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District Conditions/A Midyear Report

Our first quarter "District Conditions" analysis indicated that the recovery of the U.S. economy, then just getting under way, might turn out to be robust. This conjecture proved correct. And in light of the economy's impressive performance in the second quarter, at midyear the recovery appears even stronger than we anticipated. Forecasters are now predicting that, between the fourth quarters of 1982 and 1983, inflation-adjusted gross national product (real GNP) will increase between 5.5 and 6 percent, about one percentage point more than they were expecting last March.

Despite the gains and apparent momentum of the national economy, at midyear important sectors of the Ninth District's economy are still below their depressed levels of a year ago.* Moreover, the special circumstances which have slowed district activity are likely to remain at least through the end of this year. This is not to say the Ninth District economy is faltering. The point is, rather, that it has not recovered quite as robustly as the national economy so far this year, and it may not through the end of 1983.

A Brisk U.S. Recovery . . .

The nation's second quarter was indeed strong. Real GNP rose at a 9.2 percent annual rate between the first and second quarters, more than twice as much as many analysts had predicted in March. This growth more than offset the economy's decline during the last half of 1982, so that real GNP was several percent higher than a year earlier in the second quarter.

The second quarter surge was primarily due to a burst of consumer spending. This recovery, like most recoveries in the postwar era, began with a revival in the housing industry. Spending on new homes started rising noticeably late last year and continued strong through the first half of this year. Consumer outlays for other goods and services, which account for about two-thirds of GNP, started expanding rapidly in the second quarter, when they rose at a 10 percent annual rate, adjusted for inflation. The pickup in all kinds of consumer spending gave a lift to output at the nation's factories. One measure of U.S. output, the industrial production index, rose at an 18 percent annual rate between the first and second quarters.

Although most forecasters do not expect the national economy to maintain the second quarter's blistering pace, they do expect substantial growth through the end of 1983. In the third and fourth quarters, forecasters expect real GNP to expand at brisk annual rates of about 6.5 and 5 percent, respectively. One factor which makes these forecasts plausible is the fact that personal income increased at an 8.9 percent annual rate in the second quarter of 1983, an increase well above the 5.1 percent increase in consumer prices. This, along with the July 1 tax cut, has given consumers the wherewithal to continue boosting their purchases the rest of the year. Another positive factor is that businesses should be working to restore inventory levels in the second half of 1983. Due to the second quarter sales pickup, which was unanticipated by many manufacturers, the June inventory-to-sales ratio in manufacturing was the lowest in the 25 years for which data are available.

. . . Not Quite Matched in the District

Unlike the national economy, at midyear much of the district economy is still lagging the depressed levels of last year. We anticipated this possibility some time ago. In fact, over the last 12 months our "District Conditions" analysis has repeatedly stated that lingering weakness in agriculture and mining might keep the

*The Ninth Federal Reserve District consists of Minnesota, Montana, North Dakota, South Dakota, northwestern Wisconsin, and the Upper Peninsula of Michigan. Because economic data are not readily available for portions of states, our following state-by-state analysis is necessarily restricted to the four states that lie completely within the district's borders.

district's economy from recovering as strongly as the nation's. Although there are certainly some bright spots to report at midyear, this assessment seems to be largely correct.

Thanks to consumers, the district has undoubtedly begun to recover. The district's housing industry, like the nation's, is considerably stronger than a year ago. During the first half of 1983, the dollar value of F. W. Dodge contracts for residential building was 42 percent greater than the value in the first half of 1982. The national upturn in housing has quickly been translated into increased output and employment in the lumber industry, which is particularly important in some parts of the district. Judging from anecdotal evidence as well as sales tax receipts, district consumers have begun to buy things beside houses too, especially autos and other durable goods.

Weakness in Agriculture . . .

The district's farm sector also improved a bit in the first half—but not enough for most farmers' incomes to exceed the depressed levels of a year ago. For the last three years, most of the district's rural bankers responding to our quarterly Agricultural Credit Conditions Survey have reported income declines among farmers in their areas. In late June, however, most of the respondents (66 percent of them) said that net farm earnings in their areas in the second quarter roughly matched those of a year ago. District agriculture remains weak, since 1982 was itself a poor year for most farmers. Much of the recent stabilization of farm incomes can be attributed, directly and indirectly, to the Payment-In-Kind (PIK) program that was discussed in the last "District Conditions." The PIK program has clearly helped, but by itself seems inadequate to restore many farms to profitability.

