THE MAINSTEET ECONOMY REPORT

"A monthly survey of community bank CEO's"

February 2017

Paying for Trump's Federal Income Tax Cut: Eliminate State & Local Income Tax Deductibility

Newly elected President Trump has called for collapsing the current federal income tax brackets from seven to three; 12%, 25% and 33%. According to the Tax Foundation, this change would cost the U.S. Treasury $1.1 trillion to $2.5 trillion in tax collections over 10 years. Congressional representatives argue that adding this to the current federal debt of almost $20 trillion is irresponsible and instead must be "paid for" by eliminating deductions. One of those deductions is state and local income taxes.

According to my calculations, jettisoning this deduction would add almost $60 billion to U.S. Treasury coffers yearly. Of course, high income tax states would bear the brunt of the cost. Taxpayers bearing the biggest burden of the change would be Californian's paying $14.1 billion, New Yorkers losing $9.8 billion, and New Jersey residents forking over an additional $3.2 billion-- all three states' electoral votes captured by Clinton. In fact, the median individual income tax rate for states won by Clinton was almost 20% higher than that for states secured by Trump. In terms of shifting individual tax burdens, this change would cost taxpayers with incomes over $200,000 an average of approximately $7,000, but an average of only $100 for taxpayers making less than $200,000.

From the Trump standpoint, abolishing this deduction would produce greater tax transparency, reduce the incentives for state and local governments to raise taxes, and tend to benefit states that Trump carried in the election and costs states that Clinton captured. Ernie Goss.

MAINSTREET RESULTS

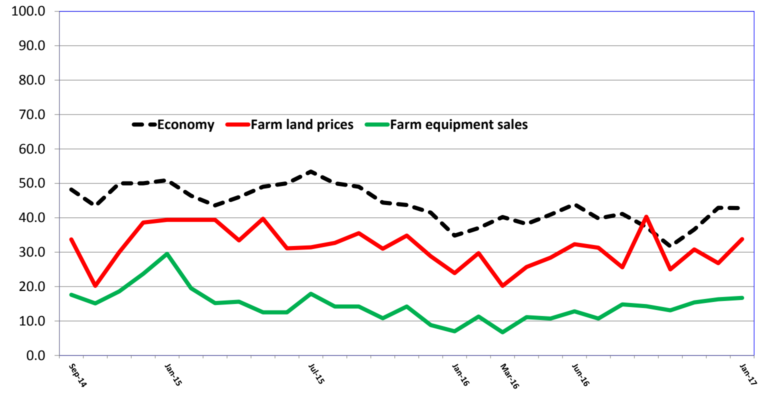
Rural Mainstreet Begins Year Weak: One-Third Indicate Loan Defaults Biggest Banking Threat

Table 1: The Mainstreet Economy	Jan 2016	Dec 2016	Jan 2017
Area Economic Index	34.8	42.9	42.8
Loan volume	55.4	78.5	52.4
Checking deposits	55.5	57.1	71.9
Certificate of deposits	42.3	38.1	43.9
Farm land prices	23.9	26.8	33.8
Farm equipment area sales	7.0	16.3	16.7
Home sales	43.3	46.4	52.5
Hiring in the area	51.2	51.2	52.5
Retail Business	32.7	45.1	39.1

Survey Results at a Glance:

- For a 17th straight month, the Rural Mainstreet Index remained below growth neutral.
- Almost one-third of bank CEOs indicated that soaring loan defaults represented the greatest Rural Mainstreet banking threat for 2017.
- Almost nine of ten bankers reported that low agriculture commodity represented the biggest threat to the rural economic for 2017.
- Eighty percent of bankers expect the Federal Reserve to raise interest rates in the first half of 2017.
- States with January Rural Mainstreet expansions: Illinois, Iowa, Missouri, Nebraska, and South Dakota; States with January Rural Mainstreet contractions: Colorado, Kansas, Minnesota, North Dakota and Wyoming.

Rural Mainstreet, Economic Indicators, Sept. 2014 – Jan. 2017
(50.0 = growth neutral)



The Creighton University Rural Mainstreet Index remained weak with a reading below growth neu-tral for the 17th 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 index, which ranges between 0 and 100 slipped to 42.8 from 42.9 in December. This was the 17th straight month that the economic gauge dipped below growth neutral 50.0. Even though the index was virtually flat from last month, the negatives are getting less negative according to our monthly surveys of bank CEOs. Over the past 12 months, livestock commodity prices have tumbled by 7.3 percent and grain commodity prices have slumped by 11.7 percent. The economic fallout from this price weakness continues to push growth into negative territory for five of the 10 states in the region.

