THE MAINSTREET ECONOMY REPORT

January 2013

"A monthly survey of community bank CEO's"

The Federal Reserve Continues to Bail Out the Federal Government: Unmatched Debt Buying Supports Federal Overspending

Since 2008, the U.S. federal government has run yearly deficits in excess of $1 trillion and has expanded its debt to $16.4 trillion. Despite this borrowing binge, interest rates on U.S. debt hover at record lows. Why? To paraphrase former Wyoming Senator Alan Simpson, U.S. debt is the healthiest horse in the glue factory. That is, investors are lending to the U.S. Treasury because all other options are more risky. But it goes beyond this. During its 100 years of operations, the Federal Reserve (Fed) never matched its current aggressive monetary expansion activity. Since December 2008, the Fed has held its short term interest rate at close to 0%. Furthermore, the Fed has launched three bond buying programs, termed quantitative easing 1, 2 and 3 (QE1, QE2 and QE3). When the Fed Launched QE1 in November 2008, the yield (market interest rate) on U.S. 10-year U.S. Treasury bonds was 3.3 percent. QE3 was inaugurated in September 2012 with the Fed currently purchasing $85 billion per month of long-dated Treasury bonds and mortgage backed securities with the result of driving the rate on U.S. Treasury bonds to 1.8 percent. At this point in time, the Fed holds more than $3 trillion in bonds, or approximately 18 percent of total U.S. federal debt. By buying U.S. Treasury bonds and keeping interest rates artificially low, the Fed has incentivized the U.S. government to borrow and overspend. When the Fed begins to sell these bonds, which they will, interest rates will move in the opposite direction. A return to pre-QE1 interest rates would cost U.S. taxpayers as much as $240 billion per year. Who will bear this guaranteed added burden? Ernie Goss

MAINSTREET RESULTS

Rural Mainstreet Index Highest Level Since 2007: Ethanol Shutdowns Expected

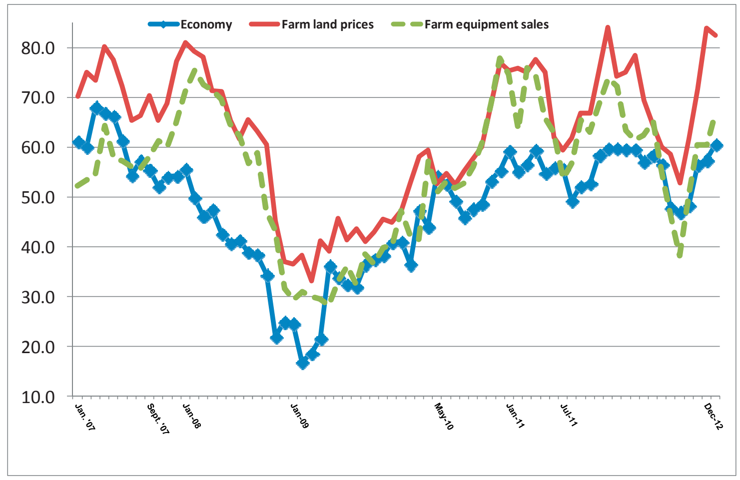
Tables 1 below summarizes the findings from the December survey with an index above 50.0 indicating growth and an index below 50.0 signifying weakness. [Index > 50.0 indicates expansion]

Table 1: The Mainstreet Economy	Dec. 2011	Nov. 2012	Dec. 2012
Area Economic Index	59.7	57.5	60.6
Loan volume	50.8	47.8	62.1
Checking deposits	68.9	75.1	75.8
Certificate of deposits	37.0	45.5	49.2
Farm land prices	84.1	83.9	83.9
Farm equipment area sales	73.8	60.4	67.0
Home sales	46.2	62.0	61.3
Hiring in the area	54.6	53.0	53.5
Retail Business	61.6	51.5	59.0
Economy 6 months from now	61.8	45.6	55.5

December Survey Results at a Glance:

- Rural Mainstreet Index climbs for a fourth straight month and to highest level since June 2007.
- Almost one-fourth of bankers expect shutdown and/or temporary closure of ethanol plants in their area.
- On average, bankers report a 15 percent growth in cash rents on farmland over past 12 months.
- Bank CEOs are reporting significant increases in borrowing to purchase farmland and farm equipment.

Rural Mainstreet, Jan. '07 – Dec. '12



For a fourth straight month, the Rural Mainstreet economy expanded according to the December survey of bank CEOs in a 10-state area. **Overall:** The Rural Mainstreet Index (RMI), which ranges between 0 and 100 with 50.0 representing growth neutral, climbed to a healthy 60.6, its highest level since June 2007, up from 57.5 in November. Very strong agriculture commodity prices and lower energy prices boosted the Rural Mainstreet business activity for the month. This is the healthiest reading that we have recorded since well before the national economic recession began in 2007.

