Ninth District economy slips into recession

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Troubles that started in the financial sector have led the U.S. and district economies into a recession. According to the Minneapolis Fed's forecast model and business outlook poll, the economic downturn is expected to continue well into 2009 and will likely dig deeper in the eastern part of the district compared with the west.

Consumer spending is expected to remain weak, employment is predicted to contract and unemployment rates are anticipated to increase in 2009. Home building and residential real estate markets have been in the doldrums, and recovery may be more than a year away. However, inflation worries have dissipated as a number of energy and commodity prices have recently decreased. Agricultural producers had a good year in 2008, but are concerned about profitability in 2009.

District follows U.S. economy into downturn

According to the National Bureau of Economic Research, the arbiter of when recessions begin and end, the U.S. economy slipped into a recession starting in December 2007. Since the beginning of 2008, the U.S. economy has lost 1.9 million jobs through November. Furthermore, initial claims for unemployment insurance benefits were up more than 50 percent in November compared with a year earlier.

The broadest measure of economic growth, gross domestic product, didn't decrease during the first half of 2008, but contracted 0.5 percent in the third quarter and is anticipated to drop further in the fourth quarter. The third and fourth quarters were dealt sharp decreases in consumer spending, which comprises more than two-thirds of the economy.

Employment and consumer spending conditions in district states largely echo those of the nation, as a number of companies announced layoffs since September. Districtwide, nonfarm employment was down 0.4 percent in October compared with a year earlier.

Sectors with the largest employment decreases include construction (−3.9 percent), manufacturing (−2.6 percent) and professional and business services (−1.5 percent). While employment as a whole was soft, not all sectors shed jobs during the first 10 months of 2008. Sectors with increases in employment include education and health services (+1.8 percent), natural resources and mining (+1.6 percent) and government (+1.4 percent). (See chart below.)

Just as not all sectors have lost jobs, not all states have lost jobs either. Montana and the Dakotas recorded job gains in October compared with a year earlier (see chart above). While economic conditions have slowed in Montana and the Dakotas, these areas are weathering the national recession better than the eastern parts of the district due, in large part, to a relatively strong agriculture sector, as well as strength in mining and oil drilling activity. However, recent drops in commodity prices have softened activity in these sectors.

As employment has contracted, claims for unemployment insurance benefits have climbed, as has the unemployment rate. In Minnesota, initial claims for unemployment insurance were up 31 percent in October compared with a year earlier. Unemployment rates increased in all areas of the district during 2008. The district unemployment rate for October reached 5.3 percent compared with 4.4 percent a year ago.

According to the Minneapolis Fed's forecasting model, employment is expected to contract in Minnesota, Wisconsin and the Upper Peninsula of Michigan in 2009, with modest growth in Montana and the Dakotas (see page 13). Meanwhile, unemployment rates are predicted to increase in all areas in 2009, except in Montana.

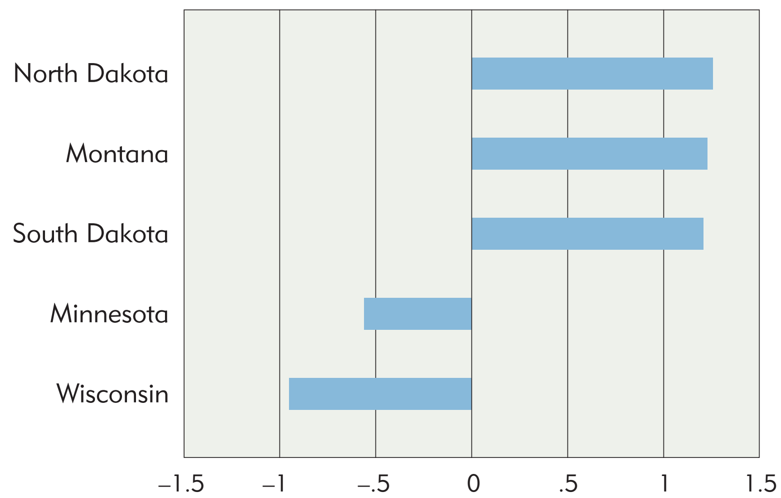
As jobs have been lost, consumer spending has been constrained. Not only has the downturn in employment stifled spending, but the ability of consumers to harness home equity and consumer loans has diminished as home values have decreased and credit standards have tightened. Reports from major retailers based in the district point to slow sales in October and November.

