Welcome to our February report covering January survey results. Follow my daily comments at: www.twitter.com/erniegoss

Federal Subsidies Fuel College Costs Up 5 Times Inflation Rate

Since 1981, U.S. Bureau of Labor Statistics data show that college tuition and fees have soared by 714.3 percent while all other items consumed by the average household increased by a more moderate 141.0 percent. Reacting to this shocking trend, President Obama, in his State of the Union address, threatened higher educational institutions with sanctions if they continued to boost tuition at this alarming rate. Contrary to the President's rhetoric, the federal government, by increasing federal financial assistance by almost 20 percent since 2009, has been one of the chief culprits allowing colleges to shift a large share of rising costs to the taxpayer. Moreover, the President boosted the federal "bailout" or subsidization of higher education by 1) Allowing borrowers to cap their student loan payments at 10 percent of discretionary income and waiving any loan balance remaining after 20 years. 2) Doubling the number of work-study jobs available, 3) Implementing the American Opportunity Tax Credit which provides up to $10,000 for four years of college. 4) Asking Congress to subsidize record low student loan interest rates. Despite rapidly rising federal support, colleges have increased the share of courses taught by part-time faculty from 34 percent in 1981 to 49 percent in 2009. Furthermore, colleges raised average faculty salaries by a scant 2.7 percent per year over the past six years. During this same period of time, the growth rate in outlays for student services (e.g. athletics, counseling) was almost double that of expenditures for instruction. Data show that colleges have used federal government support to underwrite a disproportionate growth in funds for non-academic spending and a sharp increase in tuition and fees. There is a strong correlation over time between student and parent loan availability and rapidly rising tuitions. Similar to housing, the federal government is putting air in another bubble—this time it is higher education. Ernie Goss.

LAST MONTH'S SURVEY RESULTS

Mid-America Leading Economic Indicator Soars for January: Higher Energy Prices Biggest Threat

SURVEY RESULTS AT A GLANCE

- Leading economic indicator soars for January with the biggest jump since October 2009.
- Approximately one in five supply managers indicated that farm income growth was contributing to their companies' expansion.
- Almost half of supply managers gauge higher energy prices as the biggest economic threat for 2012.
- Business confidence index soars

The Business Conditions Index for the nine-state, Mid-America region took its biggest jump since October 2009. The index, a leading economic indicator from a monthly survey of supply managers, points to improving growth for the region for the next three to six months. Overall index: The index, which ranges between 0 and 100, rose to 56.0 from December's 50.0 and November's 52.6. It now appears that December's tepid reading was due to seasonal or non-recurring factors such as flooding in Thailand. Over the last several months, reading from the surveys point to an advancing economy but with several risks factors that could derail the expansion. For much of the region very healthy farm income has been an important driver of overall economic growth. Almost one in five, or 19 percent, of supply managers reported that growth in farm income has been an important factor pushing their firm's growth higher. In terms of risk factors, this month almost half, or 46 percent, assessed rising energy prices as the greatest threat to growth prospects for their firm. Another 21 percent reported that mounting federal regulations posed the biggest impediment to expansions while 20 percent indicated that global supply disruptions would be the largest threat to expanding business. No other factor rose into double digit threat according to January responses. As one supply managers reported, "Rising energy prices are a given. Regulations can come out of the blue."

Employment: For the first time since July, the employment index climbed above growth neutral. The hiring gauge increased to a healthy 55.2 from December's 49.5. While surveys over the past several months indicate that job growth in the region has slowed significantly, January's reading is clearly good news on the employment front. However, I will have to see several months of similar readings to be assured that the labor market is back on a solid growth path. Despite adding approximately 140,000 jobs over the past 12 months, regional employment is still down from the region's pre-recession level by almost 360,000 jobs. At the current rate of job additions, it will take another 18 months to return to the pre-recession regional job level. North Dakota's and South Dakota's current employment level exceeds it pre-recession levels with Nebraska and Oklahoma expected to return to pre-recession levels before the end of 2012.

Wholesale Prices: The prices-paid index, which tracks the cost of raw materials and supplies, rose to 68.2 from 62.4 in December. As the economic outlook has improved, so have price pressures. Last week the U.S. Federal Reserve indicated that they would maintain current record low short term interest rates until 2014. In my judgment, this pro-growth stance poses significant inflation risks. This month we asked supply managers to project price increases for the product they buy for the next six months. On average, supply managers expect prices to advance by 2.9 percent in the next six months or approximately 5.8 percent annualized. This is much too high for the Fed to be so aggressive in terms of low interest rates and high money supply growth.

