THE MAINSTEET ECONOMY REPORT

"A monthly survey of community bank CEO's"

January 2015

Increasing Income Inequality: No Diploma, Births to Unmarried Women, and Higher Taxes Boost Inequality

Over the past two decades, U.S. income inequality, as measured by the Gini Coefficient (GC), has risen dramatically. This has resulted in a parade of politicians calling for taxing high income workers more heavily as a remedy. However, data from the states undermine this simplistic strategy. In 2011, states with the least income inequality were: Utah with the least, followed by Alaska, Wyoming, New Hampshire, and Iowa. The five states, including DC, with the greatest income inequality were: District of Columbia with the highest followed, by New York, Connecticut, Massachusetts and Louisiana. Importantly, three of the states with the least income inequality, Alaska, Wyoming and New Hampshire had no income tax. Furthermore, the latest tax rankings (1=highest taxes) from the National Tax Foundation show that the states with the least inequality with (tax rankings) were: Utah (28), Alaska (49), Wyoming (50), and Iowa (29). The states with the greatest degree of income inequality had rankings of: DC (20), New York (1), Connecticut (3), Massachusetts (11) and Louisiana (46). Thus, all of the states with greatest inequality, except for Louisiana, had state and local tax burdens in the top half of all states. Additionally, all of the states with the least income inequality ranked in the bottom half of states in terms of state and local tax burdens. In order to sort out the factors that contribute to income inequality, Gini Coefficients are statistically modeled against other state population characteristics. It was found that statistically speaking, only the percent of the state population without a high school diploma and percent of births to unmarried women contributed to income inequality. Higher state and local tax burdens did boost income inequality, but the impact was not statistically significant. Ernie Goss. Analysis available at: http://www.economictrends.blogspot.com/2015/01/increasing-income-inequality-no-diploma.html.

MAINSTREET RESULTS

Rural Mainstreet Index Remains Weak for December
Farmland Prices Decline for 13th Straight Month

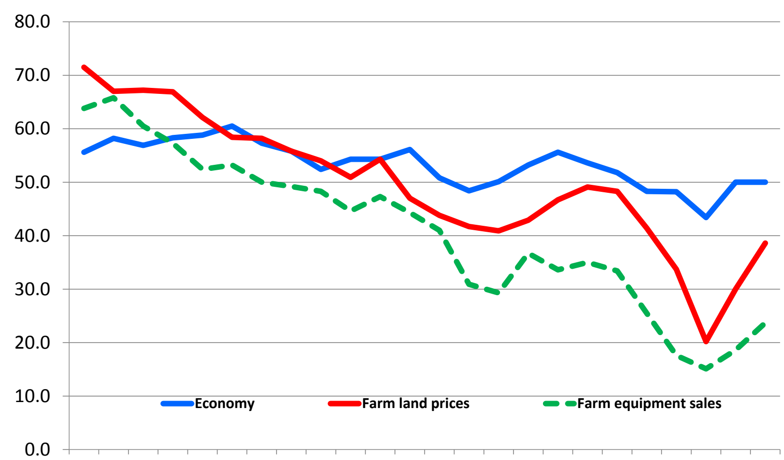
Tables 1 below summarizes the findings from this month's survey with an index above 50.0 indicating growth and an index below 50.0 signifying weakness. [Index > 50.0 indicates expansion]

Table 1: The Mainstreet Economy	Dec 2013	Nov 2014	Dec 2014
Area Economic Index	56.1	50.0	50.0
Loan volume	66.7	56.2	76.7
Checking deposits	66.0	57.9	62.1
Certificate of deposits	37.2	37.5	44.0
Farm land prices	47.0	30.0	38.6
Farm equipment area sales	44.3	18.6	23.7
Home sales	53.1	51.0	51.7
Hiring in the area	56.9	61.9	55.2
Retail Business	54.7	50.0	55.3
Economy 6 months from now	47.0	44.7	42.5

Survey Results at a Glance:

- The Rural Mainstreet Index was unchanged from November's weak growth reading.
- Farmland prices sank for the 13th straight month.
- Almost two-thirds of bankers are opposed to Fannie Mae's plans to reduce down payment requirements on housing purchases.
- Farm-equipment sales declined for the 16th consecutive month.
- Almost one-third of bank CEOs expect holiday retail sales in their area to be unchanged from 2013 levels.

Rural Mainstreet Economy January '13 – Dec. '14



The Rural Mainstreet Index for December was unchanged from November's 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, for December was 50.0, unchanged from November, but up from 43.4 in October. Lower energy and grain prices continue to restrain growth in the rural economy.

Farming and ranching: The farmland and ranchland-price index for December advanced to a weak 38.6 from November's 30.0. Much weaker crop prices continue to take the air out of the bubble in agricultural land prices. This is the 13th straight month that the index has moved below growth neutral.

