



A NEW YEAR: SNAPSHOTS OF OUR PROGRESS & STATE DETAIL


In this issue, we're looking at the progress we've made over the course of the recovery, challenges facing some of our domestic regions, and taking an in-depth look at wages, which have remained depressed throughout the recovery. It appears that qualified workers are coming back into the labor force now that things are picking up, even with wages weak—which makes for good opportunities for managers looking to accelerate production.




After a shaky start, the year ended well: payroll gains were solid, and job growth strong enough to push the unemployment rate down 0.2pp to 5.6%. Wages were off, however, and retail spending was surprisingly weak in December.




The long-term unemployed are coming back into the labor force. This has been a long-time coming, and would be a welcome relief if the trend continues. And a slender majority of states has surpassed their pre-recession employment peaks, but there's no small contingent of laggards.



The Organisation for Economic Co-operation and Development recently ranked the U.S. pretty low on the international financial vulnerability scale, but even with our current status, we continue to face risks from around the world.



We've got some risks here at home too. The decrease in fuel prices has given consumers a boost, but it's likely to take a toll in energy producing states. And a projected 14% decline in farm income is likely to adversely affect states where agriculture is dominated by field crops.



Although diesel fuel sales rose last August, we're seeing a slowing in the growth rate. Over the course of 2014 fuel sales indicated, correctly, that the slow-downs we experienced would be temporary.

If you are new to our research, and want more information on our surveys and the data points we cover, please use this link to access the reference section of our website.

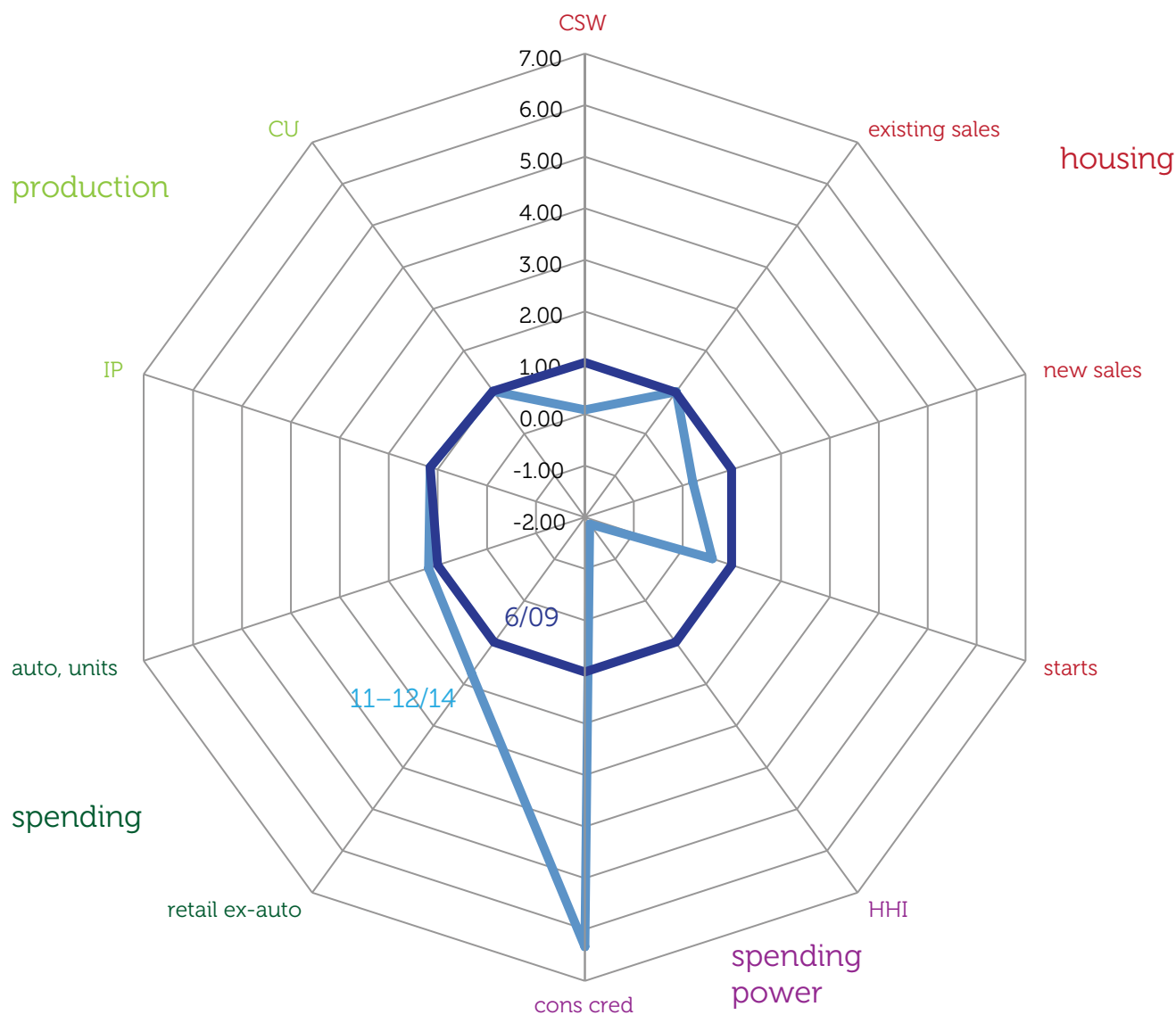
We are committed to keeping this report to twelve pages, so we have a lot of state detail not in the report. Please email us if you'd like to see it.

Contact Us

For more information about Sightlines Bulletin, please call us at 515 223 0611 or [click here](#) to email us.

TAKING THE MEASURE OF RECOVERY

HOW MUCH HAS EVERYTHING OTHER THAN THE LABOR MARKET RECOVERED?
November–December 2014 (light blue) vs. June 2009 (dark blue)