Confidence: Looking ahead six months, economic optimism, as captured by the January business confidence index, jumped to a very strong 66.5 from 59.2 in December. Recent positive economic news on the national front have had clear and positive impacts on supply mangers' outlook. Inventories: After moving below growth neutral for December, the regional inventory once again bounced to a level indicating significant inventory buildups. The January inventory reading rose to 55.3 from December's 46.7 and November's 52.9. Since the end of the recession in 2009, inventory accumulation has been an important source of regional growth. January's increase was an important factor driving the overall reading higher. The upturn in inventory levels signals expected growth in production in the months ahead and is consistent with the strong business confidence reading for the month.

Trade: January's export numbers for the Mid-America region were significantly improved from December's healthy readings. New export orders rose to 60.4 from December's 56.3. At the same time, January imports climbed to 56.7 from December's 48.0. This is the highest export index since February 2011 and import reading since March 2011. While the dollar has strengthened recently, the overall trend is decidedly toward a weak dollar making U.S. goods more competitively priced abroad. Since the end of the recession in 2009, the U.S. dollar has declined by more than five percent. At the same time, an expanding regional economy has boosted the purchases of goods from abroad even as foreign goods and services have increased in price. Other components: Other components of the January Business Conditions Index were new orders at 58.1, up from 52.3 in December; production or sales at 56.9, up from 48.4; and delivery lead time at 54.7, higher than 56.5 in December.

MID-AMERICA STATES

ARKANSAS

Arkansas’ leading economic indicator plummeted to a level pointing to slow growth in the months ahead. The December index from a survey of supply managers in the state fell to 52.0 from November’s 63.0. Components of the index were new orders at 47.2, production or sales at 51.8, delivery lead time at 53.1, inventories at 55.1, and employment at 52.3. Manufacturers in the state, both durable and nondurable, have actually reduced employment at the same time that they have increased production. As a result of higher productivity and increases in the hours worked for current employees, manufacturing activity expanded significantly for 2011. I expect this rate of growth to weaken for the first half of 2012. Jobs needed to get back to pre-recession level: A gain of 32,000, or 2.7 percent.

IOWA

For the 24th straight month, Iowa’s Business Conditions Index remained above growth neutral. The index, from a survey of supply managers, slipped to 56.3 from 57.7 in November. Components of the index were new orders at 65.3, production or sales at 53.9, delivery lead time at 55.8, employment at 56.6, and inventories at 50.2. Both durable and nondurable goods manufacturers reported strong business conditions for the month. Manufacturers in Iowa had a very good 2011 as they added to their payrolls. Food, processed, unprocessed and exported, was a big driver for the state’s economy. While strength in the U.S. dollar and a weaker global economy will be a challenge, the state’s economy will perform well for the first half of 2012. Jobs needed to get back to pre-recession level: A gain of 43,000, or 2.9 percent.

KANSAS

The Business Conditions Index, a leading economic indicator for Kansas, slipped to 50.1 from 50.9 in November. The survey is pointing to slow growth for the Kansas economy in the months ahead. Components of the index were new orders at 51.0, production or sales at 51.1, delivery lead time at 46.3, employment at 52.8, and inventories at 49.4. Both durable and nondurable goods manufacturers reported solid business conditions for the month and for most of 2011. However a stronger U.S. dollar and weaker global growth will slow growth for the state’s economy for the first half of 2012. However that growth will still be positive. Jobs needed to get back to pre-recession level: A gain of 53,000, or 4.0 percent.

MINNESOTA

The Minnesota Business Conditions Index, a leading economic indicator, was above growth neutral for the 29th straight month at 56.9 and up from 54.7 in November. Components of the index for December were new orders at 57.7, production or sales at 64.1, delivery lead time at 63.0, inventories at 52.7, and employment at 46.9. Durable goods manufacturers, especially those dependent on exports and agriculture, continue to experience healthy growth as non-durable goods producers detailed pullbacks in recent months. Jobs needed to get back to pre-recession level: A gain of 105,000, or 3.9 percent.

