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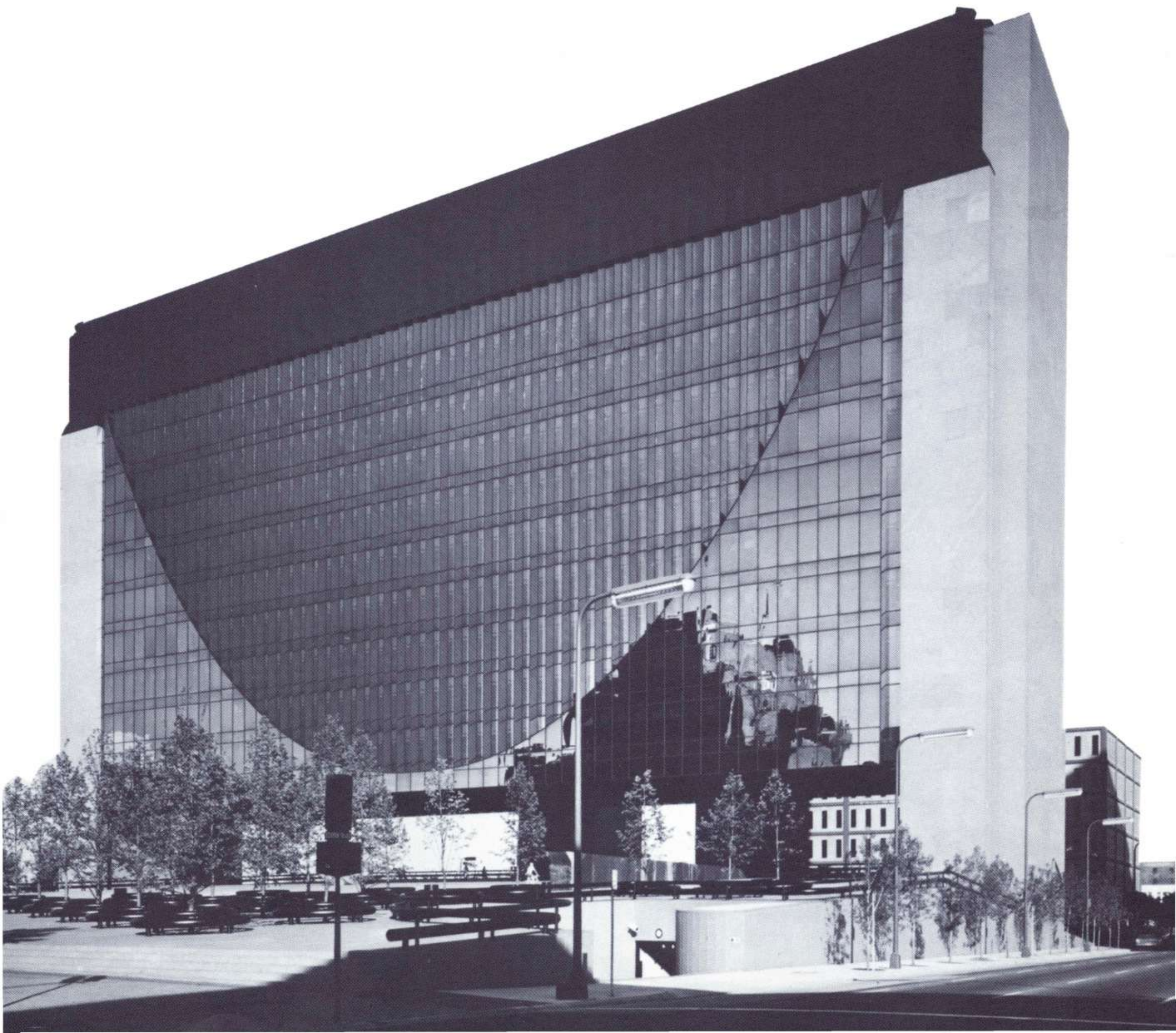

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This publication primarily presents economic research aimed at improving policymaking by the Federal Reserve System and other governmental authorities.

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District Conditions

Unforeseen events early in 1980 have increased uncertainty about the Ninth District economy over the rest of the year. Farm income fell, interest rates rose to record levels, a credit control program was imposed, and the nation apparently entered the long-awaited recession. While these events have made us less confident than before about the outlook for the district, our forecasting model still predicts that it will avoid a recession, and that prediction still seems plausible.*

Last Forecast: No Recession, High Inflation

Last winter we predicted that, despite the embargo on selling grain to the U.S.S.R., farmers would help the district stay out of a recession. Government programs appeared to be nullifying the embargo's impact, and by late January, grain prices had returned to their preembargo levels. Consequently, we expected farm output and income to be about the same in 1980 as the year before. In addition, various indicators of the national economy looked positive at the time of the last forecast. The homebuilding industry had just received an influx of new mortgage funds, thanks to a new government ruling which allowed financial firms to offer money market certificates to small savers. Besides, output was still growing, and many new jobs were available. Thus, our model forecast 2 percent growth in district employment, accompanied by 13 percent inflation.

This spring our model is still giving us the same prediction. While unexpected recent developments have made a recession seem more likely, the model still could be right.

*Using employment growth as a proxy for economic growth, our winter *Quarterly Review* forecast no recession for the Ninth District. A commonly used rule of thumb for a national recession is two consecutive quarters of decline in real gross national product (GNP), the total of all goods and services produced by the economy. But a comparable measure of production is not available for the district. To estimate it, we have to use an important input measure — employment — and assume that changes in this measure roughly correspond to changes in output. The Ninth Federal Reserve District consists of Minnesota, Montana, North and South Dakota, northwestern Wisconsin, and the Upper Peninsula of Michigan.

Farm Income Down, Interest Rates Up

One unexpected development is that farm income has fallen from a year ago. Farmers intend to plant 4 percent more acres this spring than last, but our earlier forecast of farm income nevertheless appears to be optimistic. While the government continued its efforts to nullify the impact of the grain embargo, in April market factors pushed grain prices below their preembargo levels again. In addition, farm production costs increased 6 percent between December and April. With prices decreasing and costs increasing, 56 percent of the rural bankers responding to our April survey reported their areas' farm income down from a year ago, nearly twice as large a share as said that three months earlier.

While the drop in farm income is not encouraging for the regional economy, past history suggests that the government will step in with higher price supports or other help if the drop continues. For this reason, our model's forecast of no recession in the district looks attainable in spite of the decline in farm income.

Another unexpected development is that interest rates have been much higher than predicted. Our forecasting model, along with most experts, expected interest rates to remain at their December levels, but instead they rose to record levels in the first quarter, the prime rate reaching 20 percent. These higher rates have reduced lending. If prices had risen as rapidly as interest rates, lending might not have been affected, for borrowers could have passed on the higher interest costs. But interest costs for many merchants rose faster than the prices of their merchandise, so they cut back on their borrowing to help maintain their profitability. Furthermore, in states where usury ceilings kept interest rates from rising, lending became so unprofitable