The outlook for retail suggests that consumers will continue to pull back spending through the holiday season and into 2009. A preholiday spending survey conducted by the University of St. Thomas of households in the Minneapolis-St. Paul area indicated that respondents expected to spend over 10 percent less on holiday gifts compared with last year's season. Furthermore, 85 percent of respondents to the business outlook poll expect consumer spending to decrease in their communities during 2009.

Home building and sales continue their torpor

The financial crisis has its roots in the residential real estate market, as a relatively large percentage of subprime

Nonfarm Employment, October 2008
Percent Change from a Year Earlier



Source: Bureau of Labor Statistics

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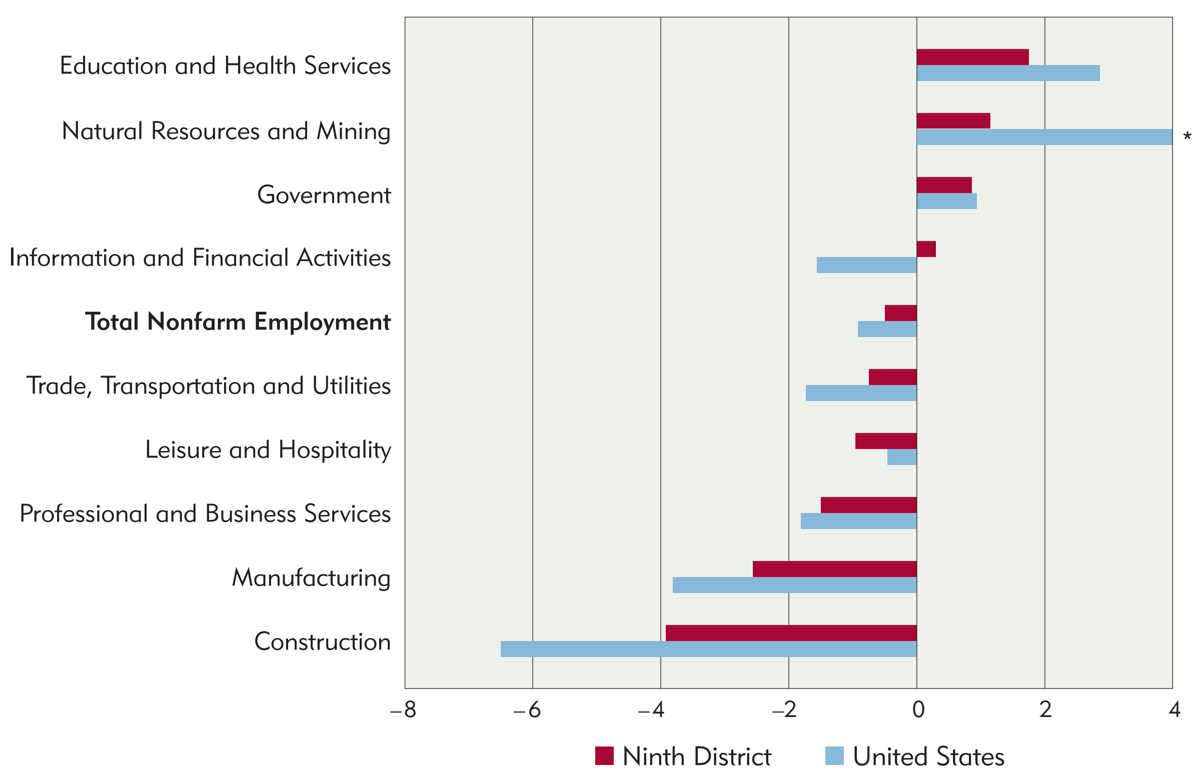
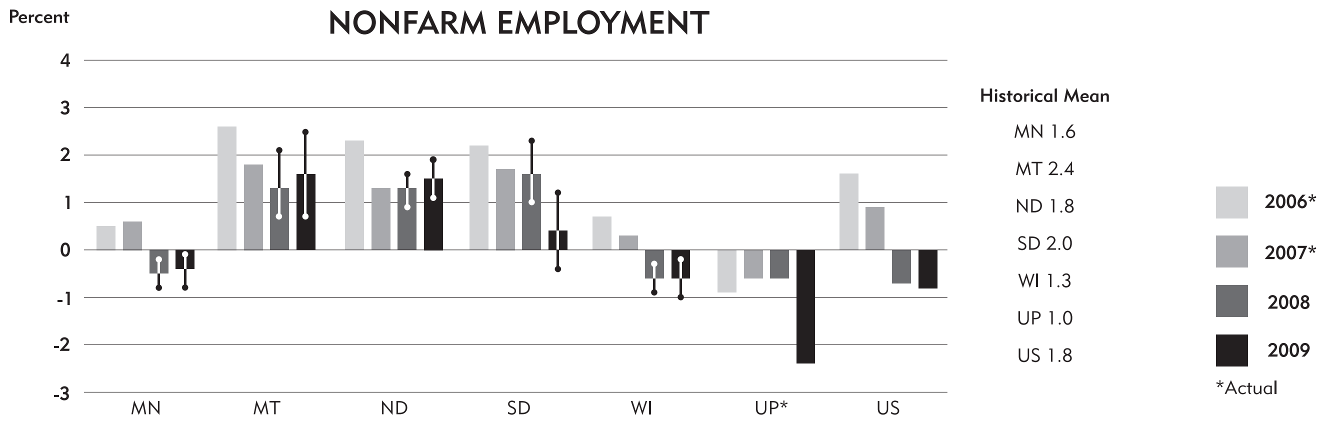