The December farm-equipment sales index expanded to 23.7 from 18.6 in November. The index has been below growth neutral for 17 straight months. This month, we asked bankers how they expected farmers to adjust their expenses to the likelihood of lower revenues. Approximately 63.6 percent expect farmers to put off equipment purchases even more due to predicted revenue decline.

In anticipation of lower farm revenues, almost one in five bankers, or 18.2 percent, anticipates that farmers will cut cash rents, 7.3 percent expect farmers to wait for better seed deals, and 3.6 percent and 7.3 predict less fertilizer and chemical usage.

Write to us at ernieg@creighton.edu

Howard Schaan, CEO of First State Bank of Harvey, N.D., said, "We have seen some temporary decreases in rents based on low commodity pricing."

Banking: The December loan-volume index soared to 76.7 from November's solid 56.2. The checking-deposit index expanded to 62.1 from November's 57.9, while the index for certificates of deposit and other savings instruments grew to a weak 44.0 from last month's 37.7.

Hiring: Despite weaker crop prices and pullbacks from businesses with close ties to agriculture and energy, rural Mainstreet businesses con-tinue to hire at a solid pace. The December hiring index slipped to a solid 55.2 from November's very healthy 61.9. Businesses on Rural Mainstreet continue to add jobs at a healthy pace even with the weaker agriculture conditions and lower energy prices. Year-over-year job growth for the region is now approximately 1.8 percent, which is well above the historic average.

Confidence: The confidence index, which reflects expectations for the economy six months out, sank to 42.5 from 44.7 in November. Much weaker crop prices and declines in energy prices have negatively affected the outlook of bank CEOs over the last several months.

Larry Rogers, executive vice-president of First Bank of Utica in Utica, Neb., said, "(I) did not expect crop prices to drop this far and we really are not sure what the six-month to one-year effect will be."

Home and retail sales: The December home-sales index grew to a tepid 51.7 from November's 51.0. The December retail-sales index re-bounded to 55.3 from 50.0 in November.

This month, Fannie Mae and Freddie Mac announced plans to allow first-time homebuyers to pay a down payment as little as 3 percent on a home purchase. Many bankers expressed concerns regarding such a program, including Jeff Bonnett, president at Havana National Bank in Havana, Ill., who said, "I still have a bad taste in my mouth regarding 'subprime lending' that helped create the 'Great Recession' that we are just now getting out of."

Bankers were asked to assess the 2014 holiday retail-buying season in their area. Approximately 5.2 percent expect the strongest buying season since the recession, 60.3 percent predict that the gain for 2014 will be the same as the gain for 2013, and 32.8 percent expect little or no increase from 2013 buying. The remaining 1.7 percent of bankers anticipates the weakest buying season since the beginning of the recession.

According to Pete Haddeland CEO of the First National Bank in Mahnomen, Minn., "We are seeing increased spending for the holidays be-cause of the reduction in gasoline 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 In-dependent Community Banks of America, created the monthly economic survey in 2005

MAIN$TREET ON YOUR $TREET

COLORADO
Colorado's Rural Mainstreet Index (RMI) remained above the 50.0 threshold for the 10th straight month, though the index dipped to 52.5 from November's 53.8. The farmland and ranchland-price rose to 48.6 from November's 46.5. Colorado's hiring index for December declined to a healthy 62.3 from 72.5 in November. Colorado Rural Mainstreet job growth for the past 12 months was 3.9 percent.

ILLINOIS
The state's RMI slipped to 49.4 from November's 49.7. The Illinois farmland-price index expanded to 36.9 from 26.2 in November. The new-hiring index fell to 52.9 from 56.3 in November. Illinois Rural Mainstreet job growth for the past 12 months was 0.8 percent.

IOWA
The December RMI for Iowa decreased to 48.6 from November's 49.8. The state's farmland-price index for December expanded to 35.1 from 30.2 in November. Iowa's new-hiring index for December slumped to 51.5 from November's 59.5. Iowa Rural Mainstreet job growth for the past 12 months was 1.0 percent.

KANSAS
The Kansas RMI for December climbed to 50.6 from November's 50.2. The state's farmland-price index increased to 40.6 from November's 34.6. The new-hiring index for Kansas sank to 55.9 from 63.0 in November. Kansas Rural Mainstreet job growth for the past 12 months was 2.0 percent.

MINNESOTA
The December RMI for Minnesota advanced to 51.0 from November's 49.7. Minnesota's farmland-price index grew to 41.6 from 36.8 in November. The new-hiring index for the state fell to a solid 56.7 from November's 75.7. Minnesota Rural Mainstreet job growth for the past 12 months was 2.4 percent.

MISSOURI
The December RMI for Missouri declined to 54.3 from November's 56.2. The farmland-price index expanded to 63.3 from November's 50.5. Missouri's new-hiring index decreased 74.1 from 75.7 in November. Missouri Rural Mainstreet job growth for the past 12 months was 5.7 percent.

