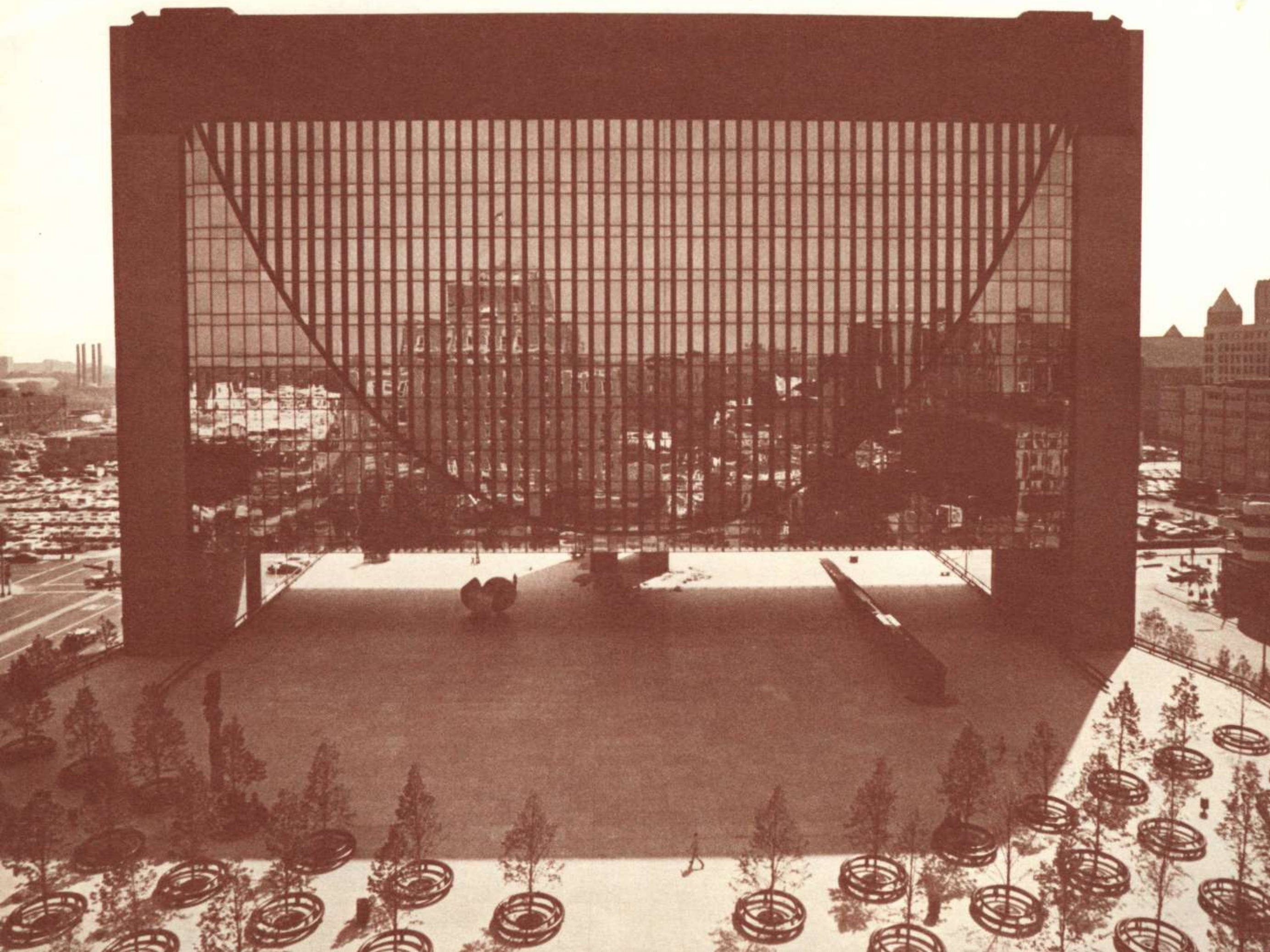
Federal Reserve Bank of Minneapolis Quarterly Review

Spring 1978



Federal Reserve Bank of Minneapolis
Quarterly Review Vol. 2, No. 2

This publication primarily presents economic research aimed at improving policy making by the Federal Reserve System and other governmental authorities.

