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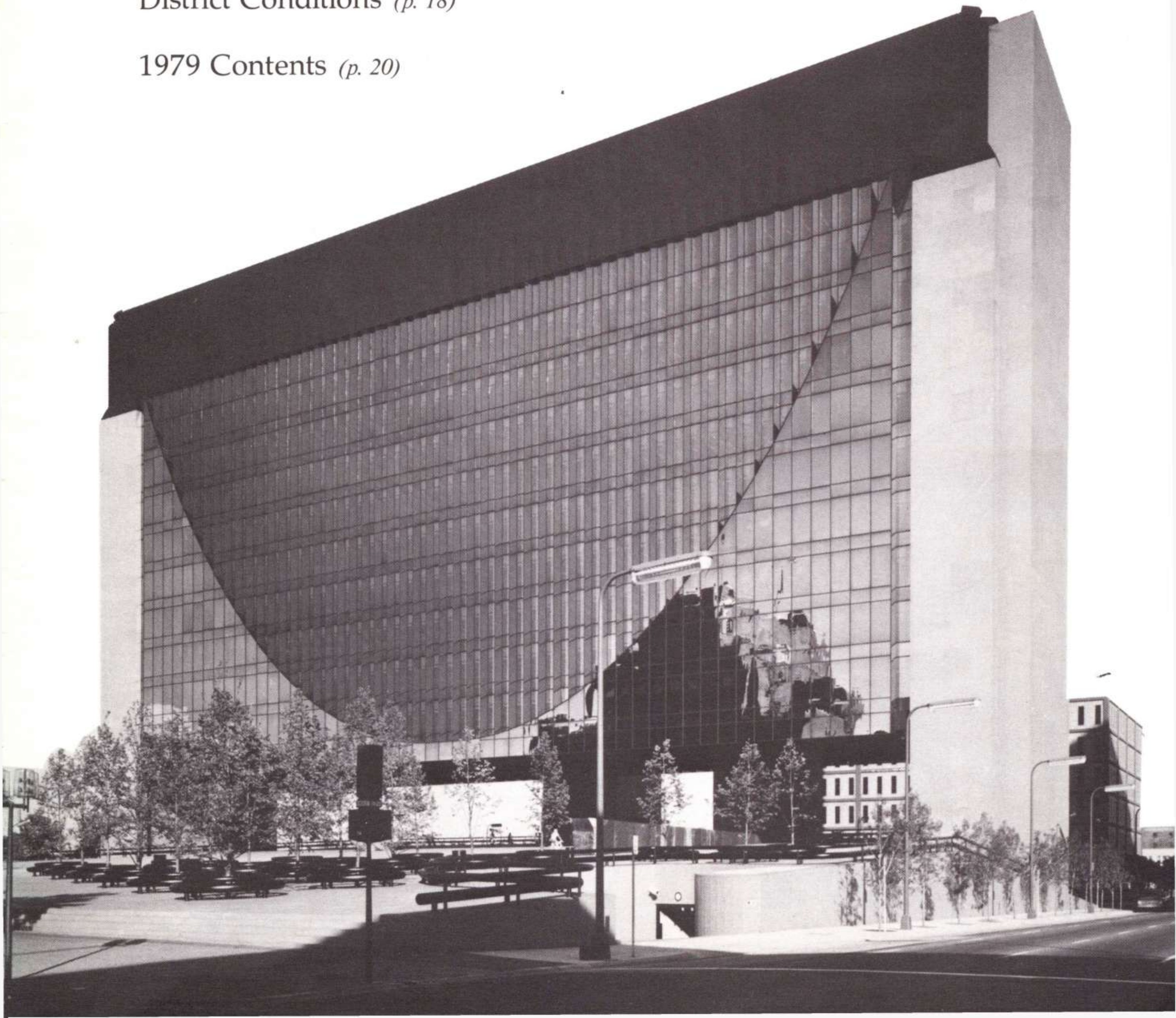
# Forecasting 1980







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This publication primarily presents economic research aimed at improving policymaking by the Federal Reserve System and other governmental authorities.

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

# District Conditions

Last fall we predicted that the district* would have double-digit inflation but no decline in output, that is, no recession in 1980. Nothing has happened since then to change this forecast; in fact, we're somewhat more confident about it now, despite the dramatic recent embargo on grain sales to the Soviet Union.

