THE MAINSTEET ECONOMY REPORT

"A monthly survey of community bank CEO's"

November 2014

Divided Government and Economic Performance: Evidence from the States

The 2012 elections saw a significant decline in the number of state governments with executive and legislative powers divided between Democrats and Republicans. Between 2012 and 2014, only 13 states were split, while 14 state governments were governed solely by Democrats, and 23 states led by Republicans—the lowest number of states with divided governments since 1952, when there were only 8 splits. Did states with split governments economically outperform those with unified power? Over the last 2 years, GDP growth of 2.9% for split states lagged behind the 3.5% growth for Democrat states and the 3.7% growth for Republican states. During the same time period, Wage growth for split states increased by 6.9%, behind both Democrat states with 8.1% and Republican states with 7.8%. Likewise, the past 2 years saw private job expansion in split states of 2.6%, with Democrat states expanding jobs at the rate of 3.7%, and Republican states growing jobs at a rate of 3.9%. In terms of 2013 State & Local tax burdens, of the 10 states with the lowest tax burdens, 3 were split states, one was Democrat-led and 6 were led by Republicans. Likewise, in terms of expanding the size of state and local government as measured by state and local government wages, Democrat states expanded by 5.8% and split states climbed by 3.2%, while Republican states rose by a smaller 2.9%. Thus, Democrat states appear to clearly expand the size of state and local government, along with the accompanying tax burden, while Republican states clearly grow the size of state and local government and the related tax burden at a slower pace. Split states fall somewhere between Democrat and Republican states. As data in this essay indicate, the political party composition of a state's executive and legislative branches, whether unified with Democrat or Republican leadership or governed by split branches of government, influences economic performance and the size state and local government. Ernie Goss

MAINSTREET RESULTS

October's Rural Mainstreet Index Plummets: Farmland Price Index Sinks to Record Low

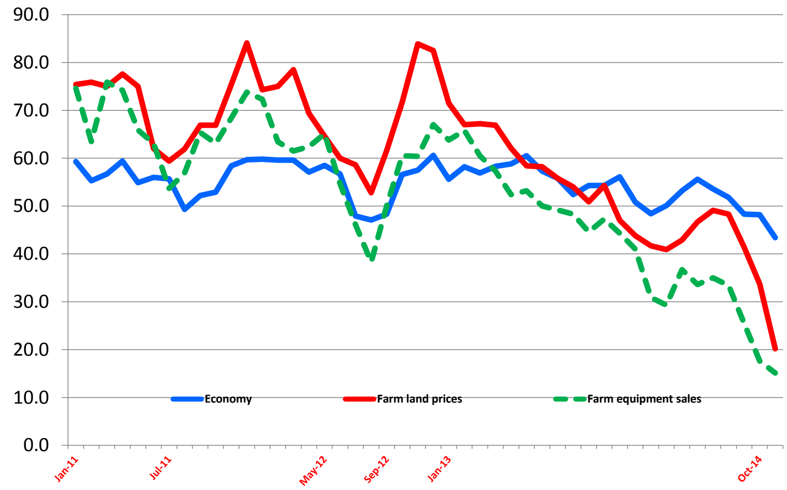
Tables 1 below summarizes the findings from this month's survey with an index above 50.0 indicating growth and an index below 50.0 signifying weakness. [Index > 50.0 indicates expansion]

Table 1: The Mainstreet Economy	Oct 2013	Sep 2014	Oct 2014
Area Economic Index	54.3	48.2	43.4
Loan volume	64.7	75.9	71.7
Checking deposits	48.3	56.4	49.1
Certificate of deposits	35.4	42.8	40.4
Farm land prices	50.9	33.7	20.2
Farm equipment area sales	44.6	17.6	15.1
Home sales	58.0	57.3	49.0
Hiring in the area	56.1	56.5	55.7
Retail Business	52.6	49.9	44.4
Economy 6 months from now	44.7	33.4	34.6

Survey Results at a Glance:

- Rural Mainstreet Index fell for the fifth straight month to its lowest level in more than four years.
- Farmland prices declined for the 11th straight month, while the index sank to a record low reading.
- On average bank CEOs expect farmland prices to decline by 5 percent over the next year.
- For a third straight month farm-equipment sales declined to a record low level.
- Bankers reported no change in share of farmland sales financed since June of this year.

Rural Mainstreet Economy January '11 – October '14
Creighton University



The Rural Mainstreet Index moved to its lowest level in more than four years, according to the October survey of bank CEOs in rural areas of a 10-state region dependent on agriculture and/or energy. The index has been trending lower since June 2013 when the reading stood at 60.5.

Overall: The Rural Mainstreet Index (RMI), which ranges between 0 and 100, with 50.0 representing growth neutral, sank to 43.4, its lowest level since February 2010, and down from September's 48.2.