MISSOURI

The December Missouri Business Conditions Index rose from November’s weak reading but remained below growth neutral. The index, a leading economic indicator from a survey of supply managers, climbed to 49.0 from November’s 47.3. Components of the Business Conditions Index were new orders at 47.6, production or sales at 50.1, delivery lead time at 55.5, inventories at 46.1, and employment at 45.6. Once again, durable goods manufacturers reported solid business conditions for the month. However, this growth was more than offset by economic pullbacks among nondurable producers and value-added service firms. Average hourly wage gains for Missouri manufacturers has significantly lagged that of manufacturers in other states in the region. Jobs needed to get back to pre-recession level: A gain of 161,000, or 6.1 percent.

NEBRASKA

The December Business Conditions Index for Nebraska remained above growth neutral 50.0 for the 14th straight month. The index, a leading economic indicator from a survey of supply managers fell to 51.4 from 55.2 in November. Components of the index were new orders at 50.2, production or sales at 45.5, delivery lead time at 53.7, inventories at 53.1, and employment at 54.3. Both durable and non-durable manufacturers experienced a very positive month and year. Contrary to firms in other Mid-America states, Nebraska manufacturers expanded employment while holding average weekly work hours little changed. Jobs needed to get back to pre-recession level: A gain of 7,000, or 0.7 percent.

NORTH DAKOTA

The leading economic indicator for North Dakota remains healthy though it declined for December. The Business Conditions Index sank to 55.6 from November’s 57.9. Components of the index for December were new orders at 56.3, production or sales at 54.5, delivery lead time at 55.6, employment at 53.4, and inventories at 58.1. Durable goods producers outperformed nondurable goods manufacturers for the month and for the year. Manufacturers increased employment, hours worked and wages significantly for 2011. I expect this to continue for 2012 but at a somewhat slower pace. Jobs needed to get back to pre-recession level: 0. Current North Dakota employment levels are at a record high.

OKLAHOMA

The Business Conditions Index for Oklahoma declined in December to 52.1 from November’s 52.5. Components of the leading economic indicator for December were new orders at 52.3, production or sales at 52.1, delivery lead time at 54.8, inventories at 53.4, and employment at 51.0. Durable goods manufacturers expanded business for the month and year. Pullbacks were recorded for nondurable goods manufacturers. Jobs needed to get back to pre-recession level: A gain of 5,000, or 0.3 percent.

SOUTH DAKOTA

The state’s leading economic indicator declined below growth neutral for December. The Business Conditions Index, from a monthly survey of supply managers, slumped to 47.7 from 50.3 in November. Components of the index for December were new orders at 47.2, production or sales at 41.2, delivery lead time at 44.6, inventories at 47.9, and employment at 57.4. Contrary to earlier in the year, manufacturing in the state tied to international markets and to agriculture and energy experienced pullbacks over the past few months. I expect this slower growth to extend into 2012. Jobs needed to get back to pre-recession level: Current South Dakota employment exceeds the state’s pre-recession level.

THE BULLISH NEWS

- Last week initial jobless claims decreased by 13,000 to a seasonally adjusted 348,000 in the week ended Feb. 11, the lowest level since March 2008, when the U.S. was in the early stages of a recession.
- For January U.S. employment expanded by 243,000 jobs and the unemployment rate declined to 8.3 percent
- The consumer price index was unchanged in December

due to a decline in gasoline prices. From Dec. 2011 and Dec. 2012, the CPI rose by 3.0 percent

- The output of all U.S. goods and services (GDP) climbed by 2.8 percent (annualized and inflation adjusted) in the Q'4 2011. However, much of the growth was due to an increase in inventories. This may subtract from Q'1 2012 when companies draw down on inventories rather than increasing production

- Between Dec. 2010 and Dec. 2010, U.S. retails grew by 6.5 percent. However, recent growth has been weaker. Excluding motor vehicles, retail sales actually declined between Nov. and Dec. 2011.

THE BEARISH NEWS

- Average hourly wage growth for U.S. workers for January was a weak 0.2 percent. Over the last year, wages have expanded by 1.9 percent. With inflation above 2.5 percent, workers inflation adjusted wages continue to decline.

- Even with January's job additions, the nation's has 5.5 million fewer jobs now than when the recession began.

- The Case-Shiller home price index declined by 1.3 percent between October and November. Compared to one year earlier, housing prices are down by 3.7 percent.

WHAT TO WATCH

- Retail sales: The U.S. Census Bureau releases retail sales for February on March 13. This will be an important release indicating how the consumer (70% of the economy) sees the economy.

- Jobs: On Friday March 4, the U.S. Bureau of Labor Statistics (BLS) will release the employment report for February. Another decrease in the unemployment rate will be bearish for bond prices and positive for stocks pushing interest rates higher.