When asked to identify the greatest economic threat to their local economy, almost nine of ten, or 87.8 percent, indicated that continuing low agriculture commodity prices was the greatest challenge or threat for 2017.

States with January Rural Mainstreet expansions: Illinois, Iowa, Missouri, Nebraska, and South Dakota; States with January Rural Mainstreet contractions: Colorado, Kansas, Minnesota, North Dakota and Wyoming.

Farming and ranching: The farmland and ranchland-price index for January rose to a frail 33.8 from December's 26.8. This is the 38th straight month the index has languished below growth neutral 50.0.

The January farm equipment-sales index increased to 16.7 from 16.3 in December. Since July 2013, weakness in farm income and low agricultural commodity prices have restrained the sale of agricultural equipment across the region. This is having a significant and negative impact on both farm equipment dealers and agricultural equipment manufacturers across the region.

Banking: Borrowing by farmers remains increased for January but at a slower pace than for December as the January loan-volume index fell to 52.4 from last month's 78.5. The checking-deposit index climbed to 71.9 from 57.1 in December while the index for certificates of deposit and other savings instruments in-creased to 43.9 from 38.1 in December.

This month bankers were asked to name the biggest challenge to rural community banks in 2017. Almost one third, or 31.7 percent, indicated that escalating loan defaults represented the greatest challenge to Rural Mainstreet banks in 2017.

Said Pete Haddeland, CEO of the First National Bank in Mahnomen, Minn., "The longer we stay in this Ag cycle, the more problems Banks will see." Eighty percent of bankers expect the Federal Reserve to raise interest rates in the first half of 2017. The remaining 20 percent anticipate the next interest rate increase to occur in the second half of 2017.

Hiring: The job gauge rose to 52.5 from December's 51.2. For the region, Rural Mainstreet employment is down by 0.6 percent over the past 12 months. Over the same period of time, urban employment for the region expanded by 1.2 percent.

Confidence: The confidence index, which reflects expectations for the economy six months out, sank to 42.7 from 43.9 in December indicating a continued pessimistic outlook among bankers. "Until agricultural commodity prices begin to trend higher, I expect banker's economic outlook to remain weak," said Goss.

Home and retail sales: Home sales moved higher for the Rural Mainstreet economy for January with a reading of 52.5 from December's 46.4. The January retail-sales index fell to 39.1 from December's 45.1.

Bank CEOs expect lackluster holiday sales growth. On average, Rural Mainstreet bankers expect a 0.4 percent increase from 2015 holiday retail sales levels.

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
Colorado's Rural Mainstreet Index (RMI) rose to 38.7 from 24.9 in December. The farmland and ranchland-price index increased to 43.8 from December's 25.5. Colorado's hiring index for January rose to 58.3 from December's 55.2. Colorado job growth over the last 12 months; Colorado Rural Mainstreet, -2.7 percent; Urban Colorado, +2.8 percent.

ILLINOIS
The January RMI for Illinois improved to a regional high of 63.2 from 34.2 in December. The farmland-price index climbed to 34.6 from December's 17.9. The state's new-hiring index rose to 55.0 from last month's 52.4. Illinois job growth over the last 12 months; Illinois Rural Mainstreet, +1.4 percent; Urban Illinois +0.6 percent.

IOWA
The January RMI for Iowa fell to 50.2 from 63.5 in December. Iowa's farmland-price index for January fell to 48.6 from 49.3 in December. Iowa's new-hiring index for January slipped to a still strong 60.1 from December's 63.9. Iowa job growth over the last 12 months; Iowa Rural Mainstreet, +0.4 percent; Urban Iowa, +0.8 percent.

KANSAS
The Kansas RMI for January increased to 29.6 from December's 16.0. The state's farmland-price index plummeted to 18.3 from 41.2 in December. The new-hiring index for Kansas rose to 49.0 from 47.9 in December. Kansas job growth over the last 12 months; Kansas Rural Mainstreet, -0.9 percent; Urban Kansas, no change.

MINNESOTA
The January RMI for Minnesota sank to a weak 39.0 from December's 41.7. Minnesota's farmland-price index climbed to 30.1 from 24.0 in December. The new-hiring index for the state slipped to a still solid 53.3 from last month's 54.7. Minnesota job growth over the last 12 months; Minnesota Rural Mainstreet, -0.3 percent; Urban Minnesota +1.4 percent.

MISSOURI
The January RMI for Missouri advanced to 51.3 from 27.1 in December. The farmland-price index slumped to 19.9 from December's 37.9. Missouri's new-hiring index rose to 49.6 from 39.6 in December. Missouri job growth over the last 12 months; Missouri Rural Mainstreet, +0.6 percent; Urban Missouri +2.2 percent.