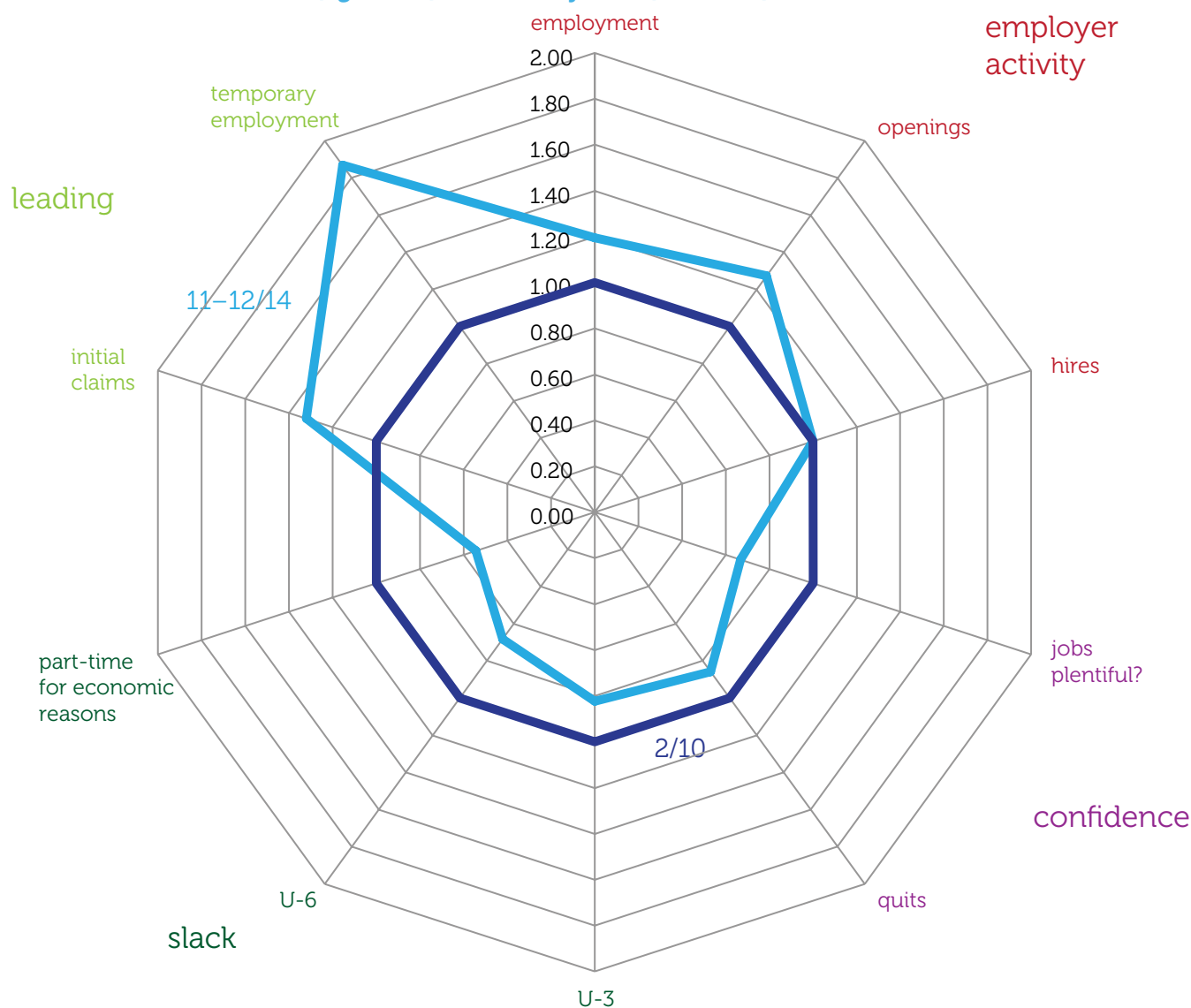
Here are two spider (or radar) graphs taking measure of the recovery. Known for capturing outliers, these spider graphs show the percentage, expressed as an integer, of recession losses that have been regained. For example, an 0.5 reading means that half the losses have been regained. (Credit goes to St. Louis Fed President James Bullard for the concept of the graph.)

Above we chart the progress made in

several metrics covering production, housing, spending and the power that drives it, over the course of the recovery. Housing remains in a torpor with real prices, as measured by the Case-Shiller-Weiss national index (CSW in the graph), barely off their lows, sales of existing homes recovering their losses, but new sales remain in the hole. Real Household Income (HHI)—the Sentier Research monthly measure—has staged no recovery—it's 7% below its pre-recession peak. Consumer credit is the real outlier in this graph. Its recession

HOW MUCH HAS THE JOB MARKET RECOVERED?

November–December 2014 (light blue) vs. February 2010 (dark blue)



loss was just \$27b, and its subsequent \$170b gain was 6.3 times that loss. Since it is boosted by student debt, this may not be such a good thing. Retail spending has recovered, as has industrial production (IP) and capacity utilization (CU), but at 79.2% CU remains below levels that indicate pressure is building.

And above, labor market. Indicators Bullard grouped as “employer behavior”—total employment and openings and hires (from JOLTS) are doing well. Doing less well are measures of confidence (job availability from the Conference Board and the quit rate from

JOLTS) and utilization (the official U-3 and broad U-6 unemployment rates and the share working part-time for economic reasons), all of which have yet to regain their recession losses. Strongest are the leading indicators—initial claims (inverted) and temp employment—which inspires hope for further improvement.

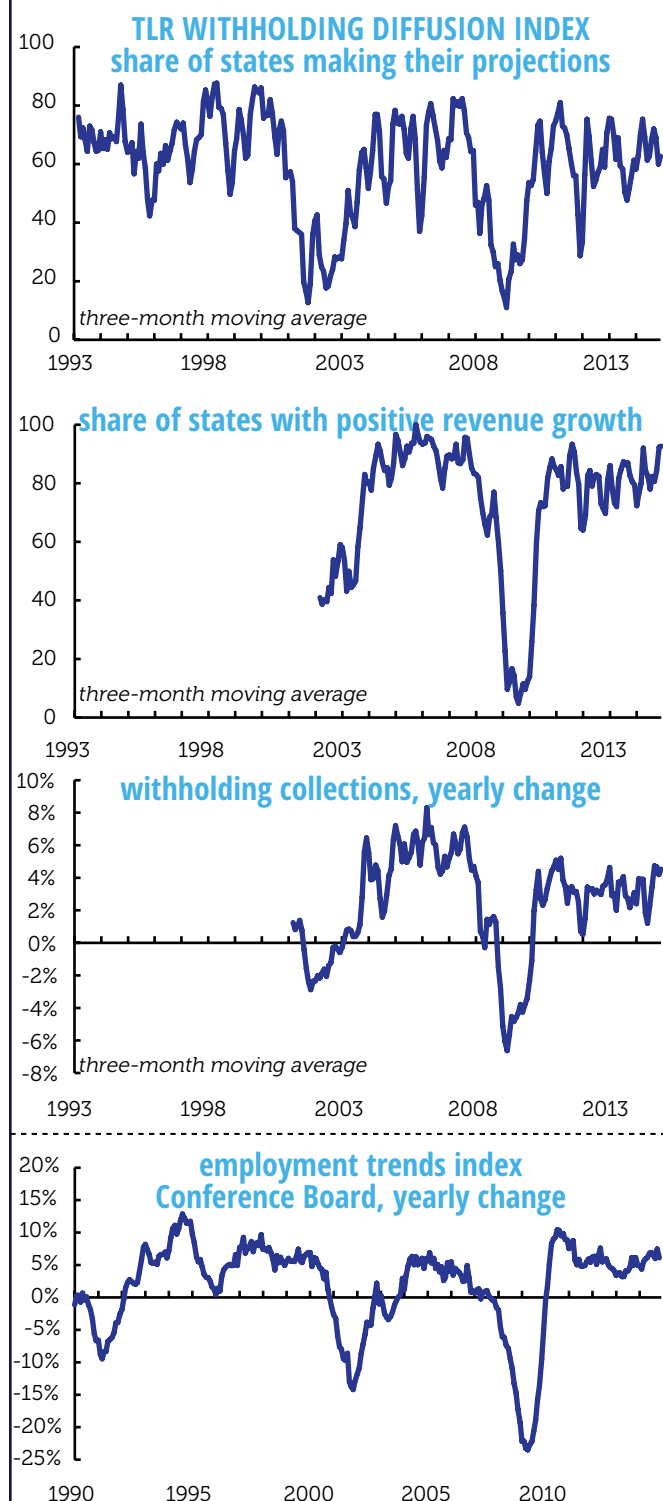


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REVENUE ROUND-UP: UNDERLYING DYNAMICS IMPROVING

FOUR EMPLOYMENT INDICATORS



The Conference Board's ETI leads payroll growth by about three months. It appears here with permission.

