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District Conditions

Last year wasn't a very good year for the U.S. economy, and while the Ninth District wasn't as bad off as some regions, it had its share of double-digit inflation and very low employment growth.* According to newly available data, in fact, real personal income in the district did not grow at all in 1980. In 1981, however, the district appears to be pulling out of its slump. So far this year, the economy seems to have been somewhat stronger than a year ago, and while the outlook at midyear is fairly cloudy, there's a chance that the economy will remain at least that strong the rest of the year.

Strength in the First Half

Both inflation and economic activity appear to have improved over year-ago levels in the first half of 1981.

Inflation in the Ninth District clearly slowed some in the first half. The only measure of district prices available, the Minneapolis–St. Paul consumer price index (CPI), rose 9 percent over its level a year earlier in the first half, a much smaller increase than the 12 percent it registered in the first half of last year. Inflation's slowing was fairly broad-based, with perhaps the most dramatic drop occurring in prices of fuel and other utilities. The first-half increases in these prices plummeted from 39 percent last year to 16 percent this year.

Economic activity seems to have improved in the first half too. Aggregate data on income generated in the district in the first half of the year won't be available until the end of the year, so how much—or even whether—the economy has actually grown so far is hard to determine. However, the next-best measure of regional economic strength, the level of employment, did grow in the first half: the number of people working in the district was 1.3 percent higher in the first six months of this year than in the comparable months last year. That may appear to be modest growth, but it is more than three times as much as employment grew in 1980.

This apparent strengthening in district economic activity has occurred despite several fairly weak sectors. Two industries were severely depressed in the first half by the nation's historically high interest rates. Rather than pay these rates, many consumers decided not to buy large items which they would have to buy on credit, and activity in the auto and housing industries therefore suffered. According to regional sales offices of domestic car manufacturers, new car sales in the Ninth District in the first half of the year just managed to meet last year's low level. Homebuilding didn't even do that well. The number of new housing units authorized by building permits in the district was 27 percent below the level a year ago in the first half.

A third industry significantly weakened by high interest rates was agriculture, but it had other problems too. In the first half of 1981, thanks in part to the high interest rates, U.S. farmers were paying prices an average of 11 percent higher than a year ago for their inputs. At the same time, many farmers in the district were not getting prices higher than a year ago for their products. Although prices of grains and hogs were up from a year ago, prices of feeder and slaughter cattle were down. Besides that, many farmers in Montana, the Dakotas, and western Minnesota had much less to sell than a year ago in the first half because of drought conditions. As a result, income and activity in this industry were obviously weaker than a year ago: more than half of the rural bankers responding to two surveys by the Federal Reserve Bank of Minneapolis in the first half of the year said the net income of farmers in their areas was down from a year earlier, and only about 10 percent said income was up.

The first-half strength in the district appears to have been centered in three other industries. The largest is the fast-growing group of firms providing a wide variety of personal and business services, such as medical, lodging, public utility, data processing, and financial services. This industry employs roughly a quarter of the district's workers in all district states, and in the first half of the year its jobs expanded about 2 percent over a year ago.

The other two growth industries are not as large as the service industry, but each employs a significant number of people in part of the district. In the western end of the district, energy mining was booming in the first half of 1981. The phased-in decontrol of oil early in the year helped spur activity enough there so that in the first half the number of oil rigs in Montana and North Dakota increased 57 percent over a year earlier. Meanwhile, in the eastern end of the district, business was booming for computer, high technology, and machinery firms which sell to the U.S. Defense Department. The Minneapolis–St. Paul area of Minnesota has many of these firms, and they benefited from a first-half spurt in defense spending. The value of military defense contracts administered in this region was reportedly up 36 percent from a year ago in the first half.

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

Possibly More Strength in the Second Half

From a midyear perspective, it seems possible that the district economy will at least maintain its recent year-over-year strength for another six months. The outlook is, however, clouded by uncertainties. They suggest that it's also possible that the economy will weaken considerably in the second half of the year.

The outlook for one economic indicator, while not certain, is not any cloudier than usual. Regional inflation will probably come in lower than a year ago in the second half and at about the same rate as in the first half. Increases in only two components of the Minneapolis–St. Paul CPI seem likely to change much from the first half. Prices of fuel and other utilities may not increase as much in the second half as in the first because petroleum inventories are currently very large and spot prices have been declining. However, the U.S. Department of Agriculture (USDA) expects tighter meat supplies in the second half to push food prices up more than they increased in the first half. While these two opposite changes are unlikely to exactly balance, since other prices show no signs of major changes, it seems reasonable to guess that the overall CPI will again grow roughly 9 percent over a year earlier. This means inflation should again be weaker than in the comparable period last year; then prices grew more than 10 percent.

The optimistic view of overall economic activity in the district, as measured by employment, is that it could grow at least as much over a year ago in the second half as it did in the first.

The major reason for such optimism is the outlook for the ag sector. The USDA expects farm production costs to increase over a year ago again in the second half of 1981, but not by as much as in the first half. And while prices of most district products probably will not increase much over a year ago, the size of many district crops probably will. Because moisture conditions have been generally better this year, many farmers will have more to sell in the second half than a year ago—quite a change from the first half. In Minnesota, for example, the USDA now predicts that farmers will harvest about 10 percent more corn in the second half than a year earlier. With more to sell and moderating production cost increases, the district's farm income and activity picture looks somewhat better than in the first half. Of rural bankers responding to the Fed's late June survey, about a quarter expected net farm income in their areas to be greater than a year earlier in the next three months, more than double the percentage reporting greater income in the first-half. In addition, the percentage of bankers expecting farm earnings down from a year ago—about one-third—was much smaller than the more than half which had reported low earnings.

If nonag industries don't lose much of their first-half strength over a year ago in the second half, overall economic activity in the district could remain strong the rest of the year. Overall second-half employment growth would then likely be as great as—and, given the ag outlook, maybe greater than—the 1.3 percent growth in the first half.

This optimistic forecast is consistent with historical trends in the Ninth District economy as projected by our regional forecasting model. Using historical data on related U.S. and regional indicators, the model projects the paths that inflation and employment will take in the future if historical relationships don't change. Based on data from the first quarter of 1960 through the first quarter of 1981, the model projects that in the second half of 1981 prices will grow about 9 percent over a year ago, the same as in the first half, and employment will grow about 2 percent, somewhat more than in the first half.

Unfortunately, that optimistic forecast for economic activity may be too optimistic. It depends quite a bit on a continuation of the general strength in nonagricultural industries which the district had in the first half, and at midyear there are two reasons to wonder whether that general strength will last.

One is the fact that at midyear workers in several district industries were on strike. How long these strikes will last is, of course, unpredictable, and our regional forecasting model could not take them into account. Should the strikes last long, economic activity in the Ninth District could weaken considerably in the second half, despite improvement in the ag sector.

The other reason for uncertainty is just-released data on economic activity in the nation as a whole. They show that after a strong first quarter real gross national product declined in the second quarter. These data were released too late to be incorporated into the history of our regional forecasting model. Had they been, the model's forecast for the district economy in the second half could be much weaker. Clearly, if this national decline continues beyond the second quarter, the district economy could slow a lot and not match its earlier year-over-year strength.