

Forecast models and surveys point to steady growth in 2013

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Results from the Minneapolis Fed's forecasting models and economic outlook surveys point to steady growth in 2013, with strong growth expected in North Dakota due to oil-drilling activity.

The housing sector is showing signs of recovery and, despite drought in some areas, the agriculture sector remains in good shape. However, concerns remain over government fiscal issues, a recent manufacturing slowdown and global economic conditions. Personal income and employment are expected to grow in 2013.

Cautious optimism

Respondents to the business outlook poll are optimistic overall, but more pessimistic than respondents a year earlier (see page 18). District business leaders are cautious about economic conditions in the nation and in their respective states, but are more optimistic about prospects for their own businesses.

One place for renewed optimism is the housing sector, where sales and building are bouncing back. According to the Minnesota Realtors Association, closed sales in Minnesota increased 13 percent in November from a year earlier.

In Sioux Falls, S.D., November closed sales were up almost 20 percent.

Stronger sales have contributed to lower inventories and higher prices. In third quarter 2012, prices in the Minneapolis-St. Paul metropolitan area increased 13 percent from a year earlier; in Sioux Falls, S.D., and Fargo, N.D., prices increased 5 percent and 4 percent, respectively.

Construction crews had more homes to build in 2012. Through November, housing units authorized were up across all district states. However, other than in North Dakota, housing units authorized totals are still far off their peak levels. According to results of the business outlook poll, overall housing starts are expected to increase during 2013. The Minneapolis Fed's forecasting models are mixed regarding the 2013 housing outlook (see page 19).

A holiday hiccup in consumer spending?

During 2012, consumer spending showed moderate gains; however, initial measures indicate that holiday shopping was relatively mild nationally. Regionally, district retailers were cautiously optimistic for the holiday season. For example, according to the University of St. Thomas Holiday Spending Sentiment Survey, households in the Minneapolis-St. Paul area were expected to spend 10 percent more on hol-

iday gifts than a year earlier. According to retail business contacts in the district, holiday sales in the region were probably somewhat stronger than in the nation.

There are signs that households are moving toward a better position to spend. Household balance sheets have generally improved during the past few years as many have paid down debt. Combined with recently increased home values, the debt pay-down has given households relatively more wealth.

Furthermore, consumers continue to face relatively stable prices. The consumer price index in November was up 1.8 percent compared with a year earlier. Home heating costs remained in check, as natural gas prices were relatively low during the early part of the winter. Minnesota gasoline prices in December were about the same as a year earlier. The core rate of inflation, which excludes energy and food prices, was up 1.9 percent from a year ago.

One area where consumer spending has been consistently strong is vehicle sales. Throughout 2012, district auto dealers have enjoyed substantial gains in sales. For example, during the first 10 months of 2012, registrations for new cars and light trucks increased 31 percent in Minnesota compared with a year earlier. Registrations were up 13 percent nationally.

The Minneapolis Fed's forecasting models suggest that personal income will grow in 2013, which will help support consumer spending (see page 18). According to the business outlook poll, 30 percent of respondents expect increased consumer spending in their communities, while 25 percent expect decreases.

Employment expected to grow moderately

Employment in district states during November grew 1.4 percent from a year earlier, the same as in the nation (see chart at left). Natural resources and mining posted the strongest growth (+10.7 percent), followed by construction (+2.6 percent) and education and health services (+2.5 percent). Leisure and hospitality was the only sector with year-over-year employment losses (-4 percent).

Gains in natural resources and mining were supported by continued expansion of oil drilling in western North Dakota and eastern Montana, the location of the Bakken oilfield. In September, 21.4 million barrels of oil were produced there, up from 13.2 million a year earlier, and accounted for 11 percent of U.S. oil output.

The number of active drilling operations in North Dakota decreased somewhat in recent months as oil companies cut costs and increased efficiency after drilling a number of initial producing wells to meet leasing requirements. While employment continues to grow rapidly in the area, the brisk pace of

growth has eased somewhat as evidenced by a leveling in the number of online job postings in the North Dakota portion of the Bakken. Meanwhile, drilling in Montana has picked up recently as oil companies have expanded exploration in the western part of the Bakken.

Growth in construction employment was supported by increases in home building. Employment gains in education and health services continue in a sector that has consistently posted increases over the past few years.

According to the Minneapolis Fed's forecasting models, nonfarm employment will grow moderately in 2013, with stronger growth expected in North Dakota and Minnesota. Employment growth in the Upper Peninsula of Michigan will remain sluggish. Unemployment rates are predicted to drop in all areas. The unemployment rate in North Dakota is expected to drop to 2.8 percent (see page 19).

