

Mild Ninth District recovery expected to warm up

By ROB GRUNEWALD
Associate Economist

TOBIAS MADDEN
Regional Economist

The mild economic recovery could warm up in 2011, according to results from the Minneapolis Fed's forecasting models and outlook surveys. Since the end of the recession in June 2009, economic conditions have slowly improved; and though employment levels dropped over this period, they have recently crept higher. Consumer spending has increased moderately, and the manufacturing sector is expanding.

Looking to 2011, respondents to the Minneapolis Fed's business outlook poll have expressed renewed optimism following two years of pessimism. Furthermore, the forecasting models predict increases in income and employment. The agriculture outlook is upbeat, with ample soil moisture and expected higher prices for outputs. However, relatively high unemployment rates are predicted in some district states, and home building is not expected to recover anytime soon.

Underlying the overall positive report is optimism expressed by respondents to the business outlook poll, where 63 percent were somewhat or very optimistic for their community's economy during 2011, up from 42 percent in last year's poll (see page 18). This level of optimism hasn't been recorded since the 2007 outlook poll. Respondents to the Minneapolis Fed's survey on business confidence were

also more positive than negative regarding business-related metrics involving their firm, including sales, profits, hiring and capital spending.

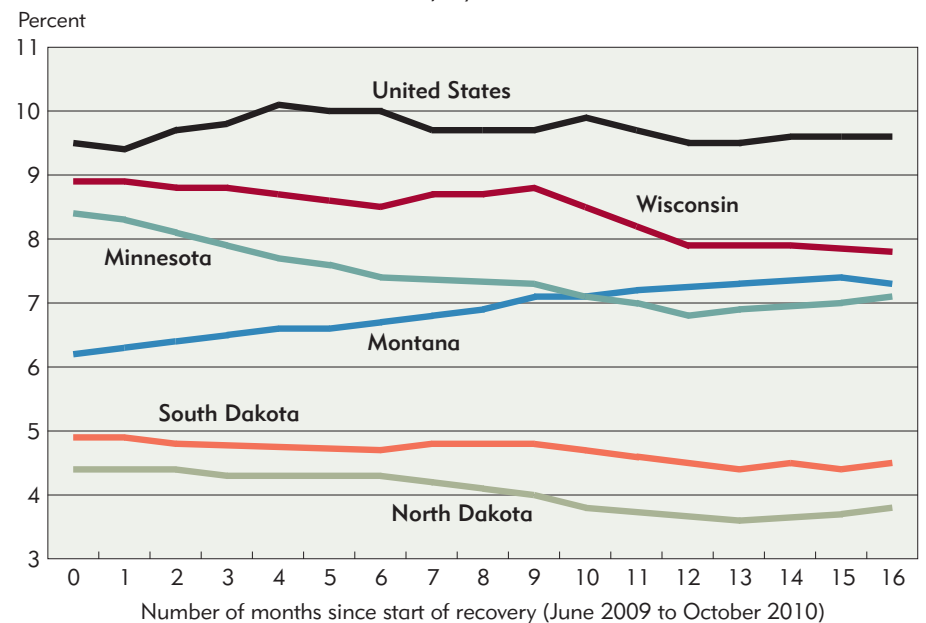
Overall employment is picking up

Since the beginning of the economic recovery in June 2009, U.S. and district employment growth has been subdued (see Chart 1). Nonfarm employment decreased in all district states except North Dakota, which was also the only district state where employment levels during the recession and recovery did not dip below prerecession levels.

However, during the second half of 2010, employment has begun to grow in district states, except in Montana, where employment levels have slid recently. But overall levels are comparatively low; Minnesota employment remains 3.6 percent below its prerecession level. Though district unemployment rates are better than the national rate across the board (see Chart 2), Minnesota, Montana and Wisconsin rates remain well above prerecession levels.

In October, district nonfarm employment was almost 1 percent ahead of last year, better than the 0.5 percent increase for the nation. Employment gains were led by natural resources and mining, which increased more than 16 percent (see Chart 3). North Dakota added 2,400 new jobs in this sector, as oil-drilling activity remains strong. In November, 139 oil rigs were active in North Dakota, up from 56 a year ago.

CHART 2 District unemployment rates below nation
Unemployment rates*



*Seasonally adjusted
Source: Bureau of Labor Statistics

Other sectors with employment gains include professional and business services (3.1 percent), manufacturing (2.6 percent), education and health services (2.5 percent) and leisure and hospitality (1.6 percent). The construction sector posted the largest decrease (-5.3 percent), a steeper drop than national construction totals (-2.5 percent).