Farming: The farmland-price index continued to show very brisk growth. The December reading dipped slightly to 82.5 from November's 83.9. This is the 35th consecutive month that the farmland-price index has risen above growth neutral. The Federal Reserve's cheap money policy is pushing agriculture land prices higher. This month we asked bankers how much cash rents for farmland changed over the past 12 months. On average, bankers reported a 15.0 percent increase in cash rents over the past year.

As a result of higher corn prices and lower ethanol fuel prices, 23.2 percent of bankers expect shutdowns or temporary closure of ethanol plants in their area. On the other hand, only 3.6 percent of bankers expect an increase in 2013 ethanol revenues from 2012 for ethanol plants in their area.

The farm-equipment-sales index bounced to 67.0 from 60.4 in November. With solid financial footing, farmers remain optimistic about future agriculture economic conditions and are expanding their purchases of farm equipment. In order to reduce costs, the 2012 drought and higher corn prices have forced ranchers to cut the size of their animal stocks. On average, the drought forced a 14.8 percent reduction in livestock herds.

Banking: After moving below growth neutral for two straight months, the loan-volume index expanded to 62.1 from November weak 47.8 and October's 44.2. The checking-deposit index advanced to 75.8 from November's 75.1, while the index for certificates of deposit and other savings instruments rose to 40.2 from 45.5 in November. Bank CEOs are reporting significant increases in borrowing to purchase farmland and farm equipment.

Larry Winum, president of Glenwood State Bank in Glenwood, Iowa as other bankers is very disappointed that Congress has failed to at least agree to vote on the TAG (transaction account guarantee) two year extension bill (S.3637). Said Winum, "The

Senate's inability to vote on an extension of bank funded FDIC coverage for non in-terest bearing accounts only benefits the large (TBTF) banks and hurts the majority of community banks and their small business customers."

Hiring: December's hiring index expanded to 53.5 from 53.0 in November. Despite recent gains in Rural Mainstreet jobs, the region's employment level is down by 3 percent from pre-recession levels.

Confidence: The confidence index, which reflects expectations for the economy six months out, expanded to 55.5 from November's much lower 45.6. Improvements in retail sales and home purchases and lower energy prices boosted banker's economic outlook.

Home and retail sales: The December home-sales index slipped to a still healthy 61.3 from November's 62.0. The December retail-sales index soared to 59.0 from 51.5 in November.

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 eco-nomic 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 approx-imately 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, CEO of CNB Community Bank of Greeley, Neb., created the monthly economic survey in 2005.

MAIN$TREET ON YOUR $TREET

COLORADO

For a third straight month, Colorado's Rural Mainstreet Index (RMI) moved above 50.0. The December RMI climbed to 55.9 from 51.8 in November. The farmland and ranchland price index increased to 70.7 from No-vember's 63.1. Colorado's hiring index for December was 44.9, up from 38.9 in November.

ILLINOIS

For a third consecutive month, the RMI for Illinois moved above growth neutral. The December index dipped to 65.2 from November's 65.9. Farmland prices bounced higher with a reading of 84.2, up from November's 79.5. The state's new-hiring index increased to 53.9 from a weak 49.8 for November.

IOWA

The December RMI for Iowa advanced to 63.6 from 61.3 in November. The farmland-price index expanded to 84.2 from November's 80.1. Iowa's new-hiring index for December increased to 53.9 from November's 50.2.

KANSAS

The Kansas RMI for December climbed to 67.7 from November's 63.1. The farmland-price index rose to 82.6 from November's 82.3. The state's new-hiring index increased slightly to 52.8 from 51.7 in November. Said Dale Bradley, CEO of the Citizens State Bank in Miltonvale, "Weather and economy are the key component for our area farmers in 2013. Dale Bradley-CEO

MINNESOTA

The December RMI for Minnesota rose to 69.6 from 63.0 in November. Minnesota's farmland-price index bounced to 87.7 from 84.6 in November. Minnesota's new-hiring index advanced to 56.2 from November's 53.2. Pete Haddeland, CEO of First National Bank in Mahnomen, said, "Very mild winter here, but very little snow. We have seen little or no effects of pending fiscal cliff.

MISSOURI

The December RMI for Missouri climbed to 58.7 from 55.5 in November. The farmland-price index for December increased to 72.2 from November's 56.7. Missouri's new-hiring advanced to 45.9 from 34.6 in November.

NEBRASKA

For a third consecutive month, Nebraska's rural economy moved into positive territory. The December RMI dipped to 57.4 from 57.7 in November. The farmland-price index slipped to 84.6 from November's 86.2. Nebraska's new-hiring index increased to 54.2 from November's 51.3.