Despite employment gains, respondents to the business outlook poll indicated that securing workers will be challenging, but a bit less so than a year earlier. In the recent survey, 39 percent expect securing workers to be a challenge or serious challenge in 2013, down slightly from 41 percent in the prior survey.

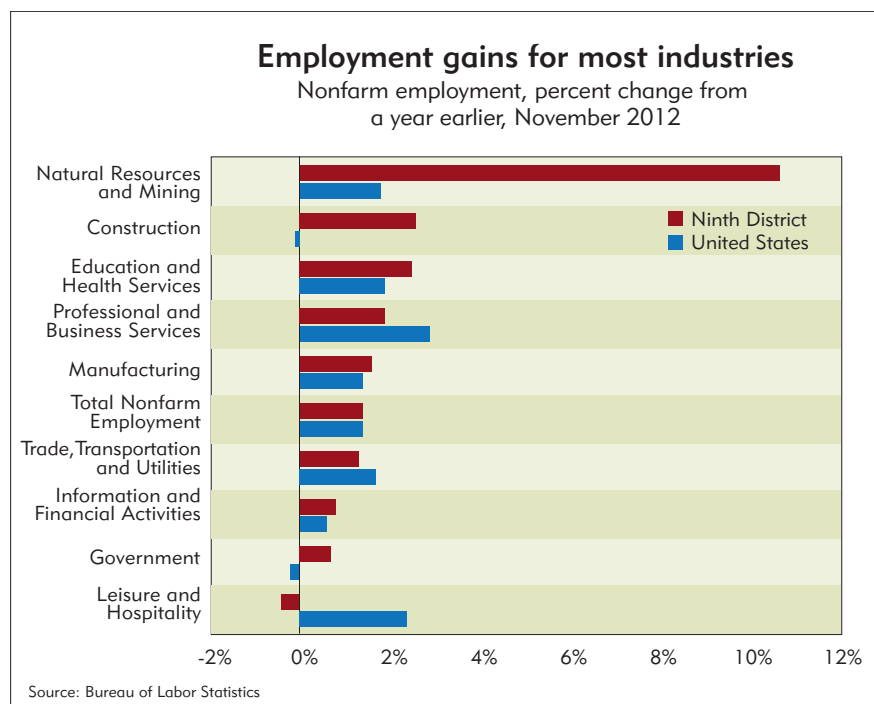
Respondents to the business outlook poll expect modest employment gains in their communities during 2013 and somewhat stronger increases in employment at their own businesses. Respondents to the manufacturing survey expect level employment for their state economies and moderate gains at their own companies (see page 17).

Signs of caution

Despite the overall positive tenor of the forecast, several risks are causing district businesses to remain cautious. Respondents were concerned about fiscal cliff negotiations and other budget issues. Business leaders seem to be looking for a clearer picture of what to expect for tax and spending policy before making some decisions on capital expenditure and hiring plans. With the "fiscal cliff" deal reached on Jan. 1, some concerns will be alleviated.

Concern was also expressed over a slowdown in manufacturing, which has been a key component of the recovery. According to a survey of purchasing managers by Creighton University (Omaha, Neb.), manufacturing activity in Minnesota and South Dakota decreased for five straight months before posting a gain in December, while manufacturing in North Dakota posted relatively strong growth throughout 2012.

One drag on the manufacturing sector is slowing growth in exports due in part to economic malaise among several trading partners. Through October 2012, manufactured exports among five



district states (not including Michigan) increased 5 percent compared with a year ago, down from 11 percent growth for the full year of 2011. Manufactured export growth ranged from a high of 25 percent in North Dakota to a 4 percent decrease in Montana.

District manufactured exports to Europe, where struggles continue with government debt and other fiscal issues, decreased 3 percent through October 2012. Manufactured exports to China were flat during this period. District manufactured exports to China have typically posted strong growth rates, including 13 percent in 2011 and 35 percent in 2010. While China's economy continues to grow, its growth rate has dropped recently, which has dampened demand for district exports.

Despite the recent slowing in the district manufacturing sector, year-over-year employment levels are up, and respondents to the manufacturing survey are relatively upbeat for their companies' orders, production and employment levels in 2013.

Agriculture remains strong despite drought

From early in the growing season, many agricultural producers were concerned about how 2012 would turn out. In contrast to 2011, a year marked by substantial flooding around the district, 2012 was a year of drought. Fortunately, much of the Ninth District was spared the worst of the dryness, and low production elsewhere put upward pressure on prices, boosting farm incomes. Livestock and dairy producers haven't fared as well, however, as higher feed costs squeezed margins. The outlook for both crop and animal product prices remains strong in 2013.