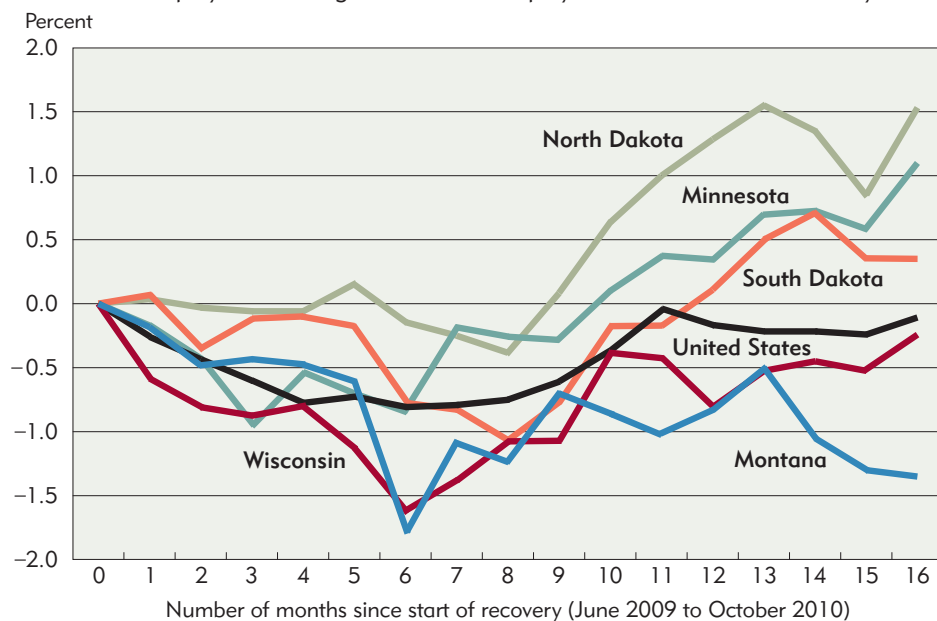
Montana's recovery has been weaker than other areas of the district and the nation. The state posted an almost 1 percent decrease in nonfarm employment in October from a year earlier, in part because Montana's construction sector shed a higher percentage of jobs than other district states, while sectors

such as professional and business services, education and health services, and leisure and hospitality performed more poorly compared with other states.

The Minneapolis Fed's forecasting model indicates that employment growth will pick up in 2011. Growth rates will exceed 2010 rates in all areas except Minnesota, where the pace of employment growth will remain the same. In many states, growth rates will meet or exceed averages over the previous 30 years.

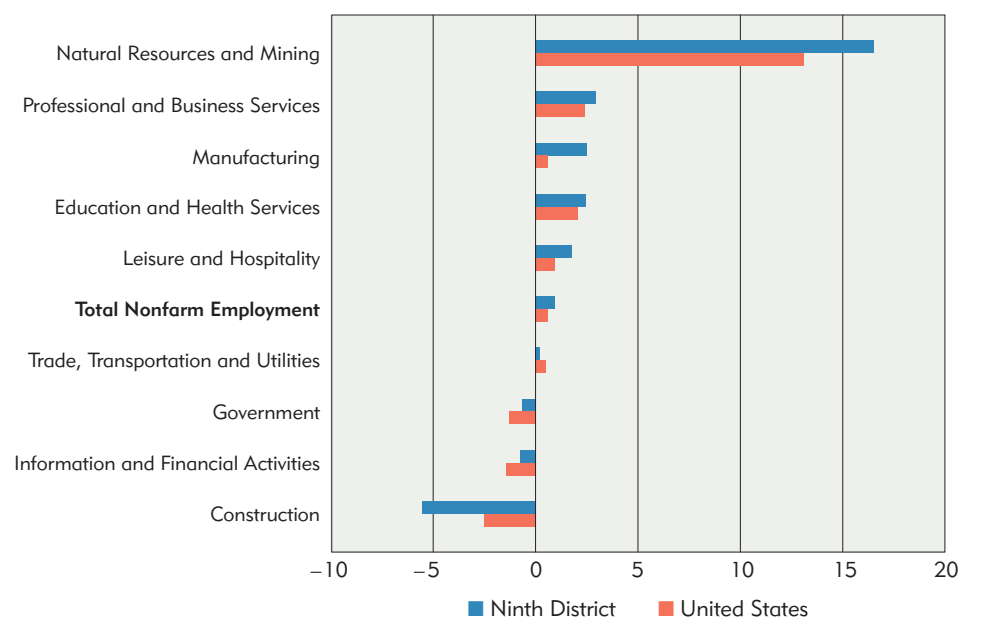
Respondents to the business outlook poll are optimistic about employment in 2011; 33 percent expect increases in full-time employees at their companies,

CHART 1 Employment growth stronger in Minnesota and the Dakotas during recovery
Employment change in nonfarm employment* from start of recovery



*Seasonally adjusted
Source: Bureau of Labor Statistics

CHART 3 Employment increases in a number of industries
Nonfarm employment, percent change from a year earlier, October 2010