State-level withholding taxes were solid in December: 79% of the states in our survey met their forecasts, with the percentage reporting growth over the year coming in at 90%, and the average over-the-year rate of change a strong 6.7%, bolstered by bonuses. State-level sales tax receipts held steady: 67% of the states reported meeting or exceeding forecasts, with average over-the-year growth holding at about 5%.

Overall, our contacts see continued improvement, one noting that, "It may have taken seven years since the onset of the Great Recession, but we're starting to see the underlying economic dynamics emerge;" another, "things continue to look pretty solid as far as major indicators are concerned." Our contacts in states around the country have expressed some concern that the Bureau of Labor Statistics may be underestimating payroll growth in their states. Generally when they think this, they are correct, in both directions.

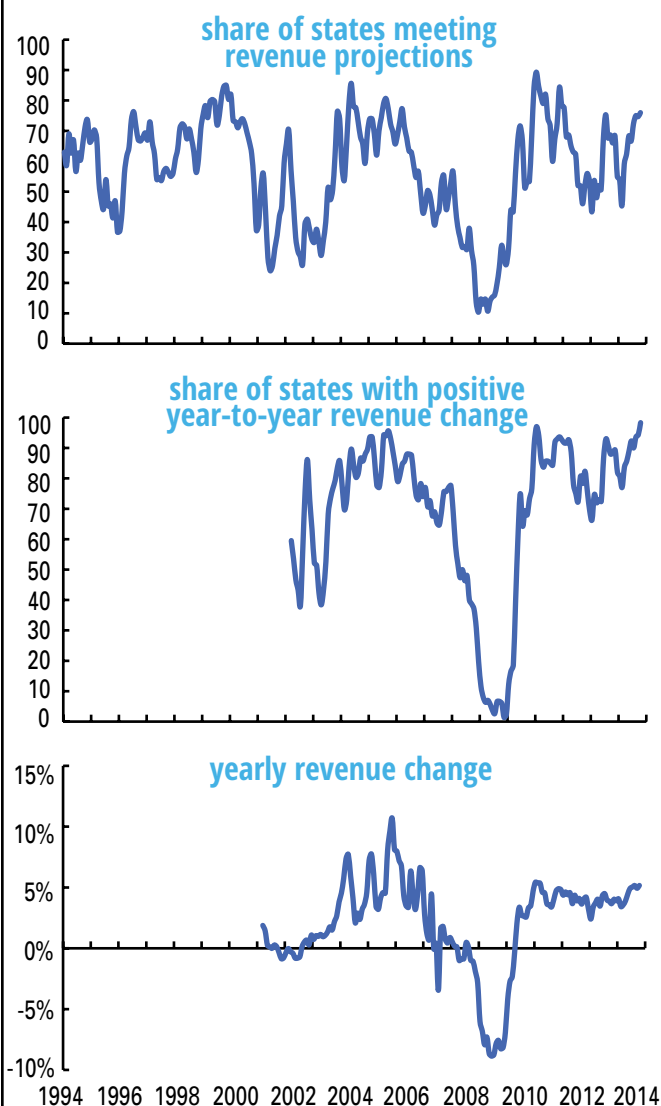
DECEMBER PAYROLLS

According to the Bureau of Labor Statistics' (BLS) report on December job creation, employers added 252,000 workers, slightly above the 246,000 average of the last year. This was in line with the newest "new normal" for payroll gains, about a quarter-million a month. Earnings were weak, which should allay fears about wage pressures, and maybe replace them with worries about buying power.

We've graphed sectoral growth over the year on p. 5. In December, only retail and transportation employment came in well below their 12-month trends; other sectors were stable.

Job gains for the year were just shy of 3 million, or 2.1%, the best annual rate since 2001. That's still short of 1990s levels, which were

TLR sales tax indexes, 1994–2014 3-month moving averages

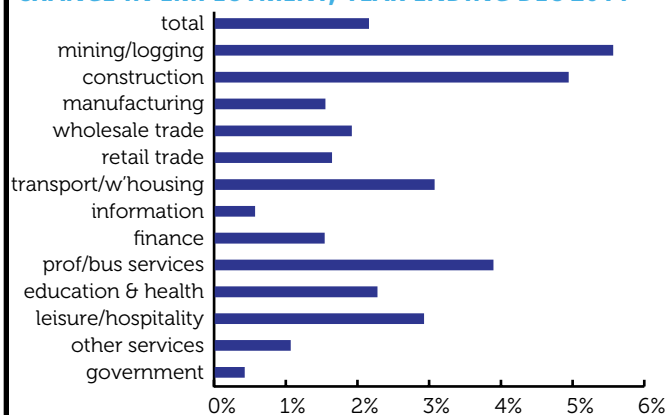


routinely above 2.5% and even above 3% sometimes, but it's a lot better than the sub-2% rates of 2011-2013.

The household survey was somewhat weaker, up 111,000 in total or 238,000 when adjusted to match the payroll concept, which brings the two series together at a 2.2% annual rate. Full-time employment was up 427,000; part-time, down 210,000 (most of it from voluntary part-timers, but the number of the unwilling was down as well).

Although job flows, movements between unemployment, employment, and sitting on the

