District Conditions*

The Ninth District has moved into 1979 just about as expected—sustaining both healthy economic growth and high inflation—and those conditions are still likely to last the rest of the year.

You've heard this before . . .

For about a year now researchers at this Bank have been predicting strong regional growth in both economic activity and prices through 1979. In mid-1978, in fact, we detailed a forecast for the next 18 months, a forecast produced by an experimental regional econometric model. Data available for the first quarter of 1979 indicate that so far the model's predictions have pretty much come true.

The forecasts of healthy growth seem to have been the best. The model predicted that throughout 1979 consumers in Minnesota (the only state with this data available) would spend 12 percent more than a year before, and in January, retail sales in that state grew 11.3 percent. The employment prediction was not quite that accurate, but this was a happy miss. During the forecast period, job growth from a year earlier was expected to average 2.8 percent, with growth slowing from above average to below average by the end of 1979. In February, district employment increased 4.4 percent, even more than expected early this year.

As the model predicted, much of this strength came from the district's very busy construction industry. We didn't predict just how busy this industry would be, but the general expectation of brisk activity despite high interest rates was clearly correct. In February, the industry was generating enough new jobs to lift construction employment 9.4 percent above its level a year ago, with North Dakota and Minnesota posting rates as high as 17 and 12 percent, respectively. The number of building permits authorized for new homes remained well above last year's level in January, despite a seasonal decline. And in February the value of contracts awarded for commercial construction shot up 60 percent.**

The model's inflation forecast proved generally right too—inflation was high in early 1979—but unfortunately it was much higher than predicted. Since early 1978, prices in the Ninth District rose 10 percent, not 8.5 percent, as expected. The model forecast missed mostly because it was based on a consensus forecast of U.S. inflation that was also 1.5 percentage points low. U.S. inflation was expected to be 7.5 percent; it came in at 9 percent.

. . . and you're hearing it again

Where the model missed significantly, its predictions obviously need some revision. Generally, though, the old forecast is still good: The district can look forward to continued healthy economic growth and high inflation the rest of 1979.

Economic activity should certainly remain at least as strong as predicted earlier. The construction industry and retail spending in the region came in on target, so we're not changing those forecasts. The model's employment forecast was somewhat low, however, so we're boosting it a little. Since the recent 4.4 percent growth was higher than expected, the slower growth later this year is likely to be higher too. We now think, therefore, that on average the number of district jobs will grow not 2.8 percent but between 3 and 3.5 percent the rest of 1979.

The inflation forecast is much more uncertain. Though inflation will undoubtedly remain high, there are conflicting signals about how high.

Based on the recent annual data, we should revise up the model's forecast of 8.5 percent growth in prices. The model projects regional inflation based on a forecast of national inflation, and both forecasts turned out to be very low. Yet the recent month-to-month changes seem to indicate that regional inflation is slowing. Between December 1978 and February 1979, growth in the Minneapolis-St. Paul consumer price index actually decreased slightly while growth in the U.S. index increased sharply. This is not only a slowing for the district but also a break from the recent pattern of prices rising faster regionally than nationally.

Whether these changes are permanent is still too early to tell, so our prediction for inflation can't be very precise. If the new patterns continue, district inflation probably won't be as far from our earlier 8.5 percent forecast as the recent experience suggests. Our best guess at this point is that in 1979 prices in the district will grow somewhat more than 8.5 percent but somewhat less than the recent 10 percent.

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

**Construction contract data provided by the F. W. Dodge Division of the McGraw-Hill Information Systems Company.