Source: Bureau of Labor Statistics

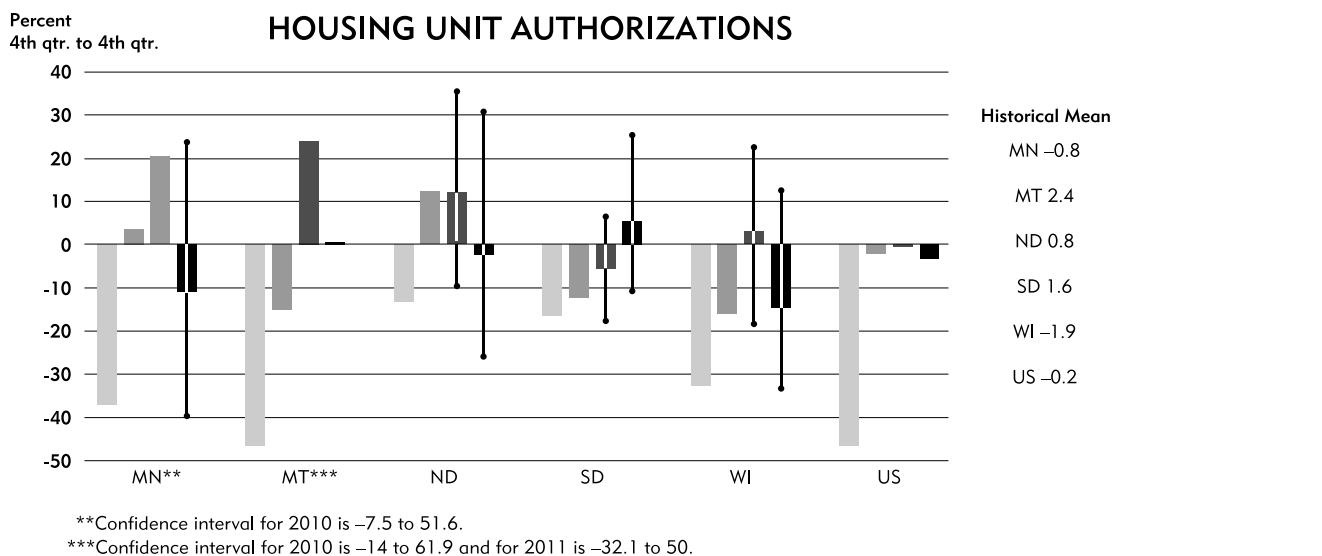
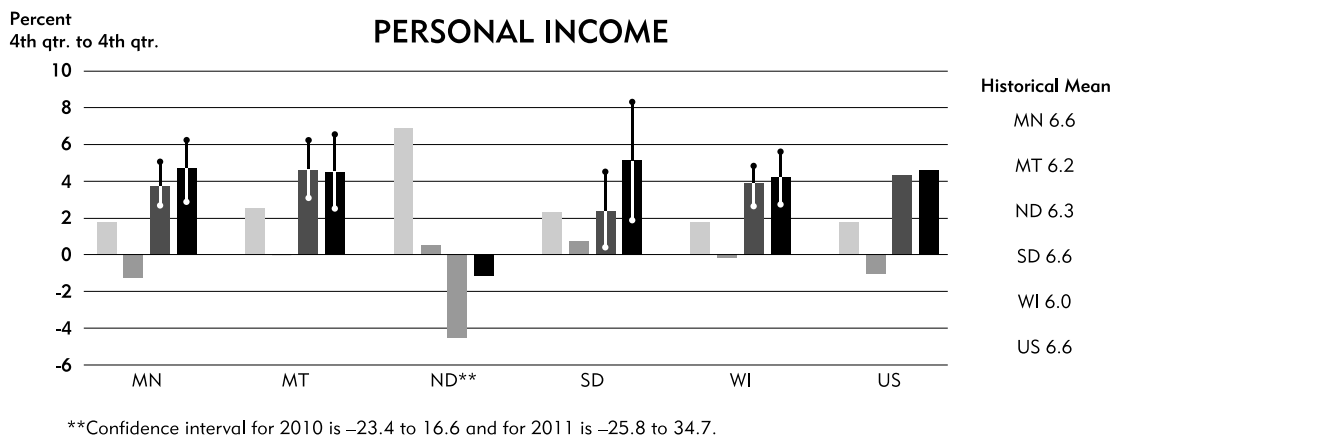