CHANGE IN EMPLOYMENT, YEAR ENDING DEC 2014

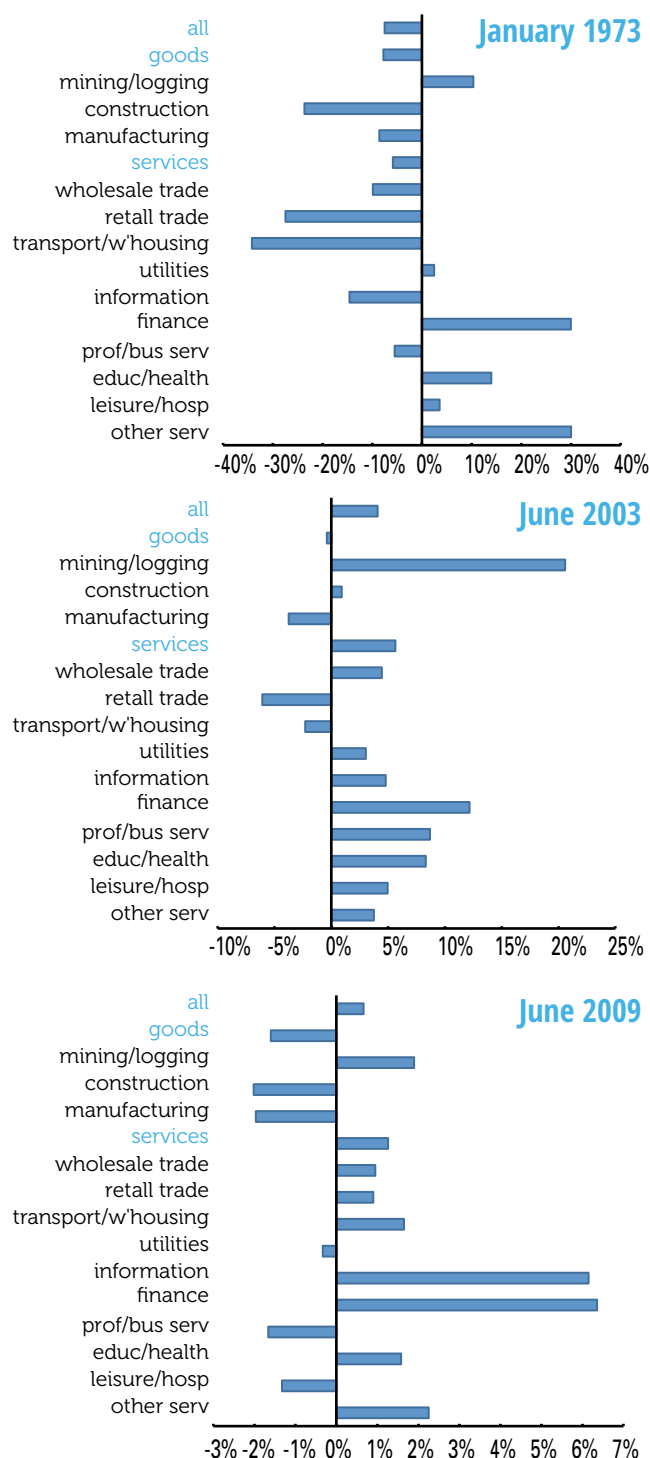


bench, were mixed, it's encouraging that the share of the November unemployed finding work in December rose 2.7 points to 24.9%, its highest level since April 2008, and the share of those outside the labor force entering work rose from 4.3% to 4.4%.

One worrisome point: Average hourly earnings were down 0.2%, and November's gain, originally 0.4%, was revised down to 0.2%. For the year ending in December 2014, hourly earnings were up just 1.6% after running at 2.0% or above since mid-2013. It's a noisy series and could swing back, but continued weakness could cause demand problems.

All in all, the report shows a labor market that is ambling, but not sprinting, towards greater health. But it's not there yet.

REAL HOURLY EARNINGS BY MAJOR SECTOR change from various months through 11/14



Real change in average hourly wage by major sector, from base month shown to November 2014. Nominal wages are deflated by the CPI-U. For the January 1973 and June 2003 graphs, figures are for production workers (just over 80% of the private sector workforce); for the June 2009 graph, it's all workers. (Data for all workers only begins in 2006.)

SPOTLIGHT ON ORDINARY WAGES

Wages of working Americans are of real concern these days, both for those families working to pay their bills, and for Federal Reserve chair Janet Yellen who has said repeatedly she'd like to see ordinary wages rise. We have a lot of ground to cover in this report, so we're going to let some graphs do the talking. In brief, real average hourly wages for production workers are 7.5% below where they were 40 years ago, in January 1973, the result of some big drops going into the 1990s. The average real wage rose over 3% during the Great Recession—surprising, perhaps, but true—and declined 1.2% since the recession ended.

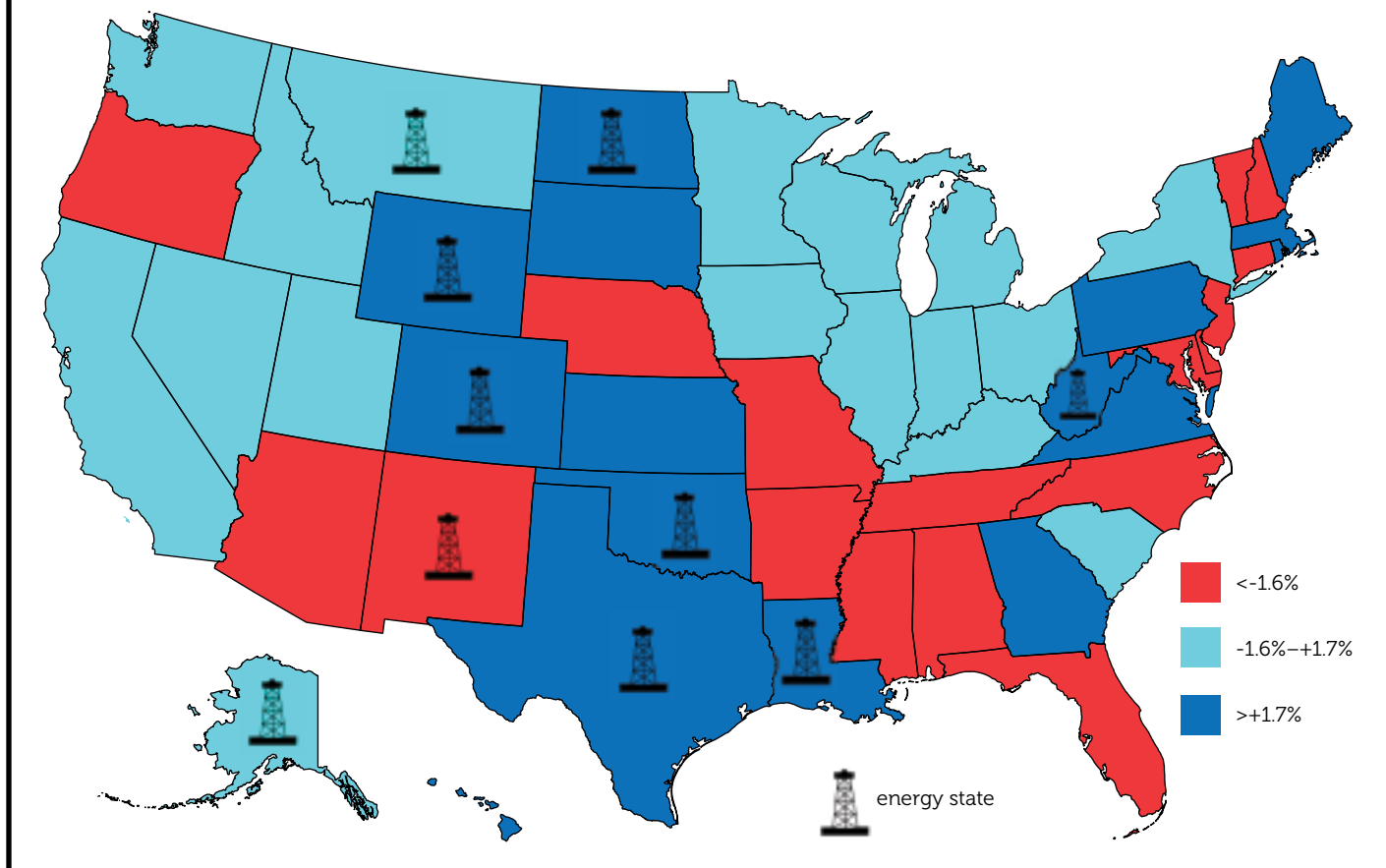
And a shift from, say, manufacturing into services employment is not to blame: the broad patterns of decline and recovery remain pretty much the same if you hold the broad composition of the workforce constant.

There were, however, significant differences in real wage performance by sector. As the top graph at left shows, most major sectors are either below or only slightly above their wage levels of almost 42 years ago; major exceptions are finance, education and health, and other services (a small grab-bag of a sector). Especially hard-hit are construction, retail, and transportation and warehousing (the last, no doubt, the result of the late 1970s deregulation of the airlines and trucking).