NORTH DAKOTA

The North Dakota RMI for December advanced to a regional high 88.3 from 86.7 in November. The farmland-price index declined to 84.5 from November's 89.5. North Dakota's new-hiring index decreased to 84.9 from November's 88.3.

SOUTH DAKOTA

The December RMI for South Dakota increased to 61.3 from 57.7 in November. The farmland price index decreased to 81.6 from 85.6. South Dakota's new-hiring index for December expanded to 52.2 from 48.0 in November.

WYOMING

The December RMI for Wyoming declined to 59.1 from 60.6 in November. The December farmland and ranchland price index expanded to 80.6 from November's 79.2. Wyoming's new-hiring index climbed above growth neutral with a December reading of 51.5 from 49.6 in November.

THE BULLISH NEWS

- Nonfarm payroll employment rose by 155,000 in December, and the unemployment rate was unchanged at 7.8%. Health care employment continued to expand in December (+45,000). Job gains occurred in ambulatory health care services (+23,000), in hospitals (+12,000), and in nursing and residential care facilities (+10,000). In 2012, health care employment rose by 338,000.
- The Consumer Price Index declined 0.3% in November. Over the last 12 months, the all items index increased 1.8%. This is well within acceptable bounds.
- According to the Case-Shiller home price index for October, U.S. home prices (year over year) increased for a fifth straight month.

THE BEARISH NEWS

- Construction spending for November 2012 was estimated to have declined by 0.3% from October's level.
- U.S. retail and food services sales for November, adjusted for seasonal variation and holiday and trading-day differences, increased by 0.3% from October and were 3.7% higher than November 2011. This is only slightly above inflation growth..
- Exports decreased to $180.5 billion in October from $187.3 billion in September. This is a potentially troubling signal

of slower global growth.

- The Conference Board Consumer Confidence Index®, which had declined slightly in November, posted another decrease in December. The Index now stands at 65.1 from 71.5 in November. The Expectations Index declined sharply to 66.5 from 80.9.

WHAT TO WATCH

- **GDP:** On Jan. 30, the U.S. Bureau of Economic Analysis releases its advance estimate for GDP growth for Q4, 2012. An annualized and seasonally adjusted growth rate above 2.5% will be very bullish. A growth rate below 1.5% will be very bearish.

- **PMI's:** On Feb. 1, Creighton releases its regional leading economic indicator (PMI) and the national Institute for Supply Management releases its national PMI. A large decline would be very bearish for the economy.

- **Jobs:** On Friday Feb. 1, the U.S. Bureau of Labor Statistics (BLS) will release the employment report for January. Watch out for a negative "surprise." Everybody is "all in" for an expanding economy. Job additions below 50,000 or an unemployment rate of 8.0% will be very bearish.

THE OUTLOOK

FROM GOSS:

- I expect inflation to pick up in 2013 (though it will remain below 3.1%)

- As a result of higher inflation and larger and larger federal budget deficits, the era of record low long-term interest rates is over. Mortgage rates will likely rise by one percent by the middle of 2013.

- U.S. unemployment rates will fail to move lower even as jobs are added.

OTHER FORECASTS:

- The Conference Board (2013 Outlook): "Across the advanced economies, the Outlook predicts 1.3 percent growth in 2013, compared to 1.2 percent in 2012. The slight uptick is largely due to the Euro Area, which is expected to return to very slow growth of 0.2 percent after the -0.6 percent contraction in 2012. U.S. growth is expected to fall from 2.1 percent in 2012 to 1.8 percent in 2013." The Conference Board expects: housing starts to expand by 16 percent for the first six months of 2013 compared to the last six months of 2012.

- Dodd-Frank cited as reason for closure of healthy community bank. COLUMBIA, Mo. (Legal Newsline). When this small-town bank in a vibrant Midwestern college town announced in early September 2012 that it would be closing due to increased federal regulations, the community and financial industry felt ripples of shock and dismay. Shelter Financial Bank was considered to be very well-capitalized. http://legalnewsline.com/in-the-spotlight/238624-dodd-frank-cited-as-reason-for-healthy-community-bank-closure

GOSS EGGS (RECENT DUMB ECONOMIC MOVES)

- The recently passed fiscal cliff tax package is loaded with breaks for Hollywood, rum makers and wind mills. The $248 million Hollywood gift does disallow credits for the production of sexually explicit content. Instead your tax dollars will support more uplifting programs such as Jersey Shore (sex out ignorance in).

FOLLOW ERNIE

Follow Ernie Goss on Twitter www.twitter.com/erniegoss

For historical data and forecasts, visit our website at: http://www2.creighton.edu/business/economicoutlook/
For ongoing commentary on recent economic developments, visit our blog at: www.economictrends.blogspot.com