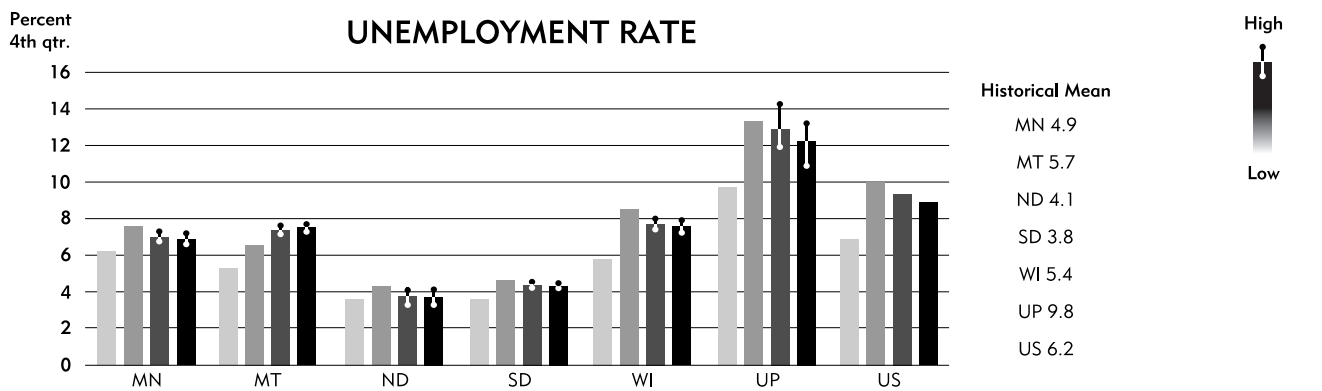
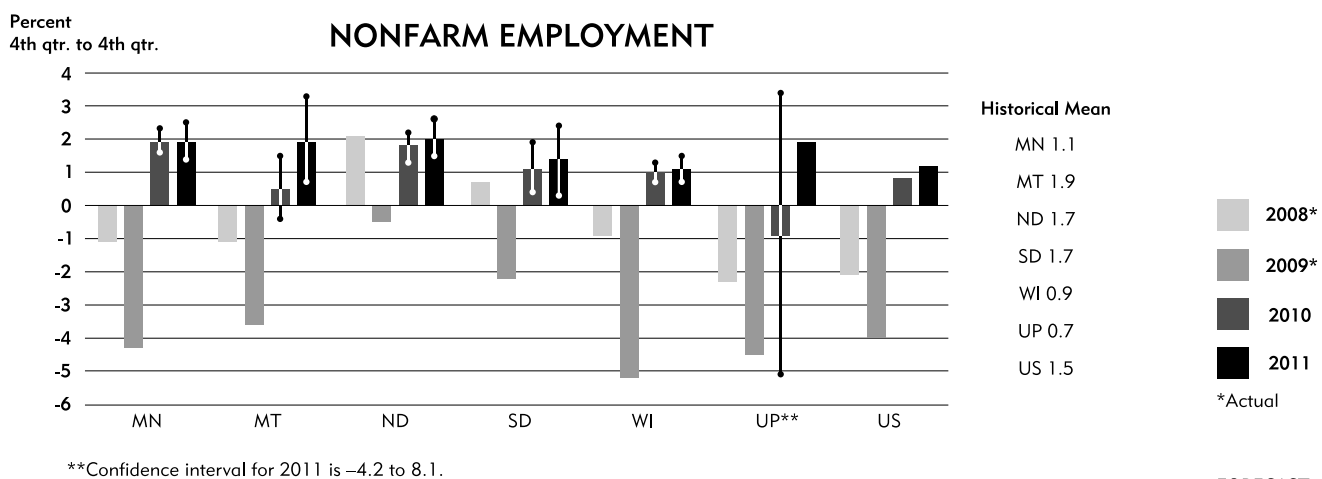
District Forecast