NEBRASKA
The Nebraska RMI for January expanded to 52.6 from December's 51.4. The state's farmland-price index rose to 37.7 from December's 29.6. Nebraska's new-hiring index declined to a healthy 56.1 from 56.7 in December. Nebraska job growth over the last 12 months; Nebraska Rural Mainstreet, +0.7 percent; Urban Nebraska, +1.3 percent.

NORTH DAKOTA
The North Dakota RMI for January sank to 37.9 from December's 38.9. The farmland-price index increased to 31.2 from December's 29.9. North Dakota's new-hiring index increased to 34.0 from 32.1 in December. North Dakota job growth over the last 12 months; North Dakota Rural Mainstreet, -4.7 percent; Urban North Dakota, +0.5 percent.

SOUTH DAKOTA
The January RMI for South Dakota fell to a healthy 56.9 from December's 60.5. The farmland-price index climbed to 43.4 from December's 39.7. South Dakota's new-hiring index slipped to a healthy 58.2 from December's 60.4. South Dakota job growth over the last 12 months; South Dakota Rural Mainstreet, +0.9 percent; Urban South Dakota, +3.6 percent.

WYOMING
The January RMI for Wyoming increased to a weak 37.8 from 30.6 in December. The January farmland and ranchland-price index fell to 24.5 from December's 35.6. Wyoming's new-hiring index slipped to 42.8 December's 43.0. Wyoming job growth over the last 12 months; Wyoming Rural Mainstreet, -2.5 percent; Urban Wyoming, -4.3 percent.

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THE BULLISH NEWS

- Federal Reserve Chair Janet Yellen saw her shadow at the rate setting committee meeting in February and announced no rate hike. This was a mistake in my judgment.
- Both Creighton's and the ISM's manufacturing index (PMI) rose sharply for January.
- The nation added 227,000 jobs in January, well above expectations.

THE BEARISH NEWS

- January U.S. wages grew by only 2.5% from a year earlier, and below the 2.7% expected.
- The nation's unemployment rate for January ticked up to 4.8% from 4.7% in December.
- For the 41st straight year, 1976-2016, the U.S. ran a trade deficit.

WHAT TO WATCH

- **Repatriation:** Signals from Congress to reduce corporate tax rates on foreign earnings for U.S. corporations brought home. It will increase the value of the U.S. dollar.
- **CPI**: On Feb. 15, BLS releases CPI. YOY growth (core) above the Fed target of 2.0% for the past 14 months.
- **Jobs**: On March 10, BLS releases its February jobs report. A strong year-over-year wage growth number (>3.0%) could push the Federal Reserve to raise interest rates later in the month.

THE OUTLOOK

FROM GOSS:

- **I now put the likelihood of a Federal Reserve rate hike in Q1, 2017 at 40%. **I expect short term and long term interest rates to continue to move higher through the first quarter of 2017, albeit at a slower pace than the last quarter of 2017. **I expect wages to continue to grow, but at a faster pace approaching 3.5% annualized by the middle of 2017.

OTHER FORECASTS:

- **National Association of Business Economists (NABE)**: "Recent interest rate increases do not appear to be generating significant headwinds across firms in the NABE survey, although the reported impacts vary by sector," noted Survey Chair Emily Kolinski Morris, CBE, chief economist, Ford Motor Company. "Firms continue to face policy uncertainty, but our panelists see a mix of risks and opportunities in the potential policy agenda of the new administration." Sales increases were more widespread in the last three months of 2016 than in earlier quarters, based on responses to the latest NABE Business Conditions Survey. Nearly half (46%) of respondents report that sales rose at their firms, compared to just 10% who report a decline. The Net Rising Index (NRI)—the percentage of panelists reporting rising sales minus the percentage reporting falling sales—is 36, the highest reading in the past two years. Expectations for sales in the coming three months also increased, with an NRI of 48. Looking ahead three months, the NRI for expected sales is 48, and is also positive for all four sectors represented in the survey. Respondents from the goods-producing sector are most optimistic (an NRI of 59), closely followed by those in finance, insurance, and real estate (FIRE), with an NRI of 57. The NRI for services is 45, while the NRI for sales growth in the next three months for transportation, utilities, information, and communications (TUIC) firms is the lowest, though still positive (25)."

GOSS EGGS (RECENT DUMB ECONOMIC MOVES)

- Congressional Representative Robert Goodlatte (R-VA) via H.R. 29 has proposed repealing the U.S. income tax and replace it with "something to be thought up by 2021." I am all for cutting income taxes but this proposal makes no sense.

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This month's survey results will be released on the third Thursday of the month, Feb. 16.