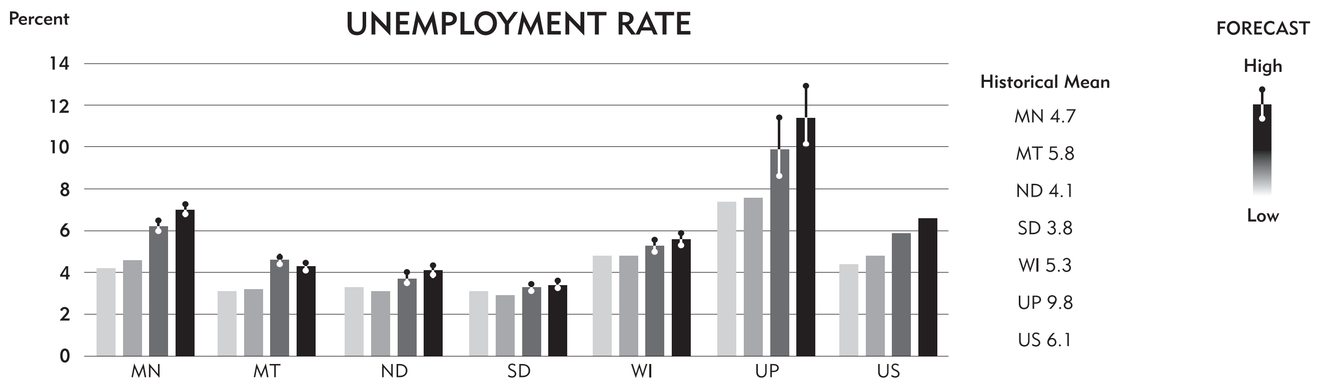
*U.S. natural resources and mining employment increased 10.3 percent.
Source: Bureau of Labor Statistics

District Forecast

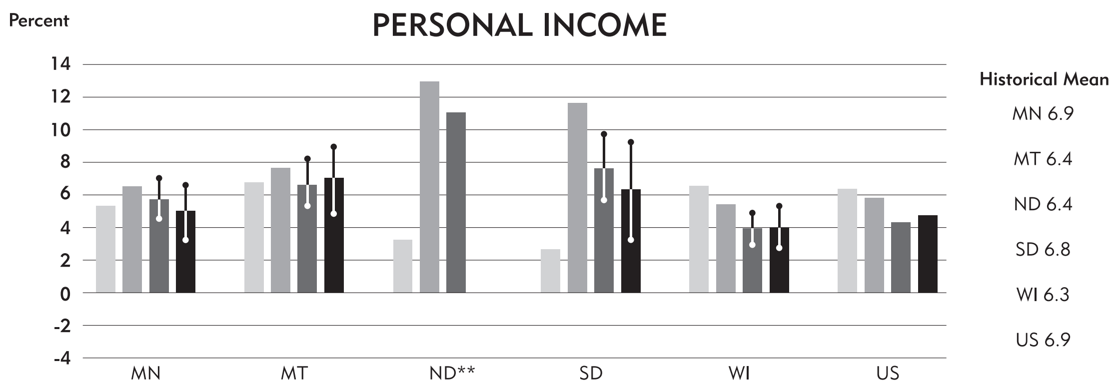
Employment is expected to contract moderately. Nonfarm employment decreased from 2007 to 2008 in Minnesota, Wisconsin and the Upper Peninsula of Michigan, while employment increased in Montana and the Dakotas, but at growth rates below historical averages. In 2009, employment will continue to decrease moderately in Minnesota and Wisconsin, while dropping more than 2 percentage points in the U.P. Meanwhile, employment growth is predicted to remain positive in Montana and the Dakotas, but at rates below historical averages.



