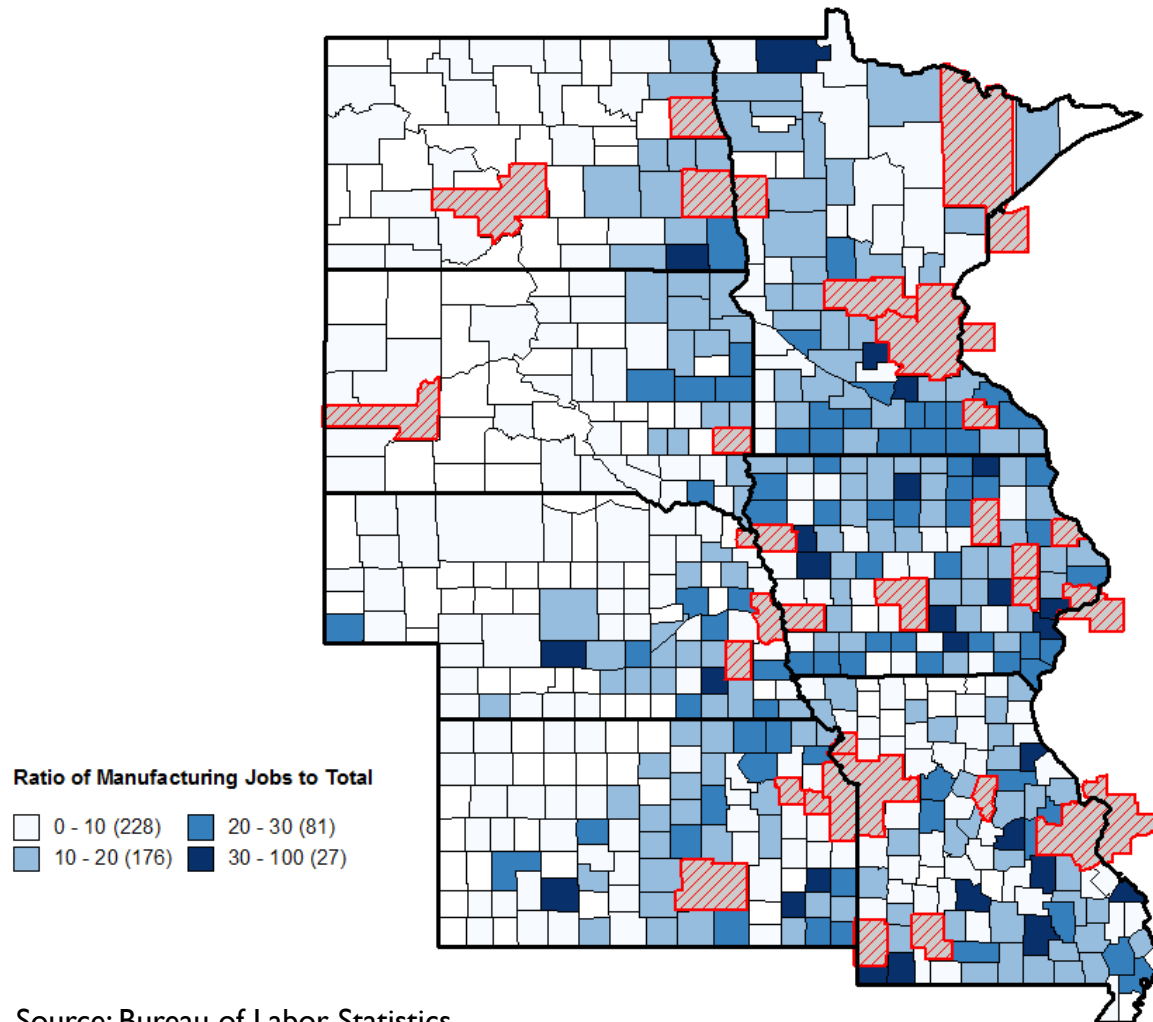


...but are there concerns on the horizon?