In 2012, farmers and ranchers saw big increases in prices for their prod-

ucts from their already strong 2011 levels (see table below). And in contrast to many agricultural states, the district saw production increases from 2011 for most crops, including corn (+5 percent), soybeans (+7 percent), wheat (+28 percent) and sugar beets (+32 percent). Dramatic production increases for sugar beets and for wheat and other small grains largely reflect a return to normal, since 2011 production was set back by flooding. While prices for several farm inputs, including fertilizer and chemicals, increased during 2012, these prices were offset by gains in crop prices.

According to the Minneapolis Fed's third-quarter (October 2012) agricultural credit conditions survey, 2012 was a strong year for agricultural income, with 95 percent of respondents reporting increased or steady income following several quarters of increases. Household spending and capital investment increased similarly. Agricultural lenders are somewhat optimistic for farm profits in the final quarter of 2011, with 60 percent expecting increased income and only 6 percent expecting decreased income.

Animal producers enjoyed continued strong prices (see table). After 2011's large increases, prices retreated slightly for hogs and milk (both down 8 percent), while cattle prices continued to rise (7 percent increase). These prices weren't enough to offset higher feed costs faced by meat and dairy producers.

Again, the outlook for 2013 is upbeat, as agricultural producers invest their profits. In addition to positive returns on investment, output prices are expected to rise. According to U.S. Department of Agriculture forecasts, 2013 prices for corn, soybeans, wheat, cattle, hogs and dairy are expected to increase. However, this outlook depends on whether the 2012 drought persists or fades into memory. **f**

Manufacturing activity up again in 2012; stable activity expected for 2013

By TOBIAS MADDEN
Regional Economist

In spite of a sluggish economy, manufacturers have seen solid gains in recent years, and they expect continued growth in the coming year, according to the November survey of manufacturers conducted by the Federal Reserve Bank of Minneapolis and the Minnesota Department of Employment and Economic Development.

The multiyear manufacturing expansion that started in 2010 moderated in 2012. Orders were up in 2012 for half of survey respondents and down for 27 percent. About a third reported increased employment in 2012, while 27 percent reported reduced staffing. Manufacturers also reported higher prices and productivity, but lower profits. The Dakotas reported the strongest growth in 2012. Large and medium-sized firms also saw stronger performance compared with small employers. Wages and benefits grew about 2.2 percent in 2012.

Manufacturers across the district expect stable growth in 2013, with the exception of those in the Upper Peninsula of Michigan. Orders and total production are expected to increase, buoyed by solid productivity gains and higher selling prices. As a result, profits should increase (see chart below).

One-quarter of respondents expect manufacturing employment to grow in 2013, while 16 percent expect job cuts.

One-quarter of respondents expect manufacturing employment to grow in 2013, while 16 percent expect job cuts. Wages and benefits are again expected to increase by around 2 percent. Increased exports are anticipated across the district in 2013.

This industry optimism runs counter to the negative outlook many have for their state economies. Respondents expect declining state economic growth and decreases in overall corporate profits, capital investments and consumer spending. However, the boom should continue in North Dakota, as all indicators are up. Inflation is also a concern, as 60 expect higher inflation, while only 1 percent foresee lower inflation. **f**

Crop, meat and dairy prices expected to increase in 2013

Average farm prices

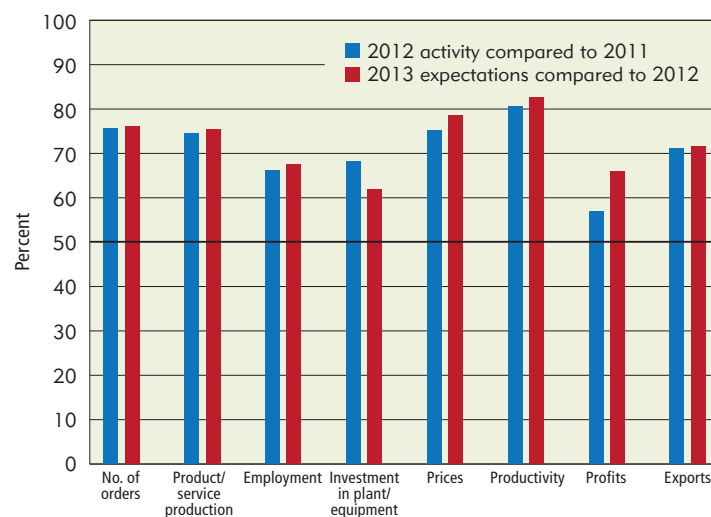
	2009/2010	2010/2011	Estimated 2011/2012	Projected 2012/2013
(Current \$ per bushel)				
Corn	3.55	5.18	6.22	6.80-8.00
Soybeans	9.59	11.3	12.5	13.55-15.55
Wheat	4.87	5.7	7.24	7.70-8.30