Weakness in farm income affects far more than farmers, of course. Agriculture directly accounts for around 8 percent of personal income in the district. Weakness in this industry, however, also hurts a considerable number of district businesses that supply farm inputs or process farm outputs.

. . . And Mining

The district's mining industry—primarily iron and copper mining in the east and copper and energy mining in the west—remains badly depressed at midyear. Overall, the mining industry is operating with substantial excess capacity, in terms of workers as well as plant and equipment. Low employment levels in mining affect overall employment, and mining is much more important in the Ninth District than it is in the nation. Partly reflecting these facts, in May 1983, nonagricultural employment was 1.2 percent below its level in May 1982 in the district but down only 0.7 percent in the nation.

Diversity Among Four District States

Recent economic conditions vary considerably among the four complete district states, reflecting the diversity of their industrial structures.

Declines in Minnesota and Montana

In Minnesota, nonagricultural wage and salary employment in May was down 1.5 percent from a year ago. This is primarily because of developments in the mining, manufacturing, and government sectors. With iron production in Minnesota down 46 percent from a year earlier during the first five months of 1983, it is not surprising that metal mining employment in May was down 30 percent in the state. At the same time, Minnesota's manufacturing employment was down 3.5 percent, with about half this decline occurring in the nonelectric machinery industry. Reflecting in part the adverse impact of the weaknesses of agriculture, mining, and manufacturing on state and local revenue, government employment in May was down 3 percent from a year ago. Some of Minnesota's large job declines were offset by a 1.5 percent increase in the services industry, the only major sector in the state to show an increase.

Nonagricultural wage and salary employment in May was down 2.7 percent from a year ago in Montana—nearly twice as much as in Minnesota—and the mining industry was largely responsible. Whereas in Minnesota mining is primarily restricted to metals, in Montana it includes energy exploration and production, and that type of mining has been severely cut back too. The number of active gas and oil rigs in Montana during the first half of 1983 was down 55 percent from a year earlier. And the state's major copper mine was permanently shut down earlier this year. These cutbacks resulted in Montana's mining employment in May being 28 percent below its year-ago level. With both mining and agriculture weak in May, industries supporting them—construction, services, and transportation—also had year-to-year declines. The only major sector in Montana offsetting these declines was the government sector, where employment was up 2.5 percent from a year ago.

Some Strength in the Dakotas

In terms of nonagricultural employment, the Dakotas have lately done better than the rest of the district.

In South Dakota, wage and salary employment off the farm was unchanged in May from a year ago. Unlike Minnesota and Montana, South Dakota does not have a large mining sector to depress activity. Just about every major employment sector in South Dakota managed to remain close to its level of a year ago in May.

In North Dakota, nonagricultural employment actually surpassed its year-ago level in May, by as much as 1.6 percent. This is surprising because North Dakota, like Minnesota and Montana, does have a sizable mining industry. The number of active oil and gas rigs in North Dakota during the first half of 1983 was down 60 percent from a year ago, which pushed mining employment 24 percent below its year-earlier level. However, the construction of a $2.2 billion coal gasification plant helped push construction employment 17 percent above its year-earlier level in May. This, combined with employment increases in the services and government sectors, more than offset the state's sharp decline in mining employment.

District Recovery to Continue

These differences in economic strength among district states will probably last through the end of 1983. And weakness in mining and agriculture should continue to restrain the performance of the district economy a bit, compared to the national economy.

The outlook for mining is not encouraging. While industry analysts expect gas and oil drilling to increase somewhat in the second half of 1983, they expect it to remain well below the high levels of past years. Analysts don't expect iron mining to pick up much the rest of the year.

Agriculture's outlook is not encouraging either. Most district bankers responding to our late June survey thought farm income in the third quarter would just match last year's weak third quarter level. District agriculture does have one bright note, though. Some Ninth District farmers might do somewhat better this year than farmers nationally because the recent extremely high temperatures have so far hurt district crops less than crops in many other parts of the country.

In summary, we expect the district's economy to continue recovering through the end of 1983, but not quite as strongly as the nation's.