THE MAINSTEET ECONOMY REPORT

"A monthly survey of community bank CEO's"

August 2015

More Government Regulation: More Income Inequality & Slower Economic Growth

President Obama just announced plans to reduce, and ultimately eliminate, coal-fired electricity generation in the U.S. Data from the Department of Energy show that electricity from existing coal-fired plants costs $38 per megawatt-hour compared to $106 per MWH from new wind facilities. Since, as a share of family income, the bottom quintile of earners spend five times that of the top quintile on electricity, this action will contribute to rising economic burdens on low income families in the U.S. Policymakers must consider potential impacts of this and other regulatory expansions on income inequality and economic growth.

Gauging income inequality with the 2013 Gini coefficient, measuring regulatory freedom with the Mercatus Center's regulatory freedom index, and capturing U.S. economic gains with 2008-13 Gross Domestic Product (GDP) reveals how rising regulation influences income inequality and economic growth. When ranking the states from the most regulatory-free, Indiana, to the most regulatory-constrained, California, distinct relationships emerge. First, the 25 states with the most regulatory freedom in 2013 experienced GDP growth of 4.2% for 2008-13, compared to the 25 with the least regulatory freedom which experienced a slower 3.3% GDP growth, and 3.7% greater income inequality. Furthermore, the top 25 states in terms of restraining regulatory growth from 2008 to 2011 experienced GDP growth of 4.6% compared to 2.6% for the 25 states expanding regulatory burdens. The 25 states growing relative regulation also suffered 2.9% greater income inequality. This surface analysis should stimulate more in-depth research that examines how Washington's boost in regulation among the states impinges on both income inequality and economic growth. Ernie Goss.

MAINSTREET RESULTS

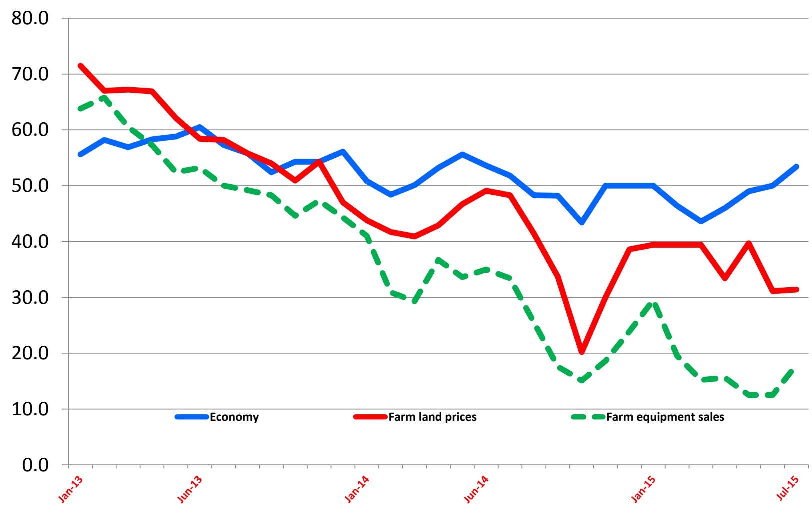
Rural Mainstreet Economy Improves for July: More Than Half of Bank CEOs Expect Higher Loan Defaults

Table 1: The Mainstreet Economy	Jul 2014	Jun 2015	Jul 2015
Area Economic Index	51.8	50.0	53.4
Loan volume	79.8	79.9	72.1
Checking deposits	53.5	48.0	53.4
Certificate of deposits	37.8	38.6	38.6
Farm land prices	48.3	31.1	31.4
Farm equipment area sales	33.4	12.5	17.9
Home sales	64.1	68.1	73.3
Hiring in the area	59.7	61.5	60.3
Retail Business	55.4	50.0	53.4
Economy 6 months from now	42.9	45.9	46.6

Survey Results at a Glance:

- The Rural Mainstreet Index improved to growth neutral, highest since January of this year.
- Farmland prices declined for the 20th straight month, but with wide variations across the region.
- On average, bankers reported a 6.8 percent fall in farmland prices over the past 12 months.
- Only 11.9 percent of bankers reported that farm loan defaults were up for the year. However, 54.8 percent of bankers expect farm loan defaults to rise over the next year.
- Retail sales rise for the month.