Mid-America Business (Manufacturing) Index		
November, 2015	Midwest	South Dakota
Manufacturing Index (Aggregate)	40.7	39.6
New Orders	34.2	33.3
Sales	36.2	35.2
Employment	41.7	40.5
<i>Inventories</i>	39.2	38.1
<i>Delivery Lead Time</i>	52.4	50.9
Confidence	41.2	--

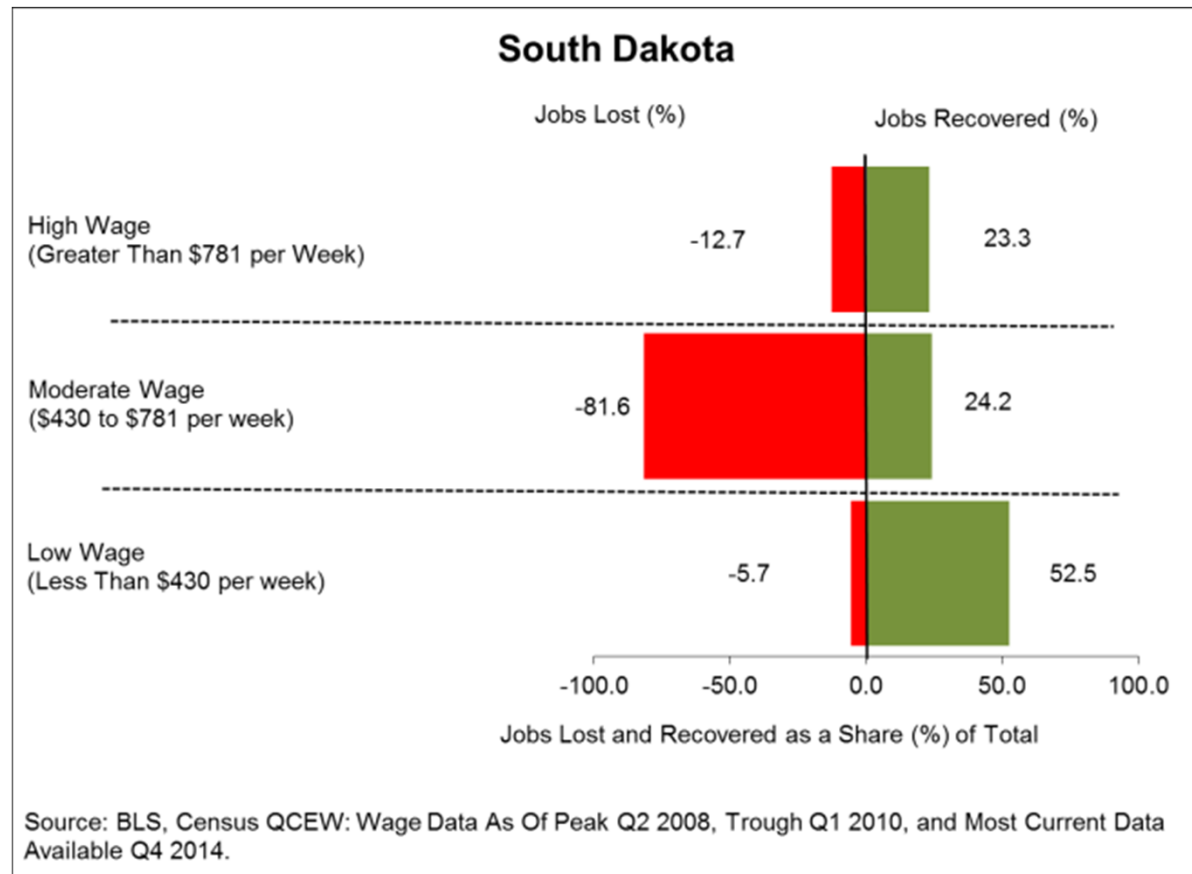
An index greater than 50 indicates an expansionary economy over the next 3 to 6 months.