Nonfarm employment growth is expected to pick up across the district. In 2010, employment grew in all areas of the district except the Upper Peninsula of Michigan, where employment decreased by less than 1 percent. Employment growth exceeded historical averages in Minnesota, North Dakota and Wisconsin, but was lower than historical figures in Montana and South Dakota. The gains followed relatively sharp decreases in employment in 2009. In 2011, increased employment is predicted in all areas of the district. According to the forecasting models, growth rates will exceed 2010 rates in all areas except Minnesota, where the pace of employment growth will remain the same. In addition, the models indicate that employment will meet or exceed historical averages in all areas except South Dakota, where the growth rate will fall below the historical average.

Unemployment rates are anticipated to remain level. Unemployment rates in 2010 decreased from 2009 in all states except Montana, where rates increased. Decreased rates in 2010 followed increased rates in 2009 across the district. Unemployment rates in 2010 were above historical averages in all areas except North Dakota, where the unemployment rate dropped below 4 percent. In 2011, unemployment rates are not expected to change more than 0.1 percentage points from 2010, except in the Upper Peninsula of Michigan, where the forecast shows the unemployment rate dropping by 0.9 percentage points. Except in North Dakota, unemployment rates are expected to remain above historical averages.

Increased personal income growth is predicted. During 2010, personal income increased in all areas of the district except North Dakota, where personal income decreased. Gains in 2010 followed slight decreases or level personal income in 2009. In 2011, personal income is expected to grow faster than in 2010 in all areas except Montana, where growth is expected to slow, and in North Dakota, where personal income is expected to decrease slightly. Note that the decreases in North Dakota estimated in 2010 and expected in 2011 are likely attributed to the volatile nature of farm income. The confidence intervals surrounding both of these figures are relatively wide, indicating a relatively high degree of uncertainty.

Levels of housing units authorized are expected to remain low. In 2010, authorizations grew in all district states except South Dakota, where they decreased. These increases followed about five years of declining authorization levels for the district as a whole. In 2011, housing units authorized are expected to increase in Montana and South Dakota and decrease in other states. However, the decreases in Minnesota and Wisconsin may be influenced by the unusual behavior in current data combined with the statistical properties of the forecasting model. In Minnesota and Wisconsin, housing units authorized have not only dropped sharply during the past few years, but they are also below levels observed over 30 years ago. Since forecasting models typically rely on long-term and recent trends, it is not surprising that the model points to continued decreases in 2011.



while 9 percent expect decreases. Meanwhile, 37 percent of respondents to the survey of manufacturers anticipate increasing employment during 2011, while 9 percent expect decreases.

Another sign of labor market improvement is the decrease in initial claims for unemployment insurance benefits nationally and in the district. From October 2009 to October 2010,

initial claims for unemployment benefits in district states decreased 22 percent; however, claims were still 34 percent more than October 2007, just before the recession began.

While labor markets are showing signs of strengthening, the Minneapolis Fed's forecasting model predicts little change in unemployment rates in 2011. Even though

employment is expected to pick up, so-called discouraged workers who dropped out of the labor force during the recession will likely begin looking for work again as job prospects improve. Workers returning to the labor force place upward pressure on unemployment rates because they get counted as unemployed instead of out of the labor force.

Consumer spending on the rise

Consumers are reaching into their pockets again after turning their backs during the recession.

Monthly U.S. retail sales through November increased on a year-over-year basis for more than 12 straight months after posting more than 12 straight

Businesses are optimistic for 2011

By TOBIAS MADDEN
Regional Economist

After two years of pessimism regarding the economy of their communities, business leaders across the Ninth District are more optimistic about the coming year, according to the November *fedgazette* business outlook poll.

Respondents believe their local economies will expand in 2011. Positive sentiment grew regarding business investment, employment and consumer spending. Respondents expect higher sales, employment and capital investment at their businesses. Employers expect small increases in wages and are not very concerned about finding qualified workers, but are very concerned about government regulation. Credit conditions appear a bit more favorable compared with last year, but housing starts are expected to fall. Leaders remain cautious about the national economy, expecting modest growth with mixed expectations for inflation.

Optimism is back

Most notable in the poll is the fact that respondents are now more optimistic than pessimistic about the outlook for their community—and by a considerable margin—compared with the previous two years (see Chart 1). The optimism is strongest in the Dakotas (see Chart 2), while respondents in northwestern Wisconsin were more pessimistic, but still positive on the whole.

Among various business metrics, expectations in local communities were positive overall; more respondents

expect growth than contraction in employment, business investment and consumer spending. But opinions differed across geography and business sectors. For example, Montana, the U.P. and western Wisconsin expect declines in these categories, and respondents in construction were more pessimistic overall than those in other sectors.

