District Conditions

Last fall our forecast for the Ninth District* economy in 1982 was mixed. We thought that the district could get some relief from high inflation, but that economic activity in the area would grow about as slowly as it did in 1981, with most of the 1982 growth coming in the second half. After a few months of the new year, that forecast seems basically sound, although a bit too optimistic about growth. Inflation in the district still seems likely to slow this year, and economic activity still should strengthen as the year progresses. Overall, however, the district's economy now seems likely to grow somewhat less in 1982 than it did in 1981.

Single-Digit Inflation

Our outlook for district inflation in 1982 does not seem to have been overly optimistic.

Like the rest of the country, the district endured double-digit inflation for much of last year. We can't tell that from changes in the usual proxy for the district's price level, the Minneapolis–St. Paul consumer price index (CPI). It has recently been discovered to have had statistical problems in the last two years, so its changes are not reliable.** However, changes in the U.S. CPI should be pretty close to changes in the district price level; prices normally rise at about the same rate across the country. In 1981, the U.S. CPI increased about 10 percent from its 1980 level.

Last fall we cautiously predicted that the district's price level would increase less than 10 percent in 1982. This fairly imprecise forecast was based on predictions for inflation nationwide. Our national economic models, which simply project historical trends, put inflation at about 8 or 9 percent in 1982. Other national forecasters, on average, put it even lower. Forecasting was harder than usual late last year because the economic environment was more uncertain than usual. Monetary policy had changed and fiscal policy appeared to be changing, so historical patterns built into the models might no longer be accurate predictors. And the public's expectations about the effect policy changes would have on inflation were not clear, so how consumers, workers, and businesses would respond wasn't either. Given all this, though, a best guess that the district's inflation rate would drop below 10 percent in 1982 seemed reasonable.

It seems considerably more reasonable now. Data available since our last forecast indicate that inflation has already dropped dramatically. Between December and February, the U.S. CPI increased at an annual rate of only 4 percent. There isn't enough 1982 inflation data for our models to use for a new prediction, but the consensus of other forecasters has fallen. Uncertainty about a single-digit inflation forecast for the district has been reduced, too, by some evidence that workers are expecting lower inflation: several large unions have made wage concessions in early 1982.

Slow Growth

Our forecast for district economic growth in 1982 does seem to have been a little too optimistic.

Last fall we expected economic activity to grow slowly, on average, in 1982, about as slowly as it had in 1981. That meant for the year we expected district employment to grow only around 2 percent. (Employment is the best available indicator of overall economic

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

**The statistical problems of the Minneapolis–St. Paul CPI have been with its shelter component. The U.S. Bureau of Labor Statistics (BLS) routinely bases these costs on the purchase prices of homes insured with Federal Housing Administration (FHA) loans. Between mid-1980 and mid-1981, however, the number of Minneapolis–St. Paul home sales covered by the FHA was too small to provide reliable estimates of shelter costs in this area. During those months, the BLS increased its sample by adding data on FHA sales in five other midwestern cities to those on sales in Minneapolis–St. Paul. Later in 1981, when enough FHA sales were again made in the Twin Cities, the BLS returned to purely Twin City data. That data eventually revealed that housing costs in the six midwestern cities were actually not comparable: housing costs had apparently been higher in Minneapolis–St. Paul than elsewhere. As a result, any changes in the overall CPI calculated with data involving the six-city sample do not accurately reflect inflation rates in Minneapolis–St. Paul. [See Tom Davies, Statistics inflated Cities' inflation, *Minneapolis Tribune* (January 26, 1982): 16.]

activity in the district.) We didn't expect growth to be evenly distributed over the year, though. Activity seemed likely to expand very slowly early in the year and then pick up enough later to compensate for the weak start.