The performance since 2003 is better, with only manufacturing, retail, and transportation and warehousing in the red, the last barely. But mining and logging, and finance are both strongly positive.

Although wage gains for retail, and leisure & hospitality workers exceeded other sectors in 2014, it's striking that these notoriously low-wage sectors were among the worst performers over the last five years. It suggests

real wage change, June 2009–November 2014



that wage dispersion, at least at the broad sectoral level, widened in the recovery/expansion.

GEOGRAPHICAL PERSPECTIVE

The graph above shows the rates of change in real wages since the 2009 recession trough. Wages in many states remain negative.

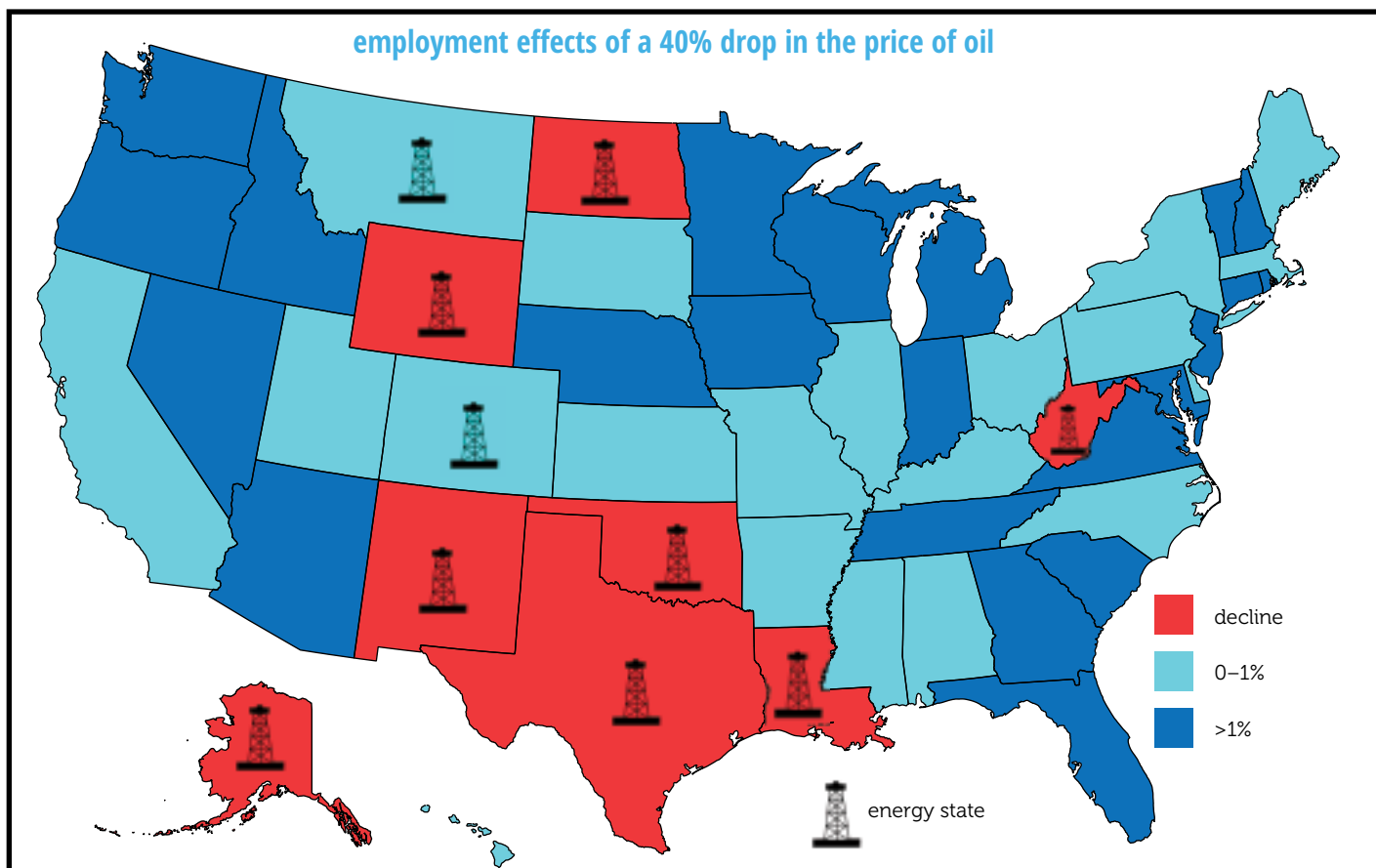
Three points:

- States with the lowest wages in June 2009 were most likely to see the strongest gains.
- It helps, a lot, if you're sitting on valuable mineral resources; and
- Although not graphed, nominal manufacturing wages are negative from the June 2009 trough in Delaware, Hawaii, Kansas, and

Michigan, and down from their 2010 peaks in Connecticut and Missouri. Negative nominal wages are very rare indeed. As the job market continues to improve, wages should begin to rise, making this a good time for managers looking to ride the surge in U.S. manufacturing to bring in new workers.

MOVING AGAIN?

Census has yet to release new statistics on the national Mover Rate—when last visited it was within a hair of its all-time low—but we've heard from several contacts that inflows into their states have improved significantly, one noted a record high, another said that his state has regained prior averages. This improvement likely reflects improvements in the housing market, and should support job growth going forward as "house-lock" loosens its grip.



Also noteworthy: for the first time since 1997 Michigan made the “balanced” list in United Van Lines report. We expect upcoming official reports on mover rates to show significant improvement when they are released.

THE OIL STIMULUS

Oil prices have taken a remarkable tumble, down almost 40% from their peak in mid-June. If sustained, this could provide a powerful stimulus on our economy—outside the energy sector, of course.

At the end of 2014, energy accounted for about 5% of personal consumption, which is quite low by historical standards—but it could fall even further. Based on the decline in prices, and the historical relationship between energy prices and the energy share of consumption, it could fall to 4.4% in the first months of 2015. Were that to happen, it would free up about \$65 billion for spending

elsewhere, which is almost six days of retail spending ex-autos.

The drop could also give a nice kick to employment. In an October 2013 paper for the Council on Foreign Relations, Stephen Brown and Mine Yücel worked out employment elasticities for oil by state. Their work experimented with a 25% increase in the oil price. But if you turn their elasticities into a 40% decline, you get some interesting results. Nationally, their estimates would translated into an extra 978,000 new jobs next year, or 81,000 a month.

But as the map above shows, impacts would vary widely by state. There’s a lot of blue, but eight energy-producing states would take employment hits, with Wyoming the worst off, down 3.4%.

STATE EMPLOYMENT: DECEMBER, AND LONGER-TERM

The BLS's state employment report showed continued improvement around the country in December. Employment rose in 41 states (14 of those moves statistically significant) and was down in 9 and D.C. (none significant). Unemployment rates were down in 42 states and D.C.: 19 of those declines were significant, and up in 4, although not significantly.