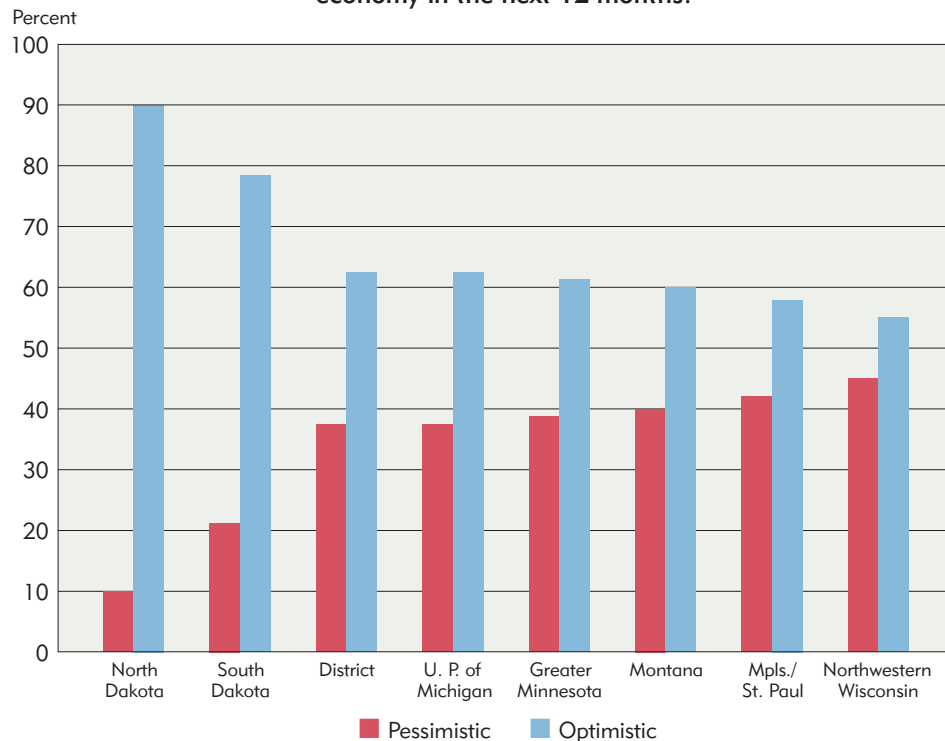
While respondents are optimistic about their own businesses and communities, they are less confident about national economic conditions. “I am apprehensive about the economic future of the U.S.,” a Minnesota service provider said. Almost three-quarters of the respondents expect GDP growth of 1 percent to 2 percent. “I think the economy will grow, but at a slow pace,” said a manufacturer from greater Minnesota. Not everyone is confident even of modest growth; almost one in 10 expects a recession this year.

Inflation expectations for this year are quite mixed: About two-thirds believe it will be below the historical average of 3 percent. But one in five believes it will be 4 percent or higher. Minnesota respondents expect lower inflation than those elsewhere. Some leaders are also concerned about delayed inflation. “No inflation spike in 2011, but thereafter I see inflation heating up,” a Minnesota farmer said.

Companies see gains in 2011

Businesses expect local consumer spending to increase overall. “My locations in North and South Dakota are

CHART 2 Overall, what is your outlook for your community's economy in the next 12 months?



Source: Federal Reserve Bank of Minneapolis business outlook poll

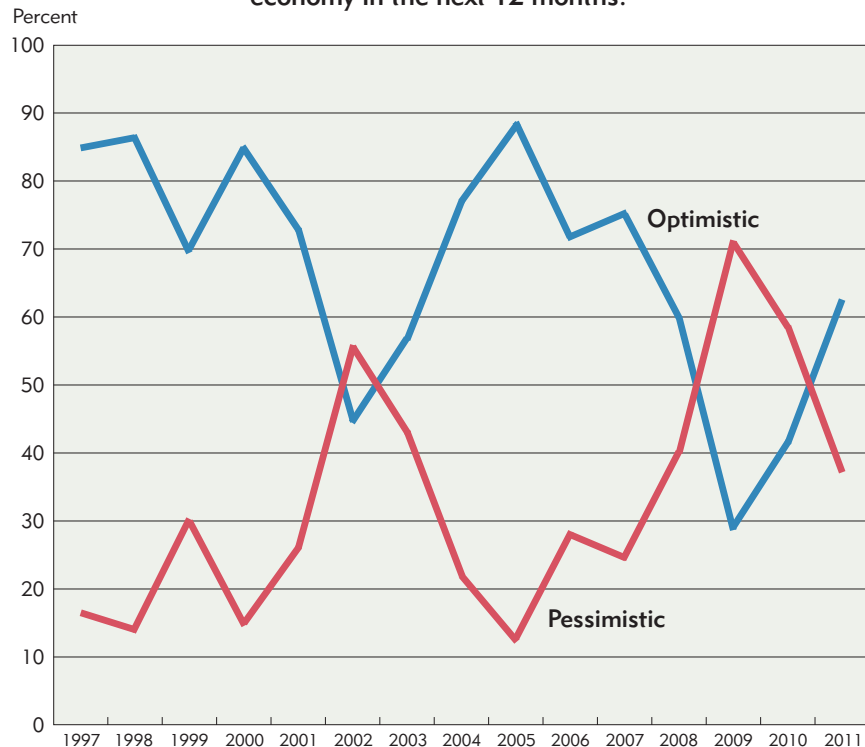
booming,” said a retailer based in western Wisconsin. Respondents from the Dakotas expect large increases in consumer spending, while Montana, the U.P. and western Wisconsin are less optimistic on this measure.

Firms see higher consumer spending translating into higher sales for their firm this year (see Chart 3). “We see some nice sales growth coming our way,” commented a northwestern Wisconsin

manufacturer. That sentiment is widespread across industry sectors and geographic areas. “I believe that it is already picking up,” said a service provider from the Minneapolis-St. Paul area. “We are launching many new products,” a high tech firm commented.