The general 1982 forecast was based on district economic conditions last fall as well as on forecasts for activity nationally. All of the district's major industries were ending 1981 weakly, too weakly for a recovery to begin early in 1982. U.S. forecasters saw that same situation nationally and predicted a slow start in 1982 followed by a modest recovery in the second half of the year. Since the district's economy is so diverse, producing a wide variety of goods and services—much like the nation as a whole—the general pattern of economic activity forecasted for the nation is usually applicable to the district.

The strength of the recovery later in 1982, however, was expected to be less in the district than in the nation as a whole. That is because the district is three times more dependent on agriculture for income than is the nation, and that sector was expected to be facing its third consecutive year of low income. While U.S. forecasts last fall were for enough strength in the second half to make the U.S. economy expand around 2 or 3 percent in 1982, the forecast for district economic growth had to be less than that: only about 1 or 2 percent, we guessed. That, again, was roughly the same moderate growth the district experienced in 1981.

The new year does seem to be off to a slow start. There are few district economic indicators available for 1982 yet. However, there are some national indicators, and as we said, the general directions they move are applicable to the district. Between December and February, available U.S. indicators were stagnant or declined. Both employment and consumer spending, seasonally adjusted, did not grow at all during this period, and sluggish demand prompted U.S. manufacturers to curtail output: industrial production, seasonally adjusted, dropped about 1 percent.

The few 1982 indicators available for the district declined. District employment, seasonally adjusted, fell 1 percent between December and February. Surveys taken by the University of Minnesota in February indicated that consumer spending and industrial activity in Minnesota had both weakened from a few months earlier. The number of retailers saying their sales were down from a year ago jumped from 47 percent in November to 65 percent in February. About half the manufacturers responding to the university's survey said new orders and production fell in the three months ending in February.

Conditions in the district's relatively large agriculture sector early this year probably made this region's economic growth even slower than the nation's. Between December and February, farmers' input costs did hold steady and some product prices increased. But these changes were partly seasonal and meant little to farmers' weak income situation. Compared to a year ago, when farm income was already low, in February 1982 overall farm costs were up 5 percent and in some areas prices for major farm products were down as much as 25 percent.

The weakness early in 1982, while predicted last fall, seems to have been a bit more pronounced than most U.S. forecasters expected, for they have lowered their forecasts for economic growth in 1982. The consensus projection for growth in the gross national product, adjusted for inflation, between the fourth quarter of 1981 and the fourth quarter of 1982 has dropped from 3.2 percent to only 1.9 percent.

The weak early 1982 data and the reduced national forecasts indicate that the economic outlook for the district must be reconsidered too. Again, the district's heavier dependence on agriculture and that industry's outlook must be taken into account. The ag outlook has not improved since last fall. According to the U.S. Department of Agriculture (USDA), the prices farmers pay for their inputs will keep rising in 1982 while the prices most receive for their products keep falling. The USDA expects U.S. net farm income this year to be 35 percent below last year's level and nearly 55 percent below the level in 1979, the last good year for farm income. This means, of course, that the district's economic growth still cannot be expected to match the nation's in 1982. With national forecasts reduced about 1 percentage point and with the continuing low farm income, we still think the district's economy will grow, on average, in 1982, but we no longer think it will grow as much as last year.

Recovery

Simply looking ahead to the rest of the year, however, the district's prospects look brighter. The overall 1982 forecast still includes enough strength in the second half of the year to offset the weakness earlier.

There are at least two reasons to expect a modest recovery to begin later in the year. This winter U.S.

businesses sharply cut back their inventories to a low level more appropriate for their recent weak sales. Low inventory stocks mean that eventually production may have to increase, even if sales remain subdued. Stronger sales are likely, though, since many consumers across the country will have more money to spend after midyear. That's when the next scheduled federal tax cut takes effect, as well as when the annual cost-of-living adjustments are made to Social Security benefits. While these national phenomena won't restore prosperity to agriculture, they should boost activity in most other district industries.

The views expressed herein are those of the author and not necessarily those of the Federal Reserve Bank of Minneapolis or the Federal Reserve System.