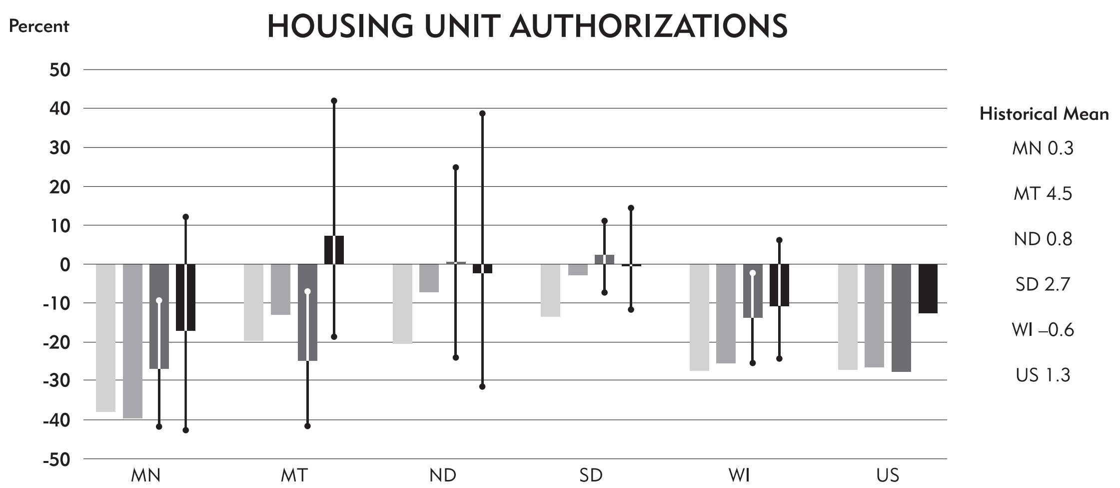
Unemployment rates are predicted to increase. In 2008, unemployment rates climbed higher in all areas of the district compared with the previous year. Unemployment rates grew more than 1 percentage point higher in Minnesota, Montana and the U.P. In addition, rates in 2008 were at or above historical averages in Minnesota, Wisconsin and the U.P. In 2009, unemployment rates are expected to climb higher in all areas, except in Montana, where rates are expected to decrease slightly. Furthermore, rates are anticipated to reach historical averages or higher in all areas except Montana and South Dakota.



Personal income is expected to grow. Personal income increased in 2008 in all areas of the district, but at slower rates than in 2007. In North Dakota, personal income grew more than 10 percent in large part due to gains in farm income. Personal income is predicted to increase in all areas of the district during 2009, except in North Dakota, where income is expected to decrease. The expected decrease in North Dakota is likely attributed to the volatile nature of farm income. Growth rates in 2009 will slow compared with rates in 2008, except in Montana and Wisconsin, where income growth is expected to pick up slightly.



Housing units authorized are expected to decrease. In 2008, housing units authorized decreased in all district states, except for slight increases in the Dakotas. Authorizations decreased more than 20 percent in Minnesota and Montana. Housing units authorized are predicted to decrease in 2009 in all district states, except in Montana, where authorizations are anticipated to increase. Authorizations in Minnesota and Wisconsin are expected to decrease more than 10 percent.



*Confidence interval for 2008 is –5.4 to 4.3 and for 2009 is –8.5 to 4.1.
**Forecast for 2009 is –6.1. Confidence interval for 2008 is –7.7 to 33.7 and for 2009 is –26.3 to 21.3.

home loans packaged into complex securities became delinquent and went into foreclosure. Since the outset of the crisis, home prices, sales and building have plummeted in many areas.

Home prices in Minneapolis-St. Paul, Fargo, N.D., and Sioux Falls, S.D., decreased 10.7 percent, 4.7 percent and 1.8 percent, respectively, during third quarter 2008 compared with a year earlier. Meanwhile, existing home sales decreased in all areas of the district during the same period.