"The stronger U.S. dollar, weaker global growth and abundant supplies have pushed U.S. grain prices down by more than 30 percent over the last 12 months. This has weakened the farm economy. Furthermore, the same factors have weakened oil prices and I expect these lower prices to begin negatively affecting areas of the region heavily dependent on energy commodity sales.

Even so, some farmers have been protected from current low commodity prices. As indicated by Jeff Bonnett, president of Havana National Bank in Havana, Ill., "Many of our farm operators had sold a good portion of their (current) corn at $5, or a little over, going into this farm year. That will work in their favor with corn prices hovering between $2.75 to $3 at this time."

Farming and ranching: The farmland and ranchland-price index for October slumped to 20.2, the lowest level since initiation of the survey in January 2006, and down from September's 33.7. Much weaker crop prices continue to take the air out of the bubble in agriculture land prices. This is the 11th straight month that the index has moved below growth neutral.

According to Michael Johnson, CEO of the Swedish American Bank in Courtland, Kan., "A quarter section of irri-gated land sold last week. Price was down 25 to 30 percent. Most likely a result of much lower crop prices."

Fritz Kuhlmeier, CEO of Citizens State Bank in Lena, ILL said, "Reduced commodity prices will stop farmland price increases and begin an erosion, especially in lower quality dirt, as well as driving cash rents slowly lower."

The October farm-equipment sales index slumped to a record low 15.1 from 17.6 in September, also a record low. The index has been below growth neutral for 15 straight months. This is lowest reading that we have recorded for the equipment index since we began the monthly survey in 2006. The more than 30 percent decline in agriculture commodity prices has pushed farmers to significantly shrink their equipment purchases.

This month bankers were asked to project farmland price changes for the next year. More than three-fourths of the bank CEOs expect farmland prices to decline over the next year with an average decline of 5 percent reported. Additionally, bankers expect cash rents to decline by an average 3.4 percent over the next year. This is down from an expected gain of one percent recorded in March of this year.

Furthermore, according to Jim Ashworth, president of CNB Bank Shares of Carlinville, Ill., "Although grain yields are very high, depressed prices could result in a decline in cash rents and land prices next year for the first time in many years."

Banking: The October loan-volume index dipped to a still strong 71.7 from 75.9 in September. The checking-deposit index slipped to 49.1 from September's 56.4, while the index for certificates of deposit and other savings instruments moved to a weak 40.4 from last month's 42.8.

According to bankers, there has been little change in the proportion of farmland purchases for cash. Approximately one-fourth of farmland sales in October and June were not financed. It is surprising that as crop prices have dete-riorated, there has not been a significant change in the share of farmland purchases that are financed.

Jim Eckert, president of Anchor State Bank in Anchor, Ill., said, "Declines in crop prices will be a damper on farm borrowings and incomes for the foreseeable future."

Hiring: Rural Mainstreet businesses continue to hire at a solid pace, though the October hiring index declined to a solid 55.7 from September's 56.5. Businesses on Rural Mainstreet continue to add jobs at a healthy pace even with the weaker agriculture conditions. Year-over-year job growth for the region is approximately 1.3 percent, which is well above the historic average. I do expect this pace to weaken in the months ahead.

Confidence: The confidence index, which reflects expectations for the economy six months out, rose to a very weak 34.6 from 33.4 in September. Much weaker agriculture commodity prices negatively affected the outlook of bank CEOs over the last several months.

Home and retail sales: The October home-sales index dipped to a 49.0 from September's 57.3. The October retail sales index decreased to 44.4 from 49.9 in September. Much like the national economy, the Rural Mainstreet economy is experiencing sub-par retail buying conditions.

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 approxi-mately 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) remained above the 50.0 threshold for the eighth straight month, with the index advancing to 52.1 from 51.8. The farmland and ranchland-price index fell to 38.2 from September's 55.9. Colorado's hiring index for October dropped to 66.9 from 72.7 in September.

ILLINOIS
For a fourth straight month, Illinois' RMI fell, moving to 39.4 from September's 41.2. The state's farmland-price index sank to 17.9 from 31.1 in September. The new-hiring index fell to 50.7 from 52.8 in September. As indicated by Jeff Bonnett, president of Havana National Bank in Havana, "Overall we expect the majority of our farmers to cash flow their 2014 crop. Going forward, we cannot have a sustained period (more than 3 years) of such low commodity pricing, 2015 looks to be a challenging year for farming and farm financing."

IOWA
The October RMI for Iowa sank to 40.5 from September's 47.2. The state's farmland-price index for October slumped to 18.9 from 34.1 in September. Iowa's new-hiring index for October slipped to 53.9 from September's 55.2. James Brown, president of Hardin County Savings Bank in Eldora, reported, "We are just beginning to see recognition from farmers that cash rent prices need to be renegotiated and land prices will drop at least 10 percent."

KANSAS
The Kansas RMI for October sank to 43.9 from September's 50.3. The state's farmland-price index for October dropped to 26.3 from September's 38.7. The state's new-hiring index fell to a still solid 57.4 from 58.9 in September.