## The embargo shouldn't dent 1980 ag income

Strength on the district's farms was expected to be a major influence on overall economic activity in 1980. Near the end of 1979 we thought high prices for most ag goods in 1980 would result in output and income at least as good as the year before. Because the ag industry directly and indirectly provides jobs for about one-third of the region's workers, such strength would significantly boost the prosperity of the region as a whole.

January 4, however, the Carter administration announced that it would block the sale of 17 million metric tons of grain to the Soviet Union. With farmers in the Ninth District producing about 25 percent of the nation's wheat and 12 percent of its corn, this embargo could have been disastrous for the district.

The potential effects of the embargo are a matter of simple economics: when demand for a good drops but its supply stays the same, the price drops too; lower demand means people are willing to pay less than before for the same amount. And that obviously means lower income for the good's producers, in this case, farmers.

The embargo will reduce the world's demand for grain. If all countries were to cooperate with the United States and not sell any additional grain to the Soviet Union, the embargo would cut demand by close to the full 17 million tons. But even if other countries do not completely cooperate, even if they produce more or buy some of the U.S. grain and sell it to the Soviet Union, the embargo will cut demand somewhat. To get grain from anywhere other than the United States will cost the Soviet Union more because of the extra production, transportation, handling, and storage expenses. Because of the embargo, therefore, the Soviet Union will want to buy less grain than it would have otherwise. This is simple economics again: when a good costs more, people want to buy less of it.

To offset this reduced demand and so prop up grain prices, the U.S. government has several plans. To increase demand, it will offer loans and tax credits for the use of grain to produce gasohol, and it will actively try to develop alternative foreign markets. Since these efforts probably won't immediately nullify the embargo's effect on demand, the government also intends to try to reduce the supply of grain. It will buy and store the embargoed grain that has reached grain dealers, and it will sweeten farmers' financial incentives to store what's left.

There's some question about whether these government actions will be enough in the long run. Gasohol production is still a costly and problematic business, so it may not absorb much of the excess grain. And simply taking grain off the market creates a huge stockpile which may someday be returned and depress prices. One extra effort the government is considering that could minimize future price effects is to pay farmers now to produce less grain in the future.

So far, however, the government's efforts seem to be working, and we don't expect farm income to suffer from the embargo in 1980. The prices of grain delivered and grain promised to be delivered this year fell sharply in the confusion after the embargo announcement. But in the next two weeks most prices returned to their preembargo levels, and some have since surpassed them. Besides that, harvests in the district have been much better than expected. Minnesota's corn crop, for example, beat its last estimate by 6 percent. With prices high and lots to sell, it thus still seems plausible

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

to predict that 1980 will be as good as 1979 for district farmers.

### New Reasons for Optimism About Output . . .

Our forecast of no district recession thus still seems plausible too. In fact, some things have happened since the fall report which make us even more confident about it.

One is a year-end boost to the weak homebuilding industry. Leading indicators for this industry pointed downward last fall, but since then the government has moved to increase the flow of funds available for mortgage lending. It allowed financial firms to offer a money market certificate which many small savers are finding attractive. While residential construction in 1980 will probably still not come near last year's level, thanks to the new source of funds the industry will likely provide more jobs and income for the district than we thought.

Another reason for optimism is that the data released early this year generally show a stronger economy than we had assumed or predicted. To make predictions for 1980 with our regional forecasting model last fall, we first had to guess what the rest of 1979 would be like nationally and locally. Our guesses were pretty close to the new data. Output in the nation as a whole actually grew slightly instead of declining slightly between the third and fourth quarters. And output in the district grew enough to add about the predicted number of people to district payrolls. Since the number of people looking for work increased somewhat faster than expected, the regional unemployment rate was also up a little more than expected. By January, though, many new jobs were available, according to the Minneapolis–St. Paul help-wanted ads, and consumers across the country were still spending heavily, indicating that the expected national recession is not yet in sight. We still think, therefore, that district output, measured by employment, will grow about 2 percent in 1980.

### . . . and Pessimism About Prices

Unfortunately, new data also reinforce our prediction for inflation in 1980. Nationally and regionally, prices grew just as expected between the third and fourth quarters of 1979, so we must retain the model's forecast of 13 percent more growth in the Minneapolis–St. Paul consumer price index this year.