Rural manufacturing jobs are concentrated in the east and south

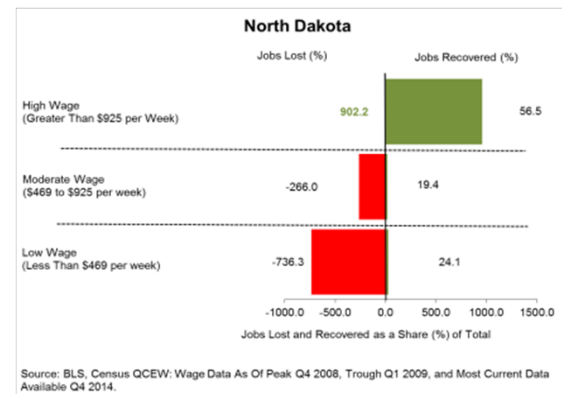
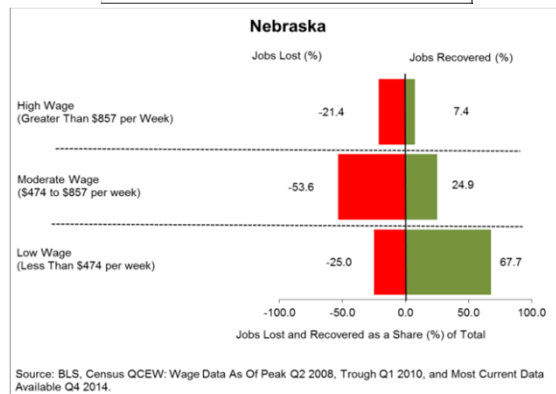
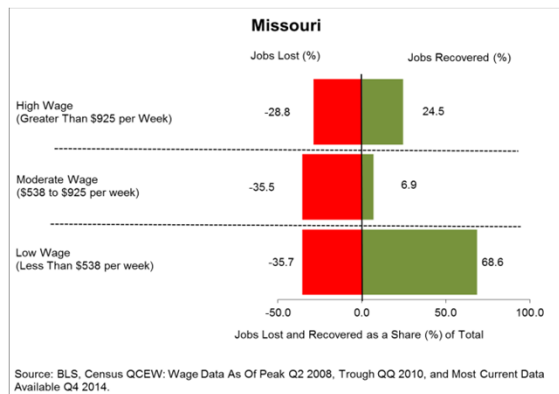
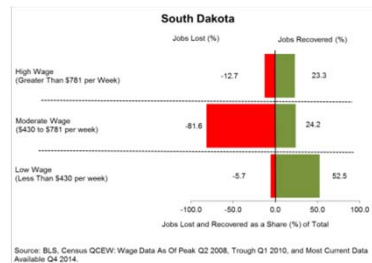
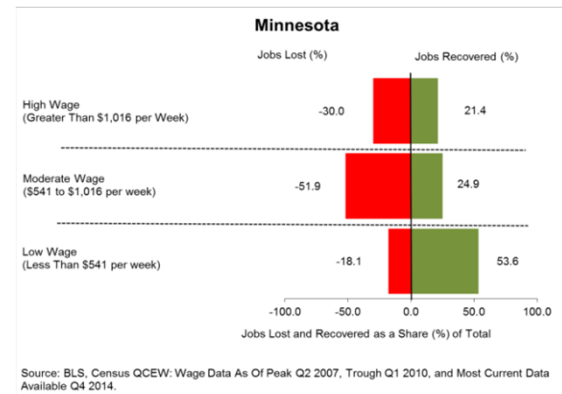
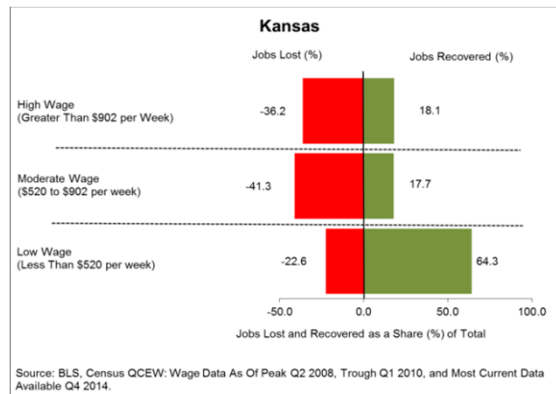
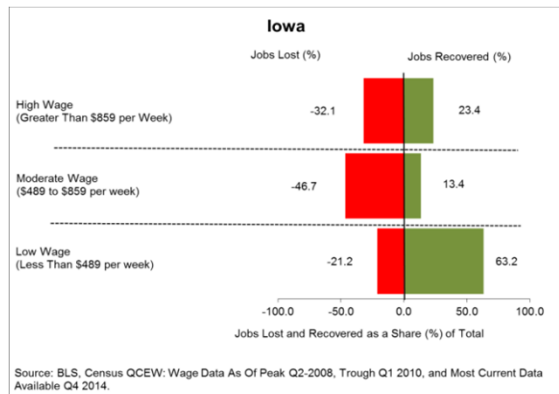


Source: Bureau of Labor Statistics.