Home building continued to tumble during 2008. Following annual decreases since 2005, housing units authorized decreased 29 percent during the first 10 months of 2008 compared with a year earlier. During the past year, nonresidential building also slowed, but it remains relatively strong compared to residential building.

The outlook for home building continues to look grim for 2009. Almost 80 percent of respondents to the business outlook poll expect housing starts to decrease in their communities during the upcoming year, and the Minneapolis Fed's forecasting model also points toward decreases in housing units authorized.

Manufacturing has also suffered during the economic downturn. In addition to job losses in the sector, Creighton University's survey of manufacturing showed that manufacturing activity in Minnesota contracted from August through November. However, manufacturing growth in South Dakota only turned negative in November, and growth continued in North Dakota. According to the Minneapolis Fed's business outlook poll and survey of manufacturers, district manufacturers are pessimistic regarding manufacturing activity in 2009 (see story on page 15).

Inflation fears dissipate

Energy and commodity prices soared during the first part of 2008. But as the economy began to slow during the latter part of the year, these and other prices began to fall as well. The consumer price index decreased 1 percent in October from September levels, the steepest one-month decline since the Bureau of Labor Statistics began releas-

Continued on page 14

Outlook from page 13

ing seasonally adjusted changes in 1947.

The energy component of the index fell almost 9 percent in October. Average Minnesota gasoline prices dropped to $1.72 per gallon by the end of November, almost $1.25 lower than a year earlier. Meanwhile, the core component of the CPI, which excludes volatile energy and food prices, decreased 0.1 percent in October from September levels and was a modest 2.2 percent higher than a year earlier.

Prices also moved lower for a number of wholesale goods measured in the producers price index; the finished goods index dropped a striking 2.8 percent in October from September. The decrease in prices from their upward trends spells good news for consumers and a number of businesses. Lower retail prices can give a shot in the arm to consumer spending, and lower input costs can help widen profit margins.

Ag profits up in 2008; concern for 2009

Price volatility increased, planting and harvests were delayed and bioenergy firms ran aground, but Mother Nature blessed producers with a large harvest in 2008. Moisture conditions improved across most of the Ninth District, except in the far eastern portion.

Average 2008 prices increased for wheat, corn, soybeans and steers; however, average input costs also increased. The outlook for 2009 is mixed, with many producers facing costs that may exceed expected revenues. Wheat and cattle prices are expected to increase, and replenished soil moisture conditions may help produce another bumper crop.

Many changes occurred in 2008 for Ninth District agricultural producers. Demand for grains initially increased as ethanol plants consumed more corn, but ethanol producers cut back usage as costs exceeded revenues. Late spring rains delayed planting, and autumn rains pushed back the harvest. After huge increases in prices through the first half of the year, prices for many commodities fell fast. For example, diesel prices increased 55 percent from January through July, but then dropped 35 percent from July to October. Propane prices increased 21 percent from January through July, but then dropped 36 percent from July to October. Poultry and pig feed prices also posted notable increases from January through July and then declined from July to October.

However, a number of other input costs increased throughout 2008. October prices for fertilizer and agricultural chemicals (including pesticides) increased 87 percent and 9 percent, respectively, from January. October cattle feed prices increased 15 percent from January.

Even with all these changes, agricultural production increased in 2008. Estimated corn production in Minnesota and the Dakotas is over 2 billion bushels, an increase of about 5 percent from 2007, and soybean production (at half a billion bushels) is expected to be on par with 2007. However, 2008 district sugar beet production dipped 7 percent from 2007. Cattle on feed in South Dakota during November 2008 were about level with November 2007.

The outlook for 2009 is mixed. Soil moisture conditions have improved, which bodes well for crop production. According to U.S. Department of Agriculture forecasts, 2009 prices for wheat will increase, remain level for corn and decrease for soybeans. However, cash rents, fertilizer and other costs are expected to eat into 2009 profit margins. Cattle and hog prices are expected to increase, while dairy prices are expected to decrease from 2008 levels (see table above). ■

AVERAGE FARM PRICES

	2005/2006	2006/2007	Estimated 2007/2008	Projected 2008/2009
(Current $ per bushel)				
Corn	2.00	3.04	4.20	3.65–4.35
Soybeans	5.66	6.43	10.10	8.25–9.75
Wheat	3.42	4.26	6.48	6.40–7.00
	2006	**2007**	**Estimated 2008**	**Projected 2009**
(Current $ per cwt)				
All Milk	12.90	19.13	18.30–18.40	14.95–15.75
Choice Steers	85.91	91.82	92.59	92.00–99.00
Barrows & Gilts	47.26	47.09	47.73	48.00–52.00

