District Conditions*

According to our small econometric model, even if the nation suffers a mild recession, economic activity in the district will grow in 1979, and inflation will remain fairly high.

One Good Year After Another?
1978 was an excellent year for the district. Although the inflation rate shot up to 11.4 percent, other economic indicators looked very healthy. Employment increased about 4.8 percent—the most in at least a decade and a gain of over 140,000 jobs. Construction activity, both residential and commercial, was very brisk. Farm cash receipts came in more than 15 percent ahead of the year before, and total personal income grew about 12 percent.

Maintaining this kind of growth would be very hard for any region, and it is not likely that the Ninth District can do it. But whatever happens to the regional economy depends a lot on what happens nationally, and forecasters seem to disagree about what that will be in 1979.

Our best guess is that the United States economy will grow moderately this year.** Real gross national product (GNP), the output of goods and services, adjusted for inflation, will increase 3 to 3.5 percent, at or just slightly below the trend over the last two decades. This implies employment growth of 2.1 percent, an unemployment rate of 6 percent, and inflation nearly 8 percent.

Some people believe, however, that a recession is likely in 1979. Most of them expect a mild slowdown, including two or three quarters of slightly shrinking real GNP, with overall growth only 1 to 2 percent. Their consensus forecast would probably be no growth in employment, an unemployment rate of 7 percent or higher sometime during the year, and inflation averaging the same as we expect, about 8 percent.

With the help of a regional econometric model developed by researchers at this Bank, we can see what each of these national outlooks would mean for the region. The model is a computer program which includes quantitative relationships between some basic regional and national economic indicators. The relationships have been estimated from historical data for both the region and the nation. Using these estimated relationships and a forecast of national economic conditions, the model can produce a forecast of regional economic conditions.

Growth—Despite Recession
The model has produced two 1979 forecasts for the district, one based on each of the national forecasts, and they both make the region look basically strong.

The outlook for employment, the most reliable indicator of regional economic activity, is especially good.

If our optimistic forecast is right and the U.S. economy grows moderately in 1979, the model says the regional economy should match that growth. The 2.1 percent increase in national employment would mean a 2.3 percent increase in regional employment. This may not look impressive compared to last year’s 4.8 percent increase, but it is substantial; remember, 1978 was an exceptionally good year.

And 1979 might not be too bad either, even if the nation has a mild recession. For according to the model, if the pessimistic forecasters are right, the regional economy will grow somewhat slower in 1979, but it will still grow. Despite two quarters of slightly declining production and essentially no growth in employment nationally, regional employment would still grow 1.2 percent. Again, that is far short of 1978’s 4.8 percent, but it represents an

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

**See the preceding article in this Quarterly Review.
crease of almost 40,000 jobs in the region at a time when employment in the nation as a whole would not be increasing at all.

Unfortunately, the outlook for inflation is not quite as bright. Everyone seems to expect U.S. inflation to average about 8 percent in 1979. Our model translates this into regional inflation around 8.5 percent—much lower than last year's 11.4 percent, but still uncomfortably high.

**It's plausible**

Thus, the model says 1979 will be a year of high inflation and modest growth for the district, even if a mild recession develops nationally. Such a forecast may seem surprising at first glance, but a closer look at regional conditions shows that it's plausible. There are at least two factors which could help make the district resistant to recession.

One is the strong outlook for the district's construction industry. Most people predicting a national recession expect a drop in building activity, but district building is not likely to follow a national slide this year. Commercial construction is booming in the region; quite a few large projects are under way which won't be completed until well into 1980. District homebuilding is relatively busy too, and historically it has lagged national downturns. In 1979, therefore, activity in the construction industry could cushion the impact of a national recession on district incomes.

The other factor supporting strength in the district is the 1979 outlook for farm income, which is also quite good. The U.S. Department of Agriculture has predicted that nationally cash farm receipts may increase as much as 10 percent, fueled by higher prices and heavy export demand, among other things. So far this year, the district outlook seems at least as good. Nearly all the rural bankers responding to our January survey expected local farm incomes in the next three months to be the same as or greater than a year ago. District livestock farmers are already getting much higher prices than a year ago. And crop farmers may be helped by this winter's bad weather: Although heavy snow could delay spring planting in many areas, right now it is protecting the winter wheat crop, and it will be providing the soil moisture essential to good crops year round.

Ninth District farmers won't necessarily be better off than other farmers in 1979, but the optimistic outlook has special implications for this district. Farming and agribusiness contribute a larger share of total income to the district than to the nation as a whole. And farm income generally isn't influenced much by the business cycle. If the U.S. economy starts to sink into a recession, therefore, the ag industry could buoy the district economy.

**In Sum**

Strength in construction and agriculture will probably do more than keep the district out of a recession, however; we think both the national and district economies will grow moderately in 1979. Even if we're wrong about the nation, though, our model predicts another year of high inflation and comfortable growth for the region.