	2010	2011	Estimated 2012	Projected 2013
(Current \$ per cwt)				
All milk	16.29	20.14	18.50-18.60	19.15-19.95
Steers	95.38	114.73	122.85	124-134
Hogs	55.06	66.11	61.1	63-67

Source: U.S. Department of Agriculture, estimates as of December 2012

Manufacturing activity up in 2012; increases expected in 2013

Above 50 indicates expansion; below 50 indicates contraction



Source: Federal Reserve Bank of Minneapolis; Minnesota Department of Employment and Economic Development

Many business leaders expect sluggish economic growth in 2013

By TOBIAS MADDEN
Regional Economist

As many look for the economy to grow faster, business confidence has become something of a buzzword or phrase, holding one of the keys to better traction. In the Ninth District, optimism for the year ahead varies widely, according to the *fedgazette's* annual business conditions poll of 335 business leaders conducted in November.

Business leaders in the Dakotas are very optimistic, thanks largely to the oil boom there, while others are more tempered in their enthusiasm. Companies across most of the Ninth District expect sales to increase in 2013, and they also plan to invest more in capital equipment and hire more people.

Firms expect to raise prices and increase wages, but are concerned about government regulation. More broadly, business leaders expect housing starts to rise, but were mixed in their local assessment of consumer spending, employment and business investment. They also expect higher inflation and slow growth at the national level.

Companies expect growth in 2013

"Demand for our products continues to be strong," said a western Wisconsin agricultural producer, which reflects the overall mood of higher sales among most industries and geographic areas across the district (see Chart 1). Respondents from the Minneapolis-St. Paul area and North Dakota are the most optimistic about sales growth, while respondents from greater Minnesota are the least optimistic about sales.

Retailers, real estate professionals and manufacturers expect the biggest gains in sales. In addition, sales prices are expected to rise, as 30 percent of all respondents expect to raise prices in 2013, compared with 20 percent who expect to drop prices. With drought covering much of the United States, 47 percent of agricultural producers expect increases, and only 13 percent expect decreases.

Almost 70 percent of business leaders also saw higher productivity last year, a trend that should continue, as capital

investment is expected to increase across all geographic areas and most sectors. "We expect high demand for our services that automate back office processes for organizations," commented a Minneapolis area technology company. In addition to increases in capital investment, slight to modest employment increases are expected at firms across much of the district and most business sectors.

Respondents indicated that they may have an easier time financing capital expenditures because access to credit has improved over the past three months. Seventeen percent of respondents indicated that access to bank credit has improved some or improved a lot versus 9 percent who noted deteriorating conditions. This improvement occurred across industry sectors, save for services, and across district states with the exception of North Dakota and the Michigan's Upper Peninsula.

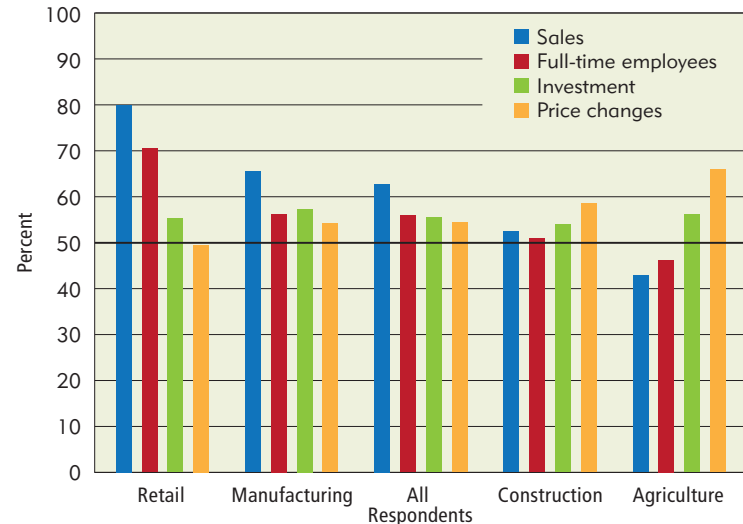