Of the states reporting statistically significant job gains, percentage increases were largest in noisy Alaska and Montana, both +0.7%, and New Hampshire, +0.6%. Largest numerical gains took place in Texas, +45,700; New York, +30,400, and Illinois, +17,100. Among the sectors, construction showed the strongest monthly growth, with strength concentrated outside the recovering housing bubble states. This is a noisy series so we don't want to make too much of monthly moves, but over the year construction employment was negative in Arizona, up close to 4% in California, close to 9% in Florida, and 8% in Nevada.

Although 19 states reported statistically significant reductions in their unemployment rates, declines in labor forces tempered that news in 11. Declines in California, Iowa, Massachusetts, Michigan, Montana, Pennsylvania, and Rhode Island were accomplished with labor forces that held steady or increased. Currently labor forces are negative over the year in 15 states.

RECOVERY ROUND-UP

Currently, fifteen states have yet to regain the pre-recession employment peaks: Alabama, Arizona, Connecticut, Florida, Idaho, Illinois, Maine, Michigan, Mississippi, Nevada, New Jersey, New Mexico, Ohio, Rhode Island, and Wyoming.

Nine states have regained the jobs they lost and are hovering around where they were in 2008: Arkansas, Georgia, Hawaii, Kansas, Maryland, Missouri, New Hampshire, Pennsylvania and Virginia. Twenty-six states, as well as DC, have now moved above their prior peaks: Alaska, California, Colorado, Delaware, Indiana, Iowa, Kentucky, Louisiana, Massachusetts, Minnesota, Montana, Nebraska, New York, North Carolina, North Dakota, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Washington, West Virginia, and Wisconsin.

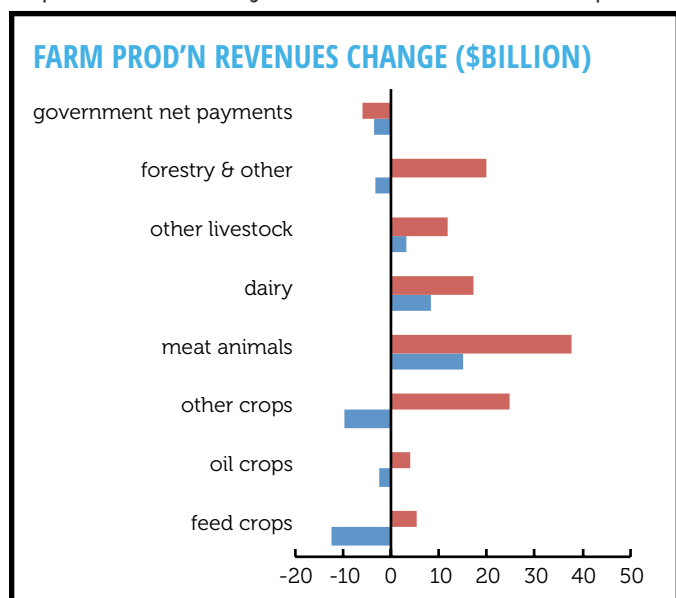
There are big divergences among states, need we add? Some examples: Resource-rich Alaska and North Dakota barely noticed the recession; employment in North Dakota is up about 30% from 2008, driven by heavy fracking activity. Employment in Texas fell just 4% during the recession, and has gained 15% in the recovery, while employment in California fell close to 9% during the recession, and has climbed 11% since its trough. Nevada fell harder, losing 14% of total employment, and regained 10%. Employment in Michigan was already falling when the recession hit, and bottomed in 2010. It's climbed about 9% since then but remains about 10% below its 2000 level. And Massachusetts has contributed about a quarter of a million jobs to the recovery, pretty good when you consider it only has about 3.5 million laboring souls.

It's nice to see the number of states that have regained their prior peaks so much longer than the ones who haven't yet done so. In light of recent assertions about the role of specific industries in overall job growth, there's a word of caution in there about cherry-picking the data as well: it's a complicated landscape, finally regaining some dynamism. It's best to evaluate each state on its own terms, which means starting with its own peak and trough.

HEADWINDS FOR OUR AGRICULTURAL ECONOMY

The U.S. Department of Agriculture (USDA) forecasts that net farm income fell to \$113.2 billion in 2014, a 14% decrease from 2013, and back to 2012's level. The character of farm output varies across the nation, and even if it is going back only to 2012's level, it will be much tougher on some states than others.

First, a look at the sources of that change. Cash farm income from the production of crops is expected to fall by \$15.2 billion and, on top of

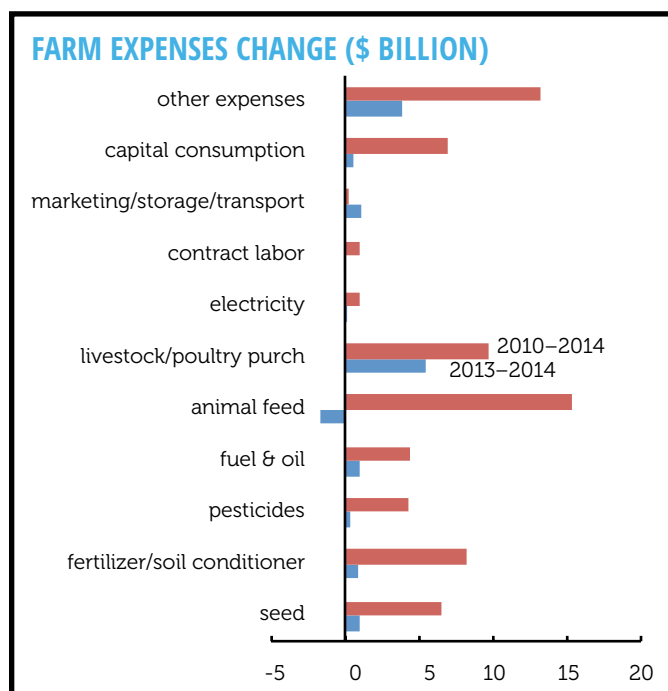


this, the value of crops in storage is expected to decrease by another \$9.3 billion, adding up to a 10.6% decrease in crop income. Income from livestock operations is expected to increase by \$26.8 billion (14.8%), which more than offsets crop income losses. (See graphs above that show expected change in 2014, and change between 2010-14 for perspective.)

These major changes in cash receipts plus some minor adjustments leave farm receipts little changed. The reasons for the decline in net farm income lie elsewhere.

On the expenditures side of the ledger the cost of purchased inputs show a \$12.1 billion increase, and another major subtraction from

income includes a \$3.4 billion decrease in net government payments. These changes reduce 2014 net value added from farming by \$16.1 billion compared to 2013. What the USDA labels as payments to stakeholders (employees, non-operator landlords, and other real estate interests) explains the remaining decrease in projected farm income. As shown in the chart below, expenditures for all of the major categories of inputs for crop production are pro-

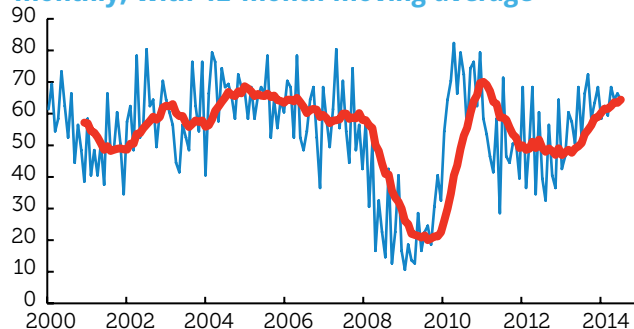


jected to increase during 2014.