- The CPI: Around the third week of each month, the BLS releases the consumer price index for the previous month. Annualized growth above 3.0 percent will begin to push long-term interest rates higher even as the Federal Reserve attempts to hold rates down.

THE OUTLOOK

FROM GOSS:

Contrary to what I think is appropriate, the Federal Reserve's interest rate setting committee announced last month that it would keep current interest rates at their current record low rates. This action if maintained will have several significant impacts:

- The value of the dollar will weaken more significantly than I indicated in previous newsletters. This will mean higher commodity prices including agriculture and energy

- Inflation as measured by the CPI will bounce higher forcing the Fed to abandon their pledge and raise rates before the end of 2013

- Growth will wane in the second half of 2012 for U.S. as the U.S. taxpayer faces that mammoth tax increase on Jan. 1, 2013

OTHER FORCASTS:

- National Association of Business Economics (NABE): About two-thirds of the companies surveyed said the European debt crisis would have little impact on their sales over the first half the year, while 27% of respondents said they expected to see a decline in sales of 10% or less. NABE found that 65 percent of the respondents in the January 2012 survey expect real GDP to grow at a rate exceeding 2 percent between the fourth quarter of 2011 and the fourth quarter of 2012. This compares to only 16% who forecast over 2% growth in 2011 in the October survey.

- William Greiner, CFA, President Scout Investments. "What we call The Long, Hard Slog continues and will do so over the foreseeable future. We see slower than normal economic growth continuing due to ever-aging population bases and unsustainably high levels of debt hampering growth opportunities in the developed world. Does this mean the world in total will see slower-than-normal growth rates over the long term? In a word, "no". But, over the short term, the world will continue to focus its attention on those "balance sheet" items, primarily in Europe and the U.S. as the peoples of those areas continue to decide what they want/need from their governmental systems."

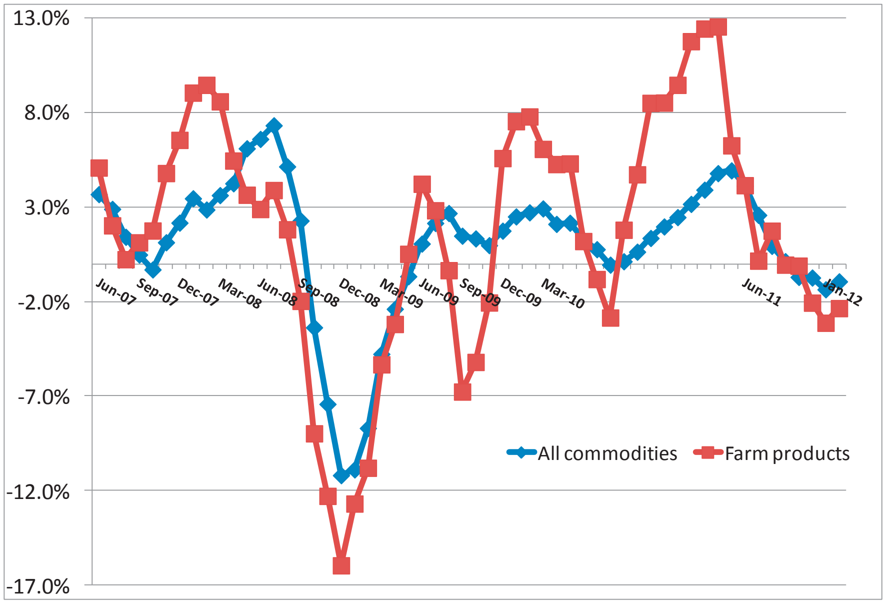
Goss Eggs (Recent Dumb Economic Moves)

- The Federal Reserve's decision to maintain current record low interest rates until 2014 is at best meaningless and at worst counterproductive. Meaningless: The Fed's track record in forecasting economic activity has been abysmal. If the U.S. economy continues to grow as it did in January, the Fed will be forced to increase rates before the end of 2013. Counterproductive: Discourages home buying since purchasers see no reason to buy now since housing prices are dropping and the Fed is promising continued low interest rates.

PRICE DATA

ALL COMMODITIES/FARM PRODUCTS 2007-2012
FUELS & RELATED/METALS & METAL PRODUCTS

Price changes, 3 month moving average, 2007-2012



Price changes, 3 month moving average, 2007-2012