Rural Mainstreet Economy January '13 – July '15
Creighton University



The Creighton University Rural Mainstreet Index rose for July from June's tepid 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, climbed to 53.4, up from June's growth neutral 50.0, and its highest level since June of last year.

This is the fourth straight month the index has risen, indicating an upturn in economic conditions for the region. Improving crop prices pushed the overall index and the economic outlook higher for the month.

Farming and ranching: The farmland and ranchland price index for July increased slightly to 31.4 from June's 31.1. This is the 20th 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.

This month Creighton asked bankers how much farmland prices had changed in their area over the last year. On average, bank CEOs reported prices had fallen by 6.8 percent over the past 12 months. Seven percent indicated that farmland prices in their area had expanded over the year.

Approximately 14 percent registered a decline of 1 to 4 percent, 34.9 percent reported a price reduction of 5 to 9 percent and 27.9 indicated farmland prices had decreased by 10 to 20 percent. The remaining 16.3 reported no change in farmland prices over the previous 12 months.

The July farm equipment-sales index rose to a very weak 17.9 from June's record low 12.5. The index has been below growth neutral for 24 straight months. With farm income expected to decline for a second straight year, farmers remain very cautious regarding the purchase of agricultural equipment.

Banking: The July loan-volume index declined to 72.1 from 79.9 in June. The checking-deposit index rose to 53.4 from June's 48.0, while the index for certificates of deposit and other savings instruments was unchanged from June's 38.6.

This month bankers were asked about farm loan defaults over the past year and expected defaults over the next year. Only 11.9 percent of bankers reported farm loan defaults were up for the year. However, 54.8 percent of bankers expect farm loan defaults to rise over the next year.

According to Pete Haddeland, CEO of the First National Bank in Mahnomen, Minn., "Farmers are holding their own, but we expect a few default problems this fall."

But in some areas, farm loan defaults remain rare. For example, James Shafer, CEO of The First National Bank in Tremont, Ill., reported, "(My bank) has not had a farm loan default in the 40 + years I have been here."

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. The July hiring index dipped slightly to a still healthy 60.3 from June's 61.5. Rural Mainstreet businesses continue to hire additional workers. Rural Mainstreet communities are growing jobs at a solid annual pace of approximately 1 percent, primarily in businesses not linked to agriculture or energy.

Confidence: The confidence index, which reflects expectations for the economy six months out, expanded to a weak 46.6 from 45.9 in June. Recent improvements in agricultural commodity prices pushed bankers' economic outlook to a weak, but higher level.

Home and retail sales: The July home-sales index soared to 73.3 from June's 68.1. The July retail-sales index increased to 53.4 from 50.0in June. This may be a signal that we are finally recording increases in retail sales stemming from the downturn in fuel prices.

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.

MAIN$TREET ON YOUR $TREET

COLORADO
After falling below growth neutral for five straight month, the state's Rural Mainstreet Index (RMI) advanced to a stronger 53.2, well above June's 48.6 reading. The farmland and ranchland price index tumbled to 12.7 from 29.1 in June. Colorado's hiring index for July declined to 52.9 from June's 56.0.

ILLINOIS
The July RMI for Illinois rose to 53.6 from 49.7 in June. The farmland-price index slumped to 31.6 from June's 34.1. The state's new-hiring index increased to 60.5 from June's 58.5. Jim Eckert, president of Anchor State Bank in Anchor said, "Excess rain in our area is significantly hurting the crop. Some soybeans were never planted. Corn crop is clearly reduced as well."

IOWA
The July RMI for Iowa advanced to 56.6 from June's 51.8. Iowa's farmland-price index for July slumped to 43.9 from June's 44.3. Iowa's new-hiring index for July jumped to 65.4 from 62.6 in June.

KANSAS
The Kansas RMI for July rose to 52.3 from June's 48.2. The state's farmland-price index for July sank to 24.6 from 26.5 in June. The new-hiring index expanded to 57.7 from 55.4 in June.