The recent drop in prices for corn, soybeans, and wheat and the continued increases in most input prices have wiped out much of the income gains for producers of these crops since 2010, while income from livestock operations remains strong. The states for which farming is likely to become a drag on overall economic growth are those where grain and oil crop production dominates. We figure the states that will take the hardest hits are the six responsible for more than 5% of the national production of these crops: Iowa, Illinois Nebraska, Minnesota, Indiana, and Kansas.

DIESEL GROWTH DECELERATES

DIESEL DIFFUSION INDEX
monthly, with 12-month moving average



As we noted in our discussion of state-level employment trends, oil and motor fuel prices continue to tumble. In December, WTI and Brent crude oil prices fell by 18.9% and 23.1%, hitting \$53.45 and \$55.27 per barrel by the end of the month. That's down from the June peaks of \$107.95 (-50.5%) and \$115.19 (-48.0%).

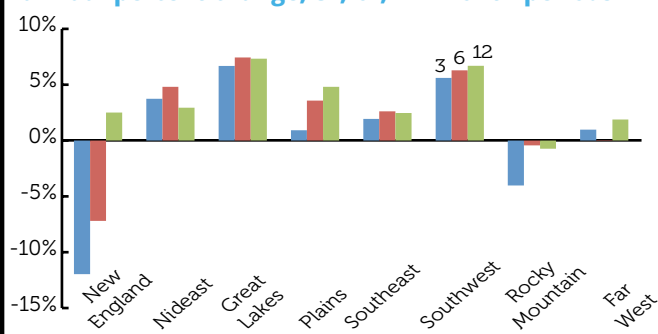
Year-over-year diesel fuel sales rose by 2.0% in August, an increase of 65.8 million gallons nationwide. Over the prior 3-, 6-, and 12-months, increases were 2.6%, 3.6%, and 4.0%. This marks a noticeable slowdown over the past year, but the number of states reporting increases was stable at 33, basically flat with July's 34.

As shown in the top chart at left, the 1-month diffusion index dropped from 66.7 to 64.7, but remains above the 50 level, where it has been for the past 17 months.

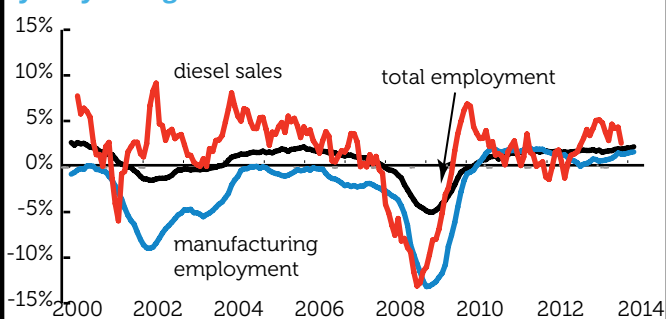
You can see in the middle chart that the strongest growth occurred in the Great Lakes region, followed by the Southwest, in the most recent 3 months. It's interesting that the 3-month growth rates fell below the 6-month rates in 7 of the 8 regions. Only the Far West bucked the trend, with the 3-month rate rising above the 6-month, but that followed almost no growth over the past 6 months.

The bottom chart shows that the growth rate for diesel sales has been trending downward over the past several months, while total and manufacturing employment growth rates continue to inch higher. We're keeping an eye on this, especially since diesel sales tend to lead employment.

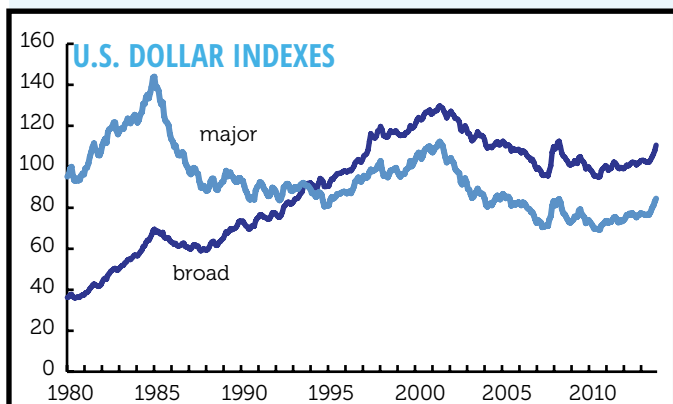
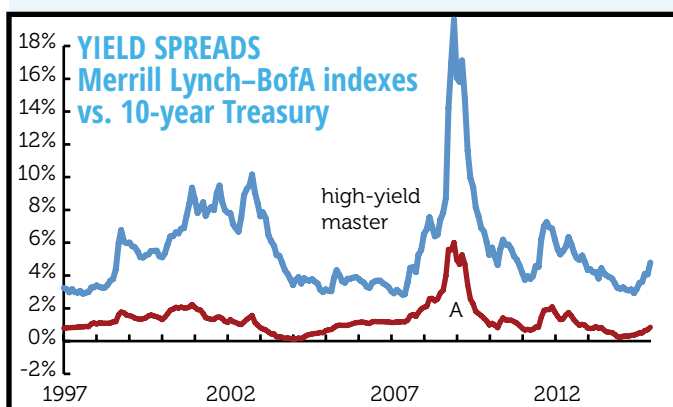
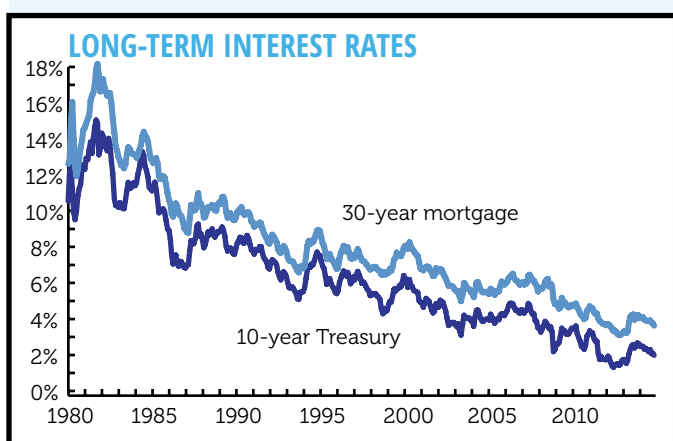
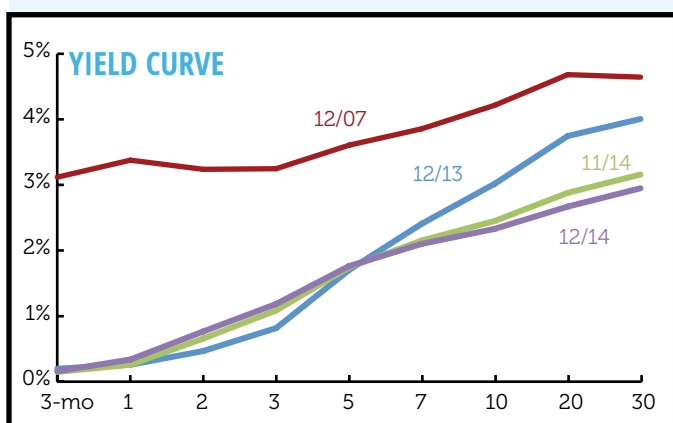
DIESEL FUEL SALES
annual percent change, 3-, 6-, 12-month periods



EMPLOYMENT & DIESEL SALES
yearly change



FINANCIAL INDICATORS



The Treasury **yield curve** continued to flatten in December. The yields for all maturities of five years and under rose, while yields for maturities of seven years and longer declined. And those declines for longer maturities continued into January, with the ten-year falling 30 basis points (bps) to 1.77%, and the 20-year and the 30-year both by 35bps to 2.12% and 2.4% by mid-month. That's the lowest yield on the 30-year going back 35 years.