Source: U.S. Department of Agriculture, estimates as of December 2008

All signs point to a down 2009

By TOBIAS MADDEN
Regional Economist

A vast majority of business leaders in the Ninth District expect a recession in the U.S. economy in 2009, according to the November *fedgazette* business outlook poll. This was evident across district states as well as across economic sectors. Leaders also have a pessimistic outlook for their own businesses and communities. One cause of the pessimism is credit conditions (see related articles in this issue). The outlook is the worst in the 18-year history of the poll. A small silver lining: Inflation concerns have moderated.

The outlook for local economies is dismal across most parts of the Ninth District. Respondents from all areas look for business investment, employment and consumer spending to drop in their communities. The severe downturn in housing starts is likely to continue, according to respondents. They see contraction in their own operations, as they expect decreasing employment and capital investment. Besides the overall economy, complying with government regulation is the main concern among responding business leaders.

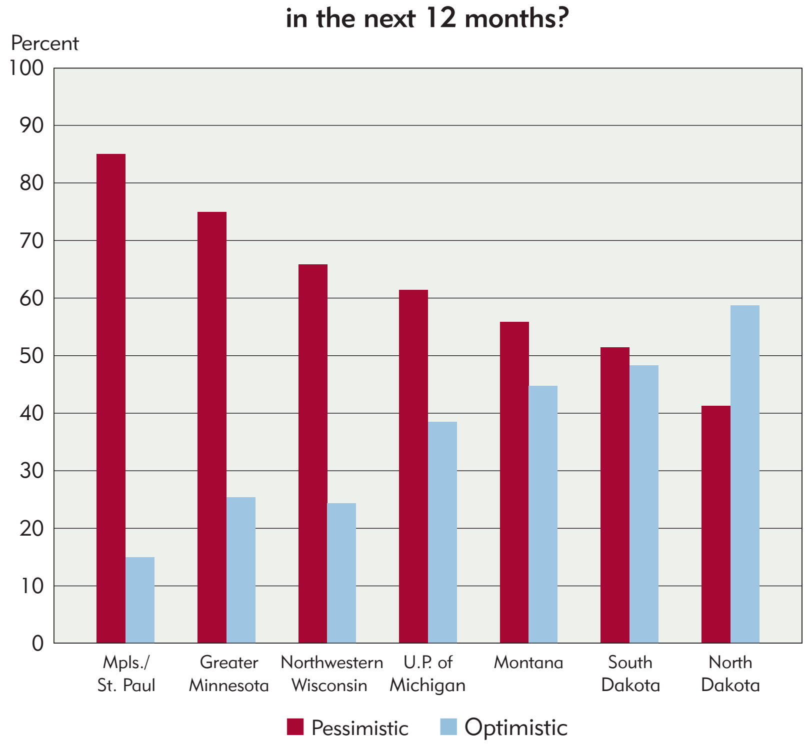
Nearly 80 percent of the respondents foresee a recession in 2009. "Deep trouble," a Minnesota wholesaler commented. The average recession responses range from 63 percent in northwestern Wisconsin to 85 percent in the Minneapolis-St. Paul area. Meanwhile, the recession responses across sectors range from 72 percent of retailers to 92 percent of agricultural producers. However, a Minnesota manufacturer said, "The current situation is part of the economic cycle; the sky is not falling."

Respondents expect inflation to moderate in 2009. About one-quarter predict inflation of around 1 percent, and about a third predict roughly 2 percent. However, 20 percent look for inflation of 4 percent or higher. The finance, insurance and real estate sector foresees the lowest level of overall inflation. The lowest inflation predictions for 2009 come from South Dakota and Montana.

The majority of respondents—71 percent, the most in the poll's history—are pessimistic about their community's economic performance in 2009 (see chart at right). The pessimism is strongest in Minnesota, and Wisconsin respondents were in a similar mood. "Look for improvement in third quarter 2009," commented a professional service firm from western Wisconsin. South Dakota respondents were neutral, and North Dakota respondents were optimistic.