Higher sales expectations appear to be positively affecting other business decisions. For example, investment in plant and equipment is expected to

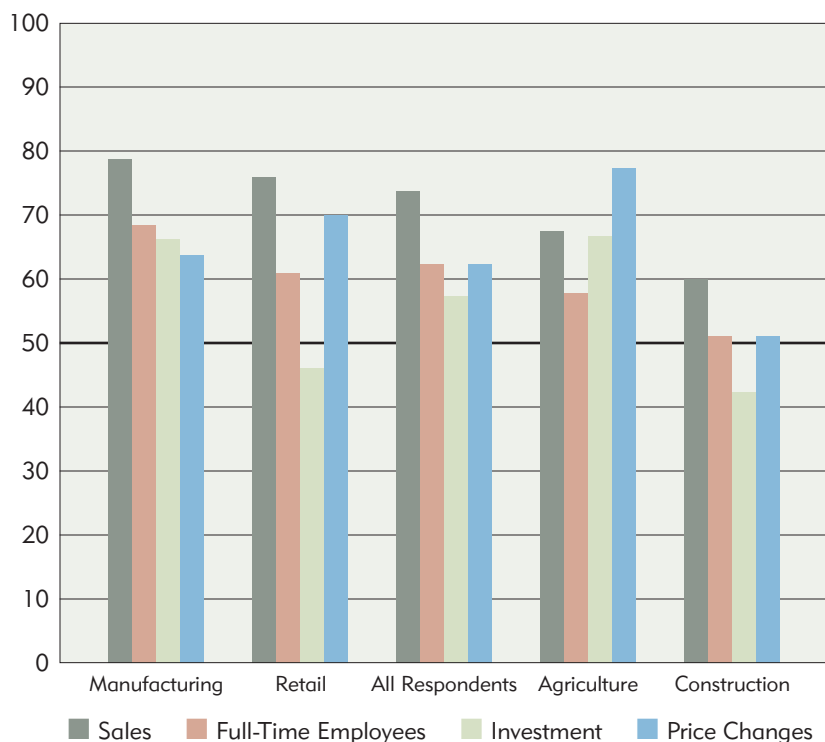
CHART 1 Overall, what is your outlook for your community's economy in the next 12 months?



Source: Federal Reserve Bank of Minneapolis, annual business outlook polls

CHART 3 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 business outlook poll

increase in 2011, except for the battered construction industry and the retail sector. Across the district, 34 percent of respondents expect increased levels and 18 percent anticipate decreased levels.

Firms across the district, and in most industry sectors, also expect hiring to pick up. One-third of respondents said they expect full-time employment this year to grow over last year's levels, compared with 9 percent expecting employment to decrease at their companies. Those looking to hire don't expect a lot of difficulty; only 25 percent indicated that securing workers is a challenge.

Not only are firms planning to add employees, but they are also getting more from their existing workforce: 70 percent reported higher productivity in 2010, with 18 percent reporting gains of

5 percent or more. "Pressure [was] placed on the workforce to increase productivity per person," commented a service provider in the Minneapolis-St. Paul area.

Wage increases are also expected, but will be modest. About half of the respondents expect 1 percent or lower wage increases, and the other half expect 2 percent to 3 percent. Workers in North Dakota can expect the largest wage increases.

Many companies are looking to raise prices in 2011 as well. Over a third of the respondents expect to increase prices on their products and services, while only 10 percent see price declines in 2011. These increases may be a result of higher confidence, but also because suppliers are raising prices, according

to numerous comments.

Access to credit appears to be improving for some firms, though many still face difficulties. Eleven percent of respondents indicated that access to credit has improved over the past three months, up from 5 percent a year ago. For those reporting improved access, most indicated that it was the result of improved financial performance by their firm. Twenty-three percent of the respondents reported that access to bank credit has deteriorated over the past three months, down from 35 percent a year ago.

The only clear pessimism is related to housing, whose downturn appears likely to continue, according to business leaders. "We fear continued weakening in the construction sector," commented a

Montana real estate respondent. Forty percent of respondents predict that housing starts will decline further in 2011, and only 12 percent expect increased housing starts. "The housing industry is in a depression," commented a respondent from a U.P. construction firm. Housing starts are expected to fall across the district, except in North Dakota.

With a variety of challenges facing businesses in the current economic environment, respondents said the biggest one facing their firm continues to be complying with government regulation; 88 percent cited it as a challenge in 2011. Said one Minnesota services company about government regulation, "We spent way too much time [on compliance, and] it takes away from growing jobs." **f**

Outlook from page 17

months of decreases during the recession. A broader measure of consumer spending, personal consumption expenditures, has also grown for more than a year.

