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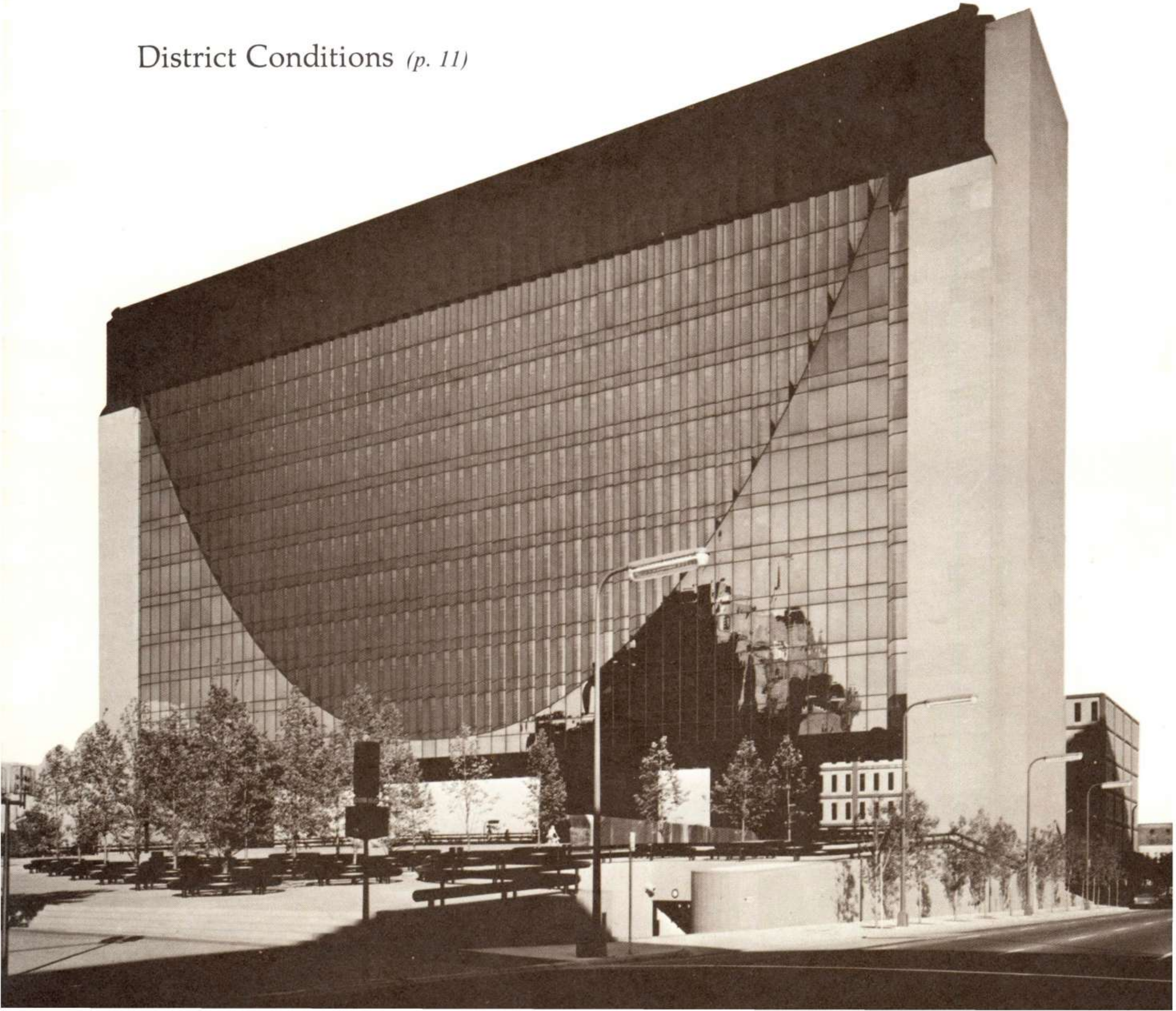

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This publication primarily presents economic research aimed at improving policy making by the Federal Reserve System and other governmental authorities.

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District Conditions*

Autumn brought the Ninth District just about what we predicted last summer—continued strong growth in both economic activity and inflation—and we still think these conditions will last into 1979. How good that forecast is now, however, depends mostly on how effective the national anti-inflation program is.

A pretty good forecast . . .

In our summer issue, we made a fairly confident forecast for a healthy district economy despite high inflation. With only the usual caveats about large margins for error and possible wrong assumptions, we reported the predictions of our small econometric model: based on data through June it said that in the next year and a half regional employment would grow at about a 3 percent annual rate, homebuilding would remain brisk regardless of interest rates, retail sales would grow steadily, and inflation would stay about 1 percentage point higher in the district than nationally, which meant probably a district rate of about 8.5 percent. We buttressed the model's forecast with results of our two latest surveys. Most rural bankers said in July that they expected farmers' income and ability to repay debt to improve in the next three months. And manufacturers responding in August expected large sales increases right through the first quarter of 1979.

Data available through fall generally say this forecast was good. In September, total employment in the district was 1 percent higher than in June and 4 percent higher than a year earlier. The construction industry posted the largest annual gain, a healthy 9 percent, and jobs in manufacturing and most other industries increased as much as 5 percent. Crops have been excellent across the district while prices have been high, so farm incomes moved up too; and rural bankers responding to our October survey remained optimistic. District consumer prices in August rose 10.2 percent above a year ago, considerably more than the nation's 7.9 percent and somewhat more than we predicted. The biggest deviation from our summer outlook, however, seems to be what happened to retail sales. Despite the job and income increases, in Minnesota (the only district state with this data available) they declined in late summer instead of growing.

A couple of other unexpected things happened too, though their effects have not shown up in the data yet. A shortage of transportation developed in the district's ag industry, mainly because of the huge grain crops. Thus, although most commodity prices are fairly high, many farmers have not been able to sell their crops. Elevator operators, with their bins already full, have stopped buying grain until they are sure they can deliver it to market. Something of a shortage also developed in Minnesota's mortgage market. The usury ceiling in that state floats two percentage points above an index of long-term government bond rates that recently dropped significantly while most other market rates were rising. In November, therefore, the usury ceiling dropped below market rates, so lenders cut back on their conventional mortgage lending in favor of better-paying FHA/VA loans (which are exempt from the ceiling).

. . . and we're sticking with it

Despite these new factors, we're sticking with our earlier forecast of at least another year of a growing economy and high inflation—though we're somewhat less confident about it.

We don't think either of the bottlenecks will last long enough to affect the forecast. Some form of transportation will undoubtedly materialize to meet farmers' needs soon, so overall farm income is not likely to be hurt. And the government loans exempt

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