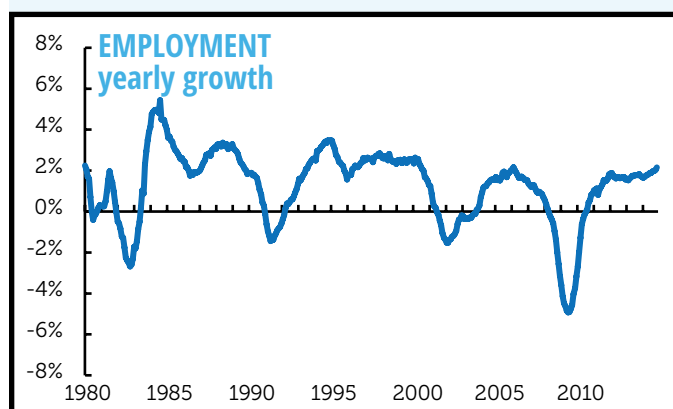
The drop in the 10-year yield contracted the spread between the 3-month and 10-year yields by 13bps, to 2.18% in December, and to just 1.74% by mid-January. The December federal funds/ 3-month spread tightened by 2bps to -0.09, while the 10-year/20-year fell 9bps to 0.34. **Risk premia** on high-yield bonds widened, as yields rose (especially on riskier credits) despite the decline in Treasury rates.

The strength of the U.S. economy relative to the rest of the world has become a magnet for foreign capital, driving down long-term Treasury yields and boosting the relative value of the **dollar**, and falling oil prices have hammered the CPI. This combination of factors has moved market expectations for the Fed's first move on interest rates out to the last quarter of 2015.

The average interest rates for 15-year and 30-year fixed rate mortgages also moved lower in December. The average 15-year rate decreased from 3.19% to 3.13% and the average 30-year rate went from 4.00% to 3.86%. Last November the rates averaged 3.48% and 4.46%.

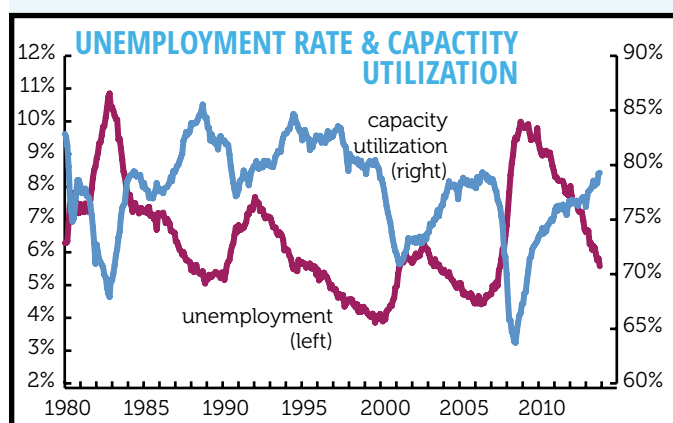
Existing home sales rose to an annual rate of 5.04 million units in December, up from November's 4.92 million. Housing starts bounced back from November's fall, rising 4.4% to an annual rate of 1.089 million. Within that, single-family homes, rose to their highest level since March 2008.

REAL INDICATORS

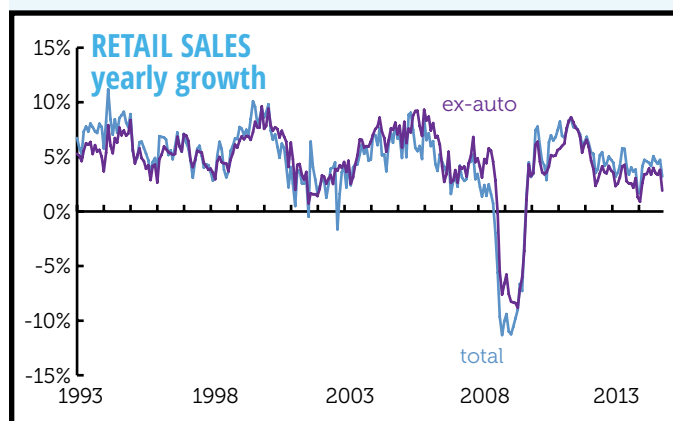


Total **employment** for the year ending in December 2014 was up 2.1%, the highest rate we've seen since 2006. For the private sector, the annual growth rate was 2.5%. While not the 1990s, these are still very respectable growth rates by historical standards—though, of course, there's a lot of ground to be made up, as the first graph shows.

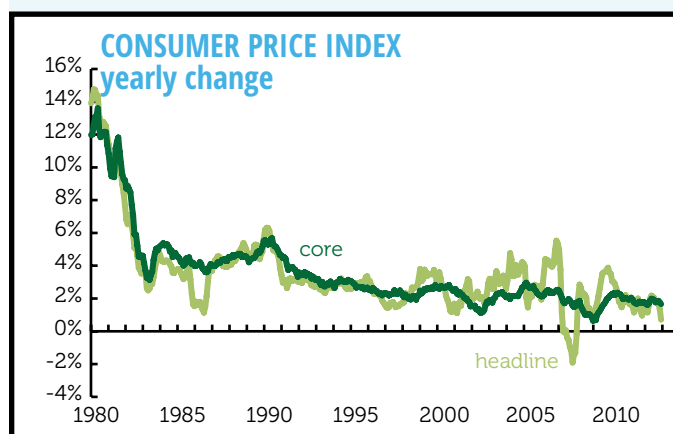
The **unemployment rate** fell to 5.6%, its lowest level since 2006, and well below the 1980–2007 average of 6.1%. Participation, however, remains depressed, suggesting that the job market isn't as tight as it looks from this measure alone.



Capacity utilization was little changed at 79.3% in December—above its 1980–2007 average of 78.6%, but still nearly 3 points below the level that sets off alarm bells at the Federal Reserve.



December **retail sales** were seriously disappointing, with total sales down 0.9% from November, and down 1.0% excluding autos. Most major sectors were off for the month. For the year, total sales were up 3.2%, or 1.9% ex-autos, a considerable slowdown from their recent pace, and one visible on the graph to the left. The decline in gas prices had been expected to give a lift to other retail spending, but that hasn't materialized yet. This is a volatile and heavily revised series, so one shouldn't draw too many conclusions from a month's data, but you have to wonder if the pinch on earnings that we write about elsewhere in this issue is a factor.



There continues to be no sign of **inflation**, as the headline CPI came in at 0.7% for the year ending in December, a full point below where it was just two months earlier. Core inflation was 1.6% for the year ending in December, down 0.2 point from October, at the low end of its narrow range over the last two years.