Most job gains since the recession have been in lower-paying sectors



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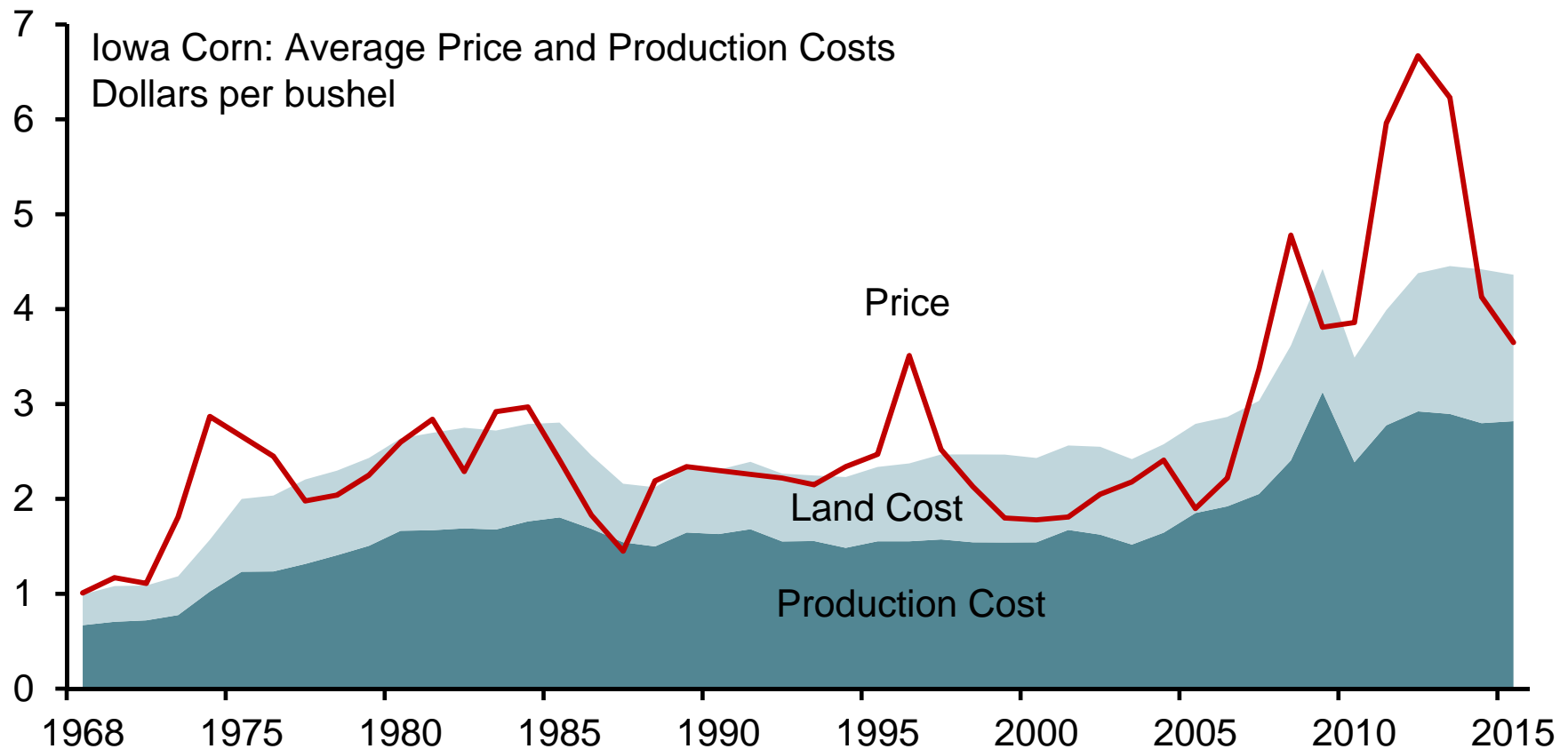
Agricultural Economy



Current thoughts on agricultural conditions

- ▶ **Market conditions** are negative with uncertainty heavily tilted to the down-side:
 - ▶ Sharply lower crop prices and farm incomes
 - ▶ Modest declines in farmland values
 - ▶ Declining exports
- ▶ **Mitigating factors** temper immediate threat of losses:
 - ▶ Industry strength
 - ▶ Cautious lending
- ▶ **Destabilizers** could quickly inflate the risk:
 - ▶ Rapidly appreciating dollar
 - ▶ Rising interest rates
 - ▶ Asian economic slowdown
 - ▶ “Stroke of the pen” risk