MINNESOTA
The RMI for Minnesota declined to 44.2 from September's 50.9. Minnesota's farmland-price index for October plummeted to 28.5 from 41.2 in September. The new-hiring index for the state decreased to 59.2 from September's 60.9. Pete Haddeland, CEO of the First National Bank in Mahnomen, said, "We think cropland prices have peaked in our area. Cash rents will slowly decline."

MISSOURI
The October RMI for Missouri sank to 41.2 from September's 47.8. The farmland-price index for October plummeted 18.6 from September's 54.1. Missouri's new-hiring index fell to 54.5 from 71.2 in September.

NEBRASKA
The Nebraska RMI for October fell to 43.0 from 44.3 in September. The state's farmland-price index for October sank to 13.1 from

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23.8 in September. Nebraska's new-hiring index decreased to 46.9 from September's 47.0.

NORTH DAKOTA
The North Dakota RMI for October decreased to 53.4 from September's 55.9. The farmland-price index fell to 53.2 from 65.1 in September. North Dakota's new-hiring index was unchanged from September's 62.5.

SOUTH DAKOTA
The October RMI for South Dakota slumped to 44.1 from September's 49.6. The farmland-price index for October dropped to 15.8 from last month's 32.8. South Dakota's new-hiring index advanced to 54.9 from 54.2 in September.

WYOMING
The October RMI for Wyoming sank to 44.4 from September's 50.5. The October farmland and ranchland-price index fell to 19.2 from September's 31.2. Wyoming's new-hiring index for October rose to 52.4 from September's 50.5.

THE BULLISH NEWS

- The U.S. economy added 214,000 jobs in October and the unemployment rate ticked down to 5.8% from 5.9% in September.
- As tax revenues increased and spending cuts took effect, the 2014 budget deficit dropped to the lowest level in six years.
- Third quarter GDP growth (annualized) came in above 3.0%. While not vigorous, it is better than we have been seeking.

THE BEARISH NEWS

- Overall, wages were up 2% for the 12 months ended in October. That was a bit better than the 1.7% inflation rate, but not nearly enough growth to make up for the ground lost during the Great Recession.
- The S&P/Case Shiller composite index gained 5.6% in August over last year, the slowest year-on-year increase since November 2012.
- Although the number of people out of work six months or longer has fallen 28% over the past year, some 3 million can't find a full-time job. That's still higher than anytime before the 2007-2009 recession.

WHAT TO WATCH

- **Case-Shiller Home Price Index:** On the last Tuesday of the month, the Case-Shiller home price index will be released. Another significant decline in the growth number will be a warning signal for the housing market. Year over year growth above 5.0% will be good.
- **Jobs:** On Friday Dec. 5, the U.S. Bureau of Labor Statistics (BLS) will release employment report for November. Another strong report (job additions above 200.000) will push the Fed to raise interest rates sooner than expected.
- **Wage data:** On Friday Dec. 5, the Bureau of Labor Statistics, as part of its employment report, releases its wage number. Year over year growth of 2.0% or less will encourage the Federal Reserve Bank to keep short term interest rates low until the middle of 2015. Above 2.0% could be an early warning signal of rate increases earlier than that time.

THE OUTLOOK

FROM GOSS:

- Well, I was dead wrong on my Q3 GDP growth forecast. I expected 2% or less and it was above 3%. There is too much weakness in the farm and energy sectors to expect Q4 growth numbers to come in above 2% or even close to Q3.
- I expect housing prices growth to continue to move lower, but remain positive.
- Part-time job creation will continue to be a big part of U.S. employment growth.

OTHER FORECASTS:

- National Association of Business Economics (NABE): "Business conditions continued to improve during the third quarter, albeit at a marginally subdued pace from that of the second quarter, and the majority of the NABE Business Conditions Survey panelists report strong expectations for continued economic growth," said NABE President John Silvia, chief economist for Wells Fargo Securities. "Results from NABE's October 2014 Business Conditions Survey suggest that growth is continuing at a majority of survey respondents' organizations, with an increasing number of panelists also reporting employment growth and less difficulty in filling open positions. The number of respondents reporting increasing profit margins at their firms fell only slightly. There continues to be little change in the share of respondents reporting higher materials costs in the third quarter or expecting higher costs in the fourth quarter. A growing share of respondents does report that they expect future price increases at their firms as the economy continues to strengthen. The majority of respondents expects the economy to continue to grow in the 2-3 percent range."

GOSS EGGS (RECENT DUMB ECONOMIC MOVES)

- Senators Harry Reid (D. NV), Dick Durbin (D. IL) and Mike Enzi (R, WY) have led a bipartisan coalition in the U.S. Senate to force online merchants to collect sales taxes on tens of thousands of items. If passed this bill would bury small online suppliers who could not afford the audits and other compliance measures that would ultimately be required.

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