MINNESOTA
The July RMI for Minnesota rose to 53.9 from June's 52.6. Minnesota's farmland-price index declined to 37.4 from 40.5 in June. The new-hiring index for the state climbed to 62.8 from 61.0 in June. According to Pete Haddeland, CEO of the First National Bank in Mahnomen, "Crops look great."

MISSOURI
The July RMI for Missouri declined to 47.1 from 49.9 in June. The farmland-price index fell to 13.9 from June's 35.0. Missouri's new-hiring index decreased to 53.4 from June's 58.8.

NEBRASKA
The Nebraska RMI for July climbed to 50.1 from 48.8 in June. The state's farmland-price index fell to 21.4 from June's 29.5. Nebraska's new-hiring index dipped to 56.4 from 56.6 in June. According to Jeffrey Gerhart, president and chairman of the Bank of Newman Grove, "Rainfall has been pretty good in Northeast Nebraska, but pivots are being turned on."

NORTH DAKOTA
The North Dakota RMI for July decreased to 50.6 from 52.6 in June. The farmland-price index fell to 36.5 from 56.0 in June. North Dakota's new-hiring index declined to 62.4 from June's 67.2.

SOUTH DAKOTA
The July RMI for South Dakota expanded to 56.7 from June's 52.2. The farmland-price index rose to 43.0 from 42.1 in June. South Dakota's new-hiring index rose to 65.0 from 61.7 in June.

WYOMING
The July RMI for Wyoming advanced to 52.5 from last month's 49.2. The July farmland and ranchland-price index slumped to 27.9 from June's 32.7. Wyoming's new-hiring index climbed to 59.0 from June's 57.9

THE BULLISH NEWS

- U.S. non-farm payroll employment expanded by 215,000 in July.
- The strongest areas of hiring for July were health care, retailing, and professional and business services. Manufac-turing added 15,000 jobs in July.

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- U.S. productivity growth rose 1.3% for Q2 of this year—weak but better than Q1.

THE BEARISH NEWS

- U.S. wage growth from July 2014 to July 2015 was 2.1%, only slightly above inflation.
- The June trade U.S. trade deficit rose to 7.1% from May to $48.3 billion.
- According to the Case-Shiller home price index, U.S. home prices fell 0.2% from April to May of this year.

WHAT TO WATCH

- **Federal Reserve:** On Sept. 17, the Fed will announce any change in short term interest rates. A 25 basis point (¼%) will be baked into markets by then. Pay special attention to Yellen's language in the press release.
- **PMIs:** On Sept. 1, the first business day of September, Creighton and the National Institute for Supply Management will release regional and national PMIs for August. A decline below growth neutral will be very bearish for stocks and bullish for bonds.
- **Chinese currency:** This week the Bank of China reduced the value of their currency, the yuan, to stimulate their economy. Another reduction will telegraph to investors just how weak the global economy really is. A reduction will also boost the value of the U.S. dollar slowing the U.S. economy.

THE OUTLOOK

FROM GOSS:

- I expect a 25 basis point (¼%) increase in short term interest hike from the Federal Reserve on Sept. 17.
- I expect long-term interest rates will remain range bound for the rest of 2015—up ½%, down ½.
- Survey results from U.S. and Creighton supply managers to weaken in the months ahead. There is too much global weakness for manufacturing to continue to expand.

OTHER FORECASTS:

- National Association for Business Economics (August 2015): "The July 2015 Business Conditions Survey results show a majority of panelists expect solid growth for the remainder of 2015," said NABE President John Silvia, chief economist at Wells Fargo. "Respondents are marginally less bullish than they were in previous surveys." "The panel reports markedly increased shortages in the July survey, especially of skilled labor," said Survey Chair Jim Diffley, senior director at IHS. "One half of the respondents continue to expect rising wages going forward."

GOSS EGGS (RECENT DUMB ECONOMIC MOVES)

- This month U.S. presidential candidates fell over each other arguing for an expansion in federal support for post-secondary education in the U.S. Candidate Clinton has a plan ("Details when I am elected.") that would make two-year colleges tuition-free. Who pays? Students must, must have "skin in the game" for any successful plan.

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This month's survey results will be released on the third Thursday of the month, August 20.