Across both geographic areas and economic sectors in the district, respondents predict significant declines in employment and business investment in their local economies. The weakness in employment may be holding down wage and salary increases. Forty percent of the respondents expect wages to be flat to up 1 percent in their communities in 2009. Most

Overall, what is your outlook for your community's economy in the next 12 months?



Source: Federal Reserve Bank of Minneapolis of the balance of respondents foresee wage increases of around 2 percent to 3 percent.

In addition, major decreases in consumer spending are predicted. A full 85 percent of the respondents look for consumers to spend less in their communities. The results are similar across the states, except for North Dakota, where 58 percent expect spending to decrease. Meanwhile, respondents from all the various economic sectors anticipate declines.

Housing starts are expected to decline again in 2009. "There is no need for additional space and housing," commented a Minnesota real estate professional. Throughout the district, 78 percent expect housing starts to fall in 2009.

Respondents are also pessimistic about their own firms. Overall sales revenue in 2009 is expected to fall from 2008 levels (see chart at right). However, sales increases are anticipated by North Dakota and western Wisconsin respondents. Meanwhile, sales drops are expected for firms in the retail, construction and manufacturing sectors. "We see little business or retail expansion in 2009," said a Minnesota real estate developer.

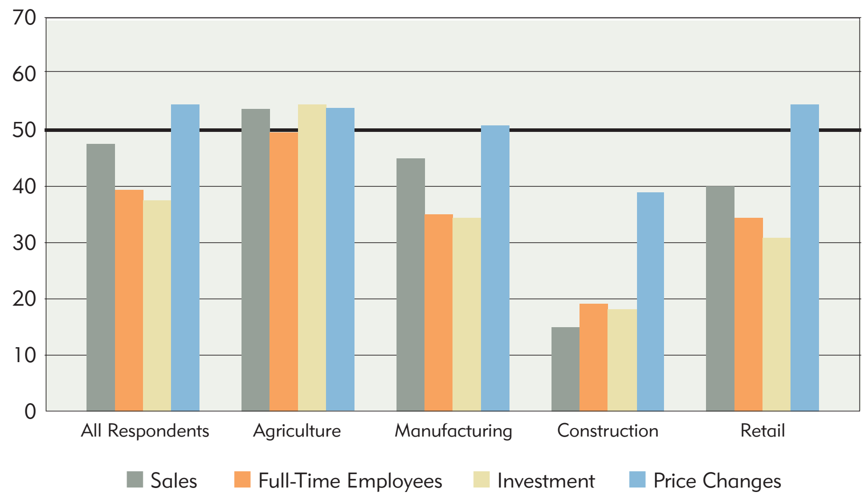
Pricing pressure has moderated. About 30 percent of respondents expect to increase prices on their products and services, while 20 percent see price declines in 2009. The biggest declines are foreseen in the construction sector. About a third of the respondents from the services sector expect price increases, and 14 percent expect price decreases.

Meanwhile, company inputs are expected to drop sharply. "We will need to make significant cuts in full-time positions to survive 2009," a Minnesota manufacturer said. Thirty-seven percent of the respondents expect to cut employment in 2009, while only 15 percent expect to increase jobs. "We are concerned that employment cutbacks from companies like ours will deepen the recession," said a retailer from Minnesota. Investment in plant and equipment is also expected to drop, with 45 percent foreseeing decreased levels and 19 percent anticipating increased levels. Although inputs may decrease, productivity grew in 2008, as 65 percent of respondents reported increased levels of productivity.

In previous business polls, finding workers was the biggest challenge facing businesses. This year, that dubious honor went to complying with government regulation, with 78 percent of respondents citing it as a challenge in 2009. f

With regard to your own company, how do you see operations changing during the next year?

(Above 50 indicates expansion; below 50 indicates contraction)



Source: Federal Reserve Bank of Minneapolis

Manufacturing sliding into 2009

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Manufacturing activity decreased slightly in 2008 across much of the Ninth District. Unfortunately, manufacturers' outlook for their operations in 2009 is faltering, as are their expectations for their state economies, according to the November survey of manufacturers conducted by the Federal Reserve Bank of Minneapolis and the Minnesota Department of Employment and Economic Development. Responses were largely similar across states, with the exception of North Dakota, where manufacturers expressed more optimism.

Manufacturers noted a slowdown in 2008: Production was flat, but the number of new orders decreased slightly. "Our customers are retailers and distributors who are buying less due to slow sales," commented a mid-size Montana manufacturer. Employment and capital investment decreased slightly due to weakened orders.