Within the district, signs pointed to a solid holiday spending season. According to the University of St. Thomas Holiday Spending Sentiment Survey, household spending for holiday gifts in the Minneapolis-St. Paul area was predicted to increase almost 7 percent this season from 2009. This is the survey's first year since 2006 that holiday shoppers anticipated spending more rather than less.

Looking to 2011, the business outlook poll shows that 30 percent of respondents expect consumer spending to increase in their communities, while 19 percent anticipate decreases. These results are the most optimistic for consumer spending in six years. Manufacturers were also sanguine about consumer spending in their respective states, with 34 percent expecting increases in 2011 and 21 percent expecting decreases. The forecasting model shows that personal income growth is expected to pick up in 2011, which bodes well for consumer spending.

As consumers are spending more, overall price increases have remained subdued. The consumer price index increased 1.1 percent in November from a year ago. The CPI's so-called core rate of inflation, which doesn't include volatile food and energy prices, rose 0.8 percent in November from a year ago.

Manufacturing making a comeback; home building still slow

During 2010, district manufacturing employment and activity expanded. A November survey of purchasing managers by Creighton University (Omaha, Neb.) showed that manufacturing activi-

ty has increased every month to date in 2010 in Minnesota and South Dakota, and for most of the year in North Dakota. Activity in the manufacturing sector received a boost from manufactured exports, which increased 18 percent in district states during the first 10 months of 2010 compared with the same period a year earlier.

Looking ahead, manufacturers are optimistic for the coming year. For 2011, 53 percent of respondents to the survey of manufacturers expect increases in production levels, while 9 percent expect decreases. Of the manufacturers who responded to the business outlook poll, 45 percent plan to boost investments in plant and equipment, while 14 percent anticipate decreases.

While the outlook for manufacturing is upbeat, home building remains slow. Nevertheless, after several years of decreases, 2010 will likely finish ahead of last year. During the first 10 months of 2010, housing units authorized in district states were up 10 percent compared with the same period a year ago. Even with this increase, district home building levels are down about 70 percent in

2010 from the height of the building boom during 2004.

Respondents to the business outlook poll were pessimistic for home building in 2011, with 40 percent expecting decreases in housing starts in their communities and 12 percent anticipating increases. In addition, the forecasting model points to lackluster performance in 2011.

Agriculture hoping for decent 2011 after stellar year

"All segments of agriculture are again currently profitable," commented a South Dakota agricultural lender in response to the third-quarter survey of credit conditions. Farmers were early into the fields and early out with this year's harvest. Almost the whole Ninth District is free from drought, although excessively wet conditions, especially in South Dakota, hurt some producers. In addition to a bumper harvest, solid output prices aided the bottom line. Meat and dairy producers faced higher feed

costs, but these costs were more than offset by higher output prices. There are optimistic expectations for newly purchased capital equipment, ample soil moisture and expected higher prices for outputs in 2011.

In 2010, both farmers and ranchers gained, but for different reasons. Farmers enjoyed a nearly ideal growing season, while ranchers benefited from significantly higher prices (see table). The district is expected to see overall production increases in soybeans (8 percent), wheat (4 percent) and sugar beets (14 percent) compared with 2009, while corn output is expected to fall slightly (2 percent). Meanwhile, ethanol prices and production trended upward during the second half of 2010. While prices for several farm inputs increased during 2010, including fertilizer, chemicals and diesel, these prices were more than offset by gains in crop prices and production.

While farmers had increases in production in 2010, ranchers enjoyed rising prices (see table). Prices surged for hogs (33 percent), milk (27 percent) and steers (14 percent). The number of cattle on feed in South Dakota feedlots increased 12 percent in November 2010 from November 2009.

Again, the outlook for 2011 is upbeat, as agricultural producers invest their profits. "Capital spending will continue as farmers invest in their farming operations," a South Dakota lender said. In addition to positive returns on investment, soil moisture conditions are good and output prices are expected to rise. According to U.S. Department of Agriculture forecasts, 2011 prices for corn, soybeans, wheat, steers and hogs are expected to increase. Meanwhile, sugar beet farmers face uncertainty regarding legal rulings on planting genetically modified seeds. **f**

Crop and meat prices expected to increase in 2011
Average prices

	2007/2008	2008/2009	Estimated 2009/2010	Projected 2010/2011
(Current \$ per bushel)				
Corn	4.20	4.06	3.55	4.80-5.60
Soybeans	10.10	9.97	9.59	10.70-12.20
Wheat	6.48	6.78	4.87	5.30-5.70
	2008	2009	Estimated 2010	Projected 2011
(Current \$ per cwt)				
All Milk	18.29	12.83	16.25-16.35	15.90-16.70
Choice Steers	92.27	83.25	95.19	96.00-104.00
Barrows & Gilts	47.84	41.24	54.91	53.00-57.00

Source: U.S. Department of Agriculture, estimates as of December 2010