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District Conditions

In 1981 the Ninth District* endured high inflation and slow economic growth. In 1982 it may experience some relief from high inflation, but it will probably get no relief from slow economic growth for at least the first several months of the year.

1981: High Inflation, Slow Growth

Inflation in 1981 was high by historical standards. During the first ten months of the year, the Minneapolis–St. Paul consumer price index (CPI) was up 12 percent from a year ago. The increase in the Minneapolis–St. Paul CPI is our best proxy for the inflation rate in the district.

The 12 percent inflation rate measured so far in 1981 was due in part to the rapid increase in the costs of shelter. If shelter costs are taken out of the CPI, the inflation rate looks more modest: 10 percent. Because the CPI, as it is now calculated, overstates the costs of shelter in the current financial environment, this adjusted figure may be the more reasonable one. Either figure, however, is high by historical standards.

In addition to rapid inflation overall, the district's economy also experienced significant changes in relative prices in 1981. Besides housing costs, the costs of energy and transportation in the Minneapolis–St. Paul area increased rapidly, while the costs of apparel and food increased at a considerably slower rate than the overall CPI.

While the district's CPI increased rapidly, the economy grew slowly in 1981. In the first half of the year, nominal personal income stood 10 percent higher than a year earlier, just about matching the increase in consumer prices. This means that real personal income was essentially unchanged from a year ago. Not all signs were bad in the first half of the year, however. Employment was up 1.5 percent from a year ago, led by healthy growth in employment in financial, business, and personal services.

Late in 1981, as the national economy appeared to be declining significantly, the district's economy began to weaken further. Real gross national product (GNP) grew only modestly in the third quarter, and with industrial production and retail sales both declining 1.5 percent between September and October, real GNP will probably fall in the fourth quarter. The district is already feeling the effects of this slowdown. District employment, seasonally adjusted, stopped growing in the third quarter, and in Minnesota, initial claims for unemployment insurance, seasonally adjusted, rose steeply between September and October.

One main reason that the district's growth was slow throughout 1981 was that sales of the district's key products were weak. Sales of the district's agricultural products, for instance, were weak partly because exports were off. Exports of feed grains, principally corn, from October 1980 to August 1981 were 2 percent lower in volume than they were in the comparable period a year earlier. Soybean exports during the same period were 18 percent lower than they were a year earlier. Several factors contributed to the weak ag exports. Supplies available for export were down because of poor American crops in 1980. Crop production in foreign countries, however, was generally good in 1980 and early 1981, reducing foreign demand for imports. Weakness in consumers' income in many foreign countries also checked foreign demand for American agricultural products. Finally, the strengthening of the dollar in foreign exchange markets tended to make American products more expensive abroad even though domestic farm prices were down.

The sales of nonagricultural products were also depressed during 1981. As homebuilding fell to new lows in 1981, lumber shipments from Montana and the surrounding western states during the first three quarters of 1981 remained at 1980's depressed levels. Similarly, since auto sales and business investment were weak, demand was soft for iron ore (taconite). Since the district is the leading iron ore producing region in the nation, this soft demand hit certain areas of the district hard. Although iron ore ship-

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

ments from the district grew through midyear, they tapered off later in the year. The 1981 shipments were 8 percent below the average levels attained in 1978 and 1979. During the first eight months of the year, manufacturing employment in the district, our best indicator of manufacturing production and sales, was down 2 percent from a year ago.

1982: Lower Inflation, More Slow Growth

In 1982 the Ninth District may well have lower inflation than in 1981. Its economic growth will probably continue to be slow early in the year and pick up modestly later on.

Our best guess is that inflation in the district will ease some in 1982. Statistical models that project the future from historical patterns of events indicate that the current slow economic growth and tight monetary policy will be followed by lower inflation in 1982. Our forecasting models, for instance, project 8 to 9 percent inflation nationwide next year. Other economic forecasters, on average, say that inflation may be even lower. If national inflation turns out to be as low as these forecasts suggest, inflation in the district will almost certainly drop below 10 percent as well.

Lower inflation in 1982 is far from certain, however. For one thing, the forecasts of lower inflation coming from the statistical models may not accurately reflect important changes in monetary and fiscal policies. In addition, it is not clear yet whether the American public believes that current and future monetary and fiscal policies will control inflation.

Models based on historical patterns never forecast with certainty, of course, but their 1982 inflation forecasts may inspire less confidence than usual. Two primary forces affecting inflation—monetary policy and fiscal policy—may be in the process of changing from the historical patterns these models reflect. The Federal Reserve's current policy of sustaining relatively slow rates of money creation is, to some extent, a break with the past. The long-term federal tax cuts passed last summer may imply that a significant change in fiscal policy is coming as well, although the extent and nature of the change will not be clear until firm decisions about future federal deficits are in place. With monetary policy apparently on a new course and fiscal policy possibly changing, the range of uncertainty surrounding the historically based forecasts of lower inflation in 1982 is unusually large.

American consumers, workers, and businesses will soon be able to signal whether they believe the forecasts of lower inflation. A number of important long-term wage contracts will be renegotiated in 1982, and data available by the end of the year should reveal whether price and wage restraint has spread from a few depressed industries to the economy as a whole. Real progress in reducing inflation in 1982 depends on sustaining monetary and fiscal policies that can convince the public that inflation will be controlled in 1982 and in the years to come.

But while inflation may improve, the district's economic growth in 1982 will probably start slow, pick up later in the year, and average not much better than in 1981. At the start of the year, economic growth should be very slow and may be negative. No immediate pickup should occur in agricultural income, for instance. Although district farmers had bumper crops in 1981, poor prices should continue to restrain farm income.

Economic activity off the farm should also be slow in early 1982. With housing starts reaching record lows in late 1981, no quick turnaround in the district's lumbering industry is likely. Metal mining is not expected to improve soon either. The current high rate of unemployment among Minnesota's taconite workers is not likely to change as long as automobile and durable goods sales remain poor, as they are predicted to at least through early 1982.

Furthermore, a pickup in manufacturing production early in the year seems unlikely because growth in new orders has recently eased. Last spring, 46 percent of the manufacturers responding to a University of Minnesota survey reported that their new orders were increasing, but in August and November, only 35 percent reported increasing new orders.

Consistent with the sluggish outlook for the district's major industries in early 1982 is the bleak outlook for the national economy in the coming months. The leading indicators dropped 2.2 percent in September and 1.8 percent in October, and the consensus of economic forecasters is that real GNP may drop a bit in the first quarter.

There will probably be an improvement in the district's economy in the second half of 1982, but of modest proportions. Growth in the national economy should contribute to the district's economic growth. One of our national forecasting models predicts that real GNP will increase 2.7 percent from the fourth quarter of 1981 to the fourth quarter of 1982, with much of the growth occurring in the second half. Economic forecasters, on average, expect even faster growth—3.2 percent in the same period—also with the preponderance occurring in the second half. The district's growth for the year on an annualized basis will probably be around only 1 or 2 percent even if the national economy rebounds.

The district's increase for the entire year will be modest, because of its dependence on agriculture. Even if the nation's economy springs back sharply, the district's economy will not respond rapidly, because farm income —which is three times as important in the district as in the nation—will not snap back as quickly as income in other parts of the economy. The U.S. Department of Agriculture is forecasting that farm income in 1982 will be close to 1981's low level.

Our regional forecasting model, based on historical trends, also supports this forecast of slow regional growth for the year. This model predicts district employment to rise 2 percent in 1982, less than the average annual increase of 3 percent experienced in the 1970s.