NEBRASKA
The Nebraska RMI for December advanced to 48.8 from 48.3 in November. The state's farmland-price index expanded to 32.9 from 21.5 in November. Nebraska's new-hiring index sank to 49.7 from November's 52.5. According to Jon Schmaderer, CEO of Tricounty Bank in Stuart, "Higher livestock prices are strengthening the economy in north-central Nebraska." Nebraska Rural Mainstreet job growth for the past 12 months was 0.2 percent.

NORTH DAKOTA
The North Dakota RMI for December slipped to 56.7 from November's 57.0. The farmland-price index climbed to 71.7 from 61.5 in November. North Dakota's new-hiring index dipped to 80.8 from November's 84.5. North Dakota Rural Mainstreet job growth for the past 12 months was 8.1 percent

SOUTH DAKOTA
The December RMI for South Dakota rose to 49.6 from November's 49.0. The farmland-price index for December increased to 37.6 from last month's 31.4. South Dakota's new-hiring index slumped to 53.5 from 60.4 in November. South Dakota Rural Mainstreet job growth for the past 12 months was 1.0 percent.

WYOMING
The December RMI for Wyoming slipped to 50.5 from November's 51.0. The December farmland and ranchland-price index grew to 42.8 from November's 36.2. Wyoming's new-hiring index sank to 57.7 from November's 64.3. Wyoming Rural Mainstreet job growth for the past 12 months was 1.9 percent.

THE BULLISH NEWS

- The U.S. economy added 321,000 jobs in November. Over the past 12 months, the economy has added an aver-age of 224,000 jobs per month. This is very good. The problem is that many of these jobs are temporary, part-time or in low wage occupations.
- The consumer price index (CPI) for Nov. was 1.3% higher than the reading for Nov. 2013. This is a good but on the low end of the Fed's targeted 2%. Lower gasoline prices are holding price growth below optimum.
- In the 12 months ending in Oct. 2014, the Case-Shiller index indicated that average U.S. home prices rose by 4.5%. This is good but I am concerned that the growth in the index is coming down too fast.
- U.S. retail sales expanded by 0.7% in Nov. and were 5.1% above sales for Nov. 2013.

THE BEARISH NEWS

- Year over year wage growth for U.S. workers were 2.1% higher in November. This is just not high enough to really propel the U.S. economy back into solid growth range.
- The Euro is near a 9-year low against the U.S. dollar. Concern that Greek elections will re-install left leaning politicians who reject austerity and embrace more spending.

WHAT TO WATCH

- **GDP:** On Jan. 30, the U.S. BEA releases preliminary estimate of Q4 GDP. Annualized growth of less than 2.5% will be very disappointing and give bond prices a boost and push interest rates lower.
- **Retail trade:** On Jan. 14, the Census Bureau releases retail sales for December. This will be an important gauge of the U.S. consumer. A year over year gain of more than 5.5% will be bullish for the U.S. economy and U.S. stocks and bearish for bond prices (higher yields).
- **Wage data:** On Friday Jan. 14 and Feb. 6, the U.S. Bureau of Labor Statistics (BLS) will hourly wage growth numbers.

Year over year wage growth over 2.5% will encourage the Federal Reserve to raise short term interest rates earlier than expected. Currently the market expects a rate hike in June 2015.

THE OUTLOOK

FROM GOSS:

- I expect Mario Draghi, head of the European Central Bank, to make the same mistake made by the U.S. Federal Reserve by launching a sovereign bond buying program. The European economy does not need lower interest rates. German bond rates are already as low as 0.5% (yes you read that right). Europe needs structural economic reform that encourages work rather than leisure. This is outside the purview of the ECB.
- The U.S. trade deficit is about to soar. If your business depends on exports, it is going to be tougher in the months ahead.

OTHER FORECASTS:

- National Association of Business Economics (NABE): "Economists participating in NABE's December 2014 Outlook Survey expect economic growth to accelerate in 2015," according to NABE President John Silvia, chief economist of Wells Fargo. "The NABE panelists' median forecast is for real GDP growth to measure 3.1% on an annual average basis next year, a marked improvement from the 2.2% growth rate currently expected for 2014. On a Q4/Q4 basis, the panel's median forecast is for real GDP to climb 2.2% in 2014 and 2.9% in 2015. The Outlook Survey panelists anticipate the solid pace of output growth will be accompanied by continued labor market firming, with nonfarm employment expanding by nearly 220,000 jobs per month next year and the unemployment rate falling to 5.4% by the fourth quarter of 2015. These views are slightly more optimistic than those expressed in NABE's previous Outlook Survey released in September."

GOSS EGGS (RECENT DUMB ECONOMIC MOVES)

- Crippling cargo backups at U.S. West Coast ports stretched into a third month. The slowdowns have coincided with prolonged labor talks between 20,000 dockworkers and the Pacific Mari-time Association. This is forcing some shippers to abandon U.S. ports for Canada ports such as Prince Rupert. This will do permanent damage to ports like Los Angeles' and jeopardize U.S. union jobs.

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This month's survey results will be released on the third Thursday of the month, Jan. 15