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District Conditions*

Business is blooming . . .

Despite high inflation rates, spring finds economic activity in the district still flourishing: business is just as good as in the nation as a whole and much better than a year ago. And it seems likely to thrive right through 1978.

The labor market reflects the situation clearly. About 142 thousand more people were employed in the district this April than last. That's a better than 5 percent increase, slightly more than recorded nationally. And it means the seasonally adjusted unemployment rate dropped more than one full percent—from 5.4 to 4.1 percent in the district (the lowest it's been in eight years) and from 7.4 to 6.2 percent nationally.

The new jobs have mainly resulted from continued expansion in three industries.

Manufacturing has been very strong. According to our May survey, first-quarter sales by district manufacturers were up about 18 percent from a year earlier, nearly twice as much as the 10 percent national increase.

Construction activity has been booming too. In the district it was so strong that this industry employed a phenomenal 20 percent more workers during the first quarter of 1978 than in the first quarter of 1977. U.S. construction employment, meanwhile, increased a more moderate but still sizable 7 percent.

Not only have workers been manufacturing and building more this spring, they have also been buying and selling more at the retail level. In the first quarter retail sales increased a whopping 12 percent over a year earlier in Minnesota, the only district state with this data available. Again, the U.S. increase was smaller but still strong, at about 8 percent.

. . . even for farmers

And for a change, even farm businesses have some increases to report. Sharp jumps in cattle prices pushed first-quarter cash receipts from livestock operations in the district up more than 15 percent from last year's first quarter—about the same as in the nation. Thanks to sales of (and loans on) stored harvests in Minnesota and South Dakota, though, crop farming seemed more profitable in the district than nationally: first-quarter money coming in from crops was down 5 percent in the U.S. as a whole but up 17 percent in the district.

Unfortunately for us all, business activity is not the only thing that has increased since last year. Prices paid by consumers this April were 6.5 percent higher than last April in the nation and 8.5 percent higher in and around Minneapolis-St. Paul. And prices in the money market suggest that investors don't expect inflation to slow; interest rates on short-term debt were about a third higher than a year ago.

Funds are tightening at financial firms

These higher interest rates have had a large impact on financial institutions faced with strong business loan demand. Because of federal interest rate ceilings on time and savings deposits, these traditional sources of funds for banks and savings and loan associations have become increasingly unattractive compared to other money market investments. Deposit inflows to banks and S&Ls have therefore not kept up with the demand for loans.

These financial firms have so far been able to get the funds they need elsewhere. Banks have altered the composition of their assets, shifting out of securities and into loans, and relied more heavily on the sale of large certificates of deposit. In May banks sold 50 percent more large CDs than a year ago in the district and 40 percent more nationally. S&Ls have borrowed more from Federal Home Loan Banks. In April their borrowings were up nearly 90 percent from a year earlier in the district and up 70 percent nationally.

The future supply of lendable funds at regional

*The Ninth Federal Reserve District consists of Minnesota, Montana, North and South Dakota, northwestern Wisconsin, and Upper Michigan.

and national financial firms may be helped along by a recent change in regulations, though it's still too early to tell how much. The change allows higher interest rates to be paid on new time certificates, which should make banks and S&Ls better able to compete for funds.

The outlook is good

And the demand for those funds is likely to be strong the rest of the year. We don't have enough data to compare forecasts for the district and U.S. economies, but both are generally expected to continue to grow. And we do have several indicators that the district economy's growth will be fairly strong.

Using a new statistical technique, researchers at this Bank predict increases of more than 3 percent in employment and about 12 percent in retail sales. And while homebuilding may slow, they think commercial building will expand enough to keep the construction industry booming.

District manufacturers in our survey panel are optimistic too. In May they expected this year's sales to be up about 15 percent over last year's.

And happily, most rural bankers responding to our April survey expected farm earnings to continue to improve.