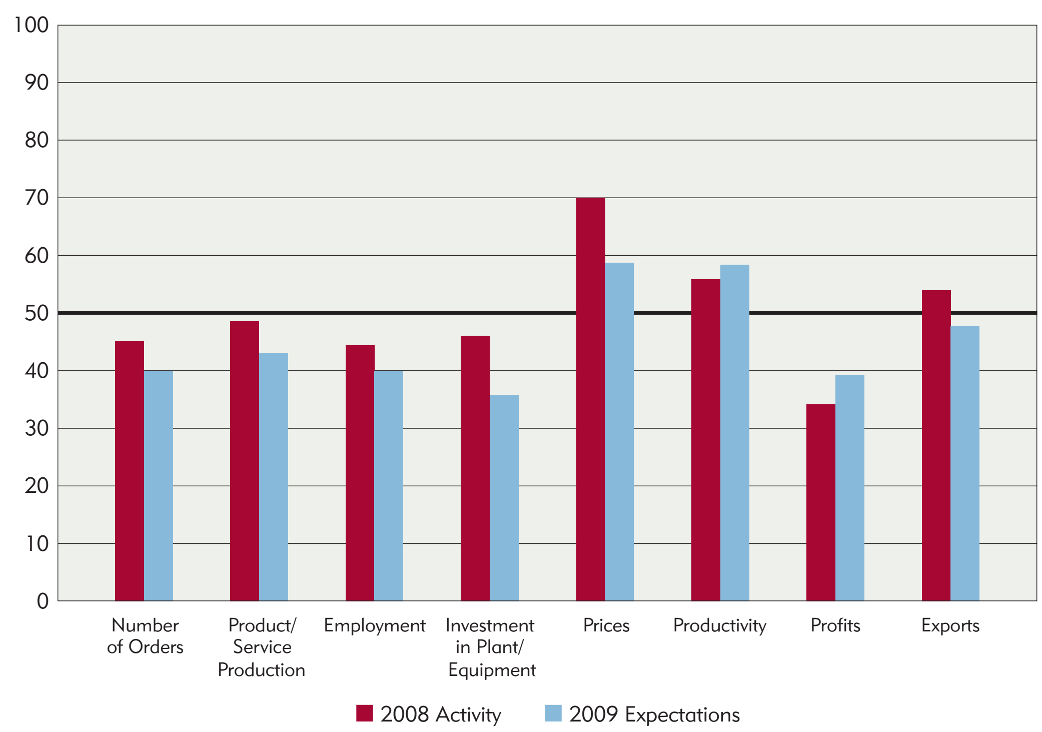
On the bright side, exports increased in 2008. The 2008 overall results were similar across the district, except in North Dakota, where respondents reported that 2008 manufacturing exceeded 2007 indicators. Manufacturers are experiencing tighter credit, but apparently not to the same extent as other sectors. Only one in five manufacturing firms said their access to credit had declined in the previous three months, and for large manufacturers, it was just 13 percent. This compares to 30 to 35 percent of firms across the Ninth District, based on other surveys by the Minneapolis Fed (see cover article).

Manufacturers across the district expect the 2008 slowdown to continue into 2009 (see chart below). Expectations for profits and orders are down, although exports are projected to remain relatively stable. In response to lower anticipated demand, manufacturers expect to lower both production and employment levels. Investment is also projected to decline. Several respondents attributed their investment and expansion concerns to increased uncertainty related to credit conditions and the president-elect's agenda. Conversely, manufacturers expect productivity to increase over the next 12 months. The 2009 outlook was largely shared throughout the district with two notable exceptions. Montana manufacturers responded more pessimistically than the rest of the district, while in North Dakota expectations were positive.

When asked specifically about their state economies, over 68 percent of respondents said they expect lower economic growth in 2009. A similar proportion of respondents expect declines in employment, investment and corporate profits, and 79 percent expect decreased consumer spending. In addition, over half of respondents indicated that they expect inflation to increase. Again, these results were robust across district states with the exception of North Dakota, which expects to fare better than the rest of the district. f

Manufacturers See Continued Slowdown in 2009

(Above 50 indicates expansion; below 50 indicates contraction)



Source: Federal Reserve Bank of Minneapolis. Manufacturers Survey conducted in cooperation with the Minnesota Department of Employment and Economic Development.