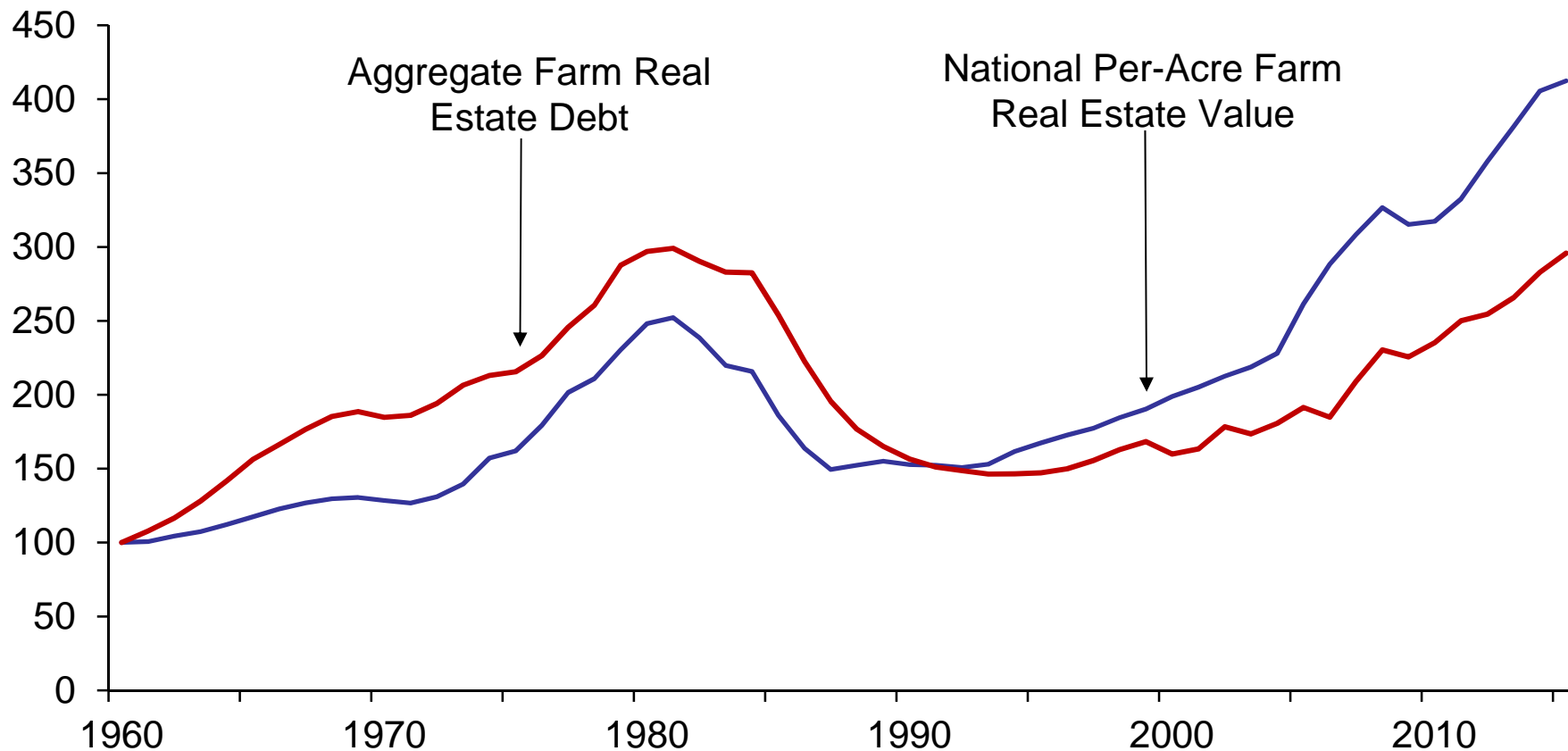
Unlike recent years, profitability will depend on farmers' ability to operate efficiently, market strategically, and manage their debt.



Sources: Iowa State University, USDA.

Unlike the 1970s, farm real estate debt has grown much more slowly than farm real estate values.

Indexed Values (1960=100), Inflation-Adjusted



Source: USDA National Agricultural Statistics Service. Nominal data that have been inflation-adjusted by the FDIC.

Risk appears manageable at this point – several mitigating factors temper the immediate threat of losses in the sector.

▶ **Agricultural borrower strength and support**

- ▶ Solid equity and working capital
- ▶ Safety net of farm programs and crop insurance

▶ **Farm bank conditions**

- ▶ Good financial shape – earnings, capital levels, asset quality
- ▶ Agricultural delinquencies and charge-offs near record-lows
- ▶ Farm Service Agency (FSA) farm loan guarantees

▶ **Conservative underwriting**

- ▶ Cautious lending against rapidly inflating farmland values
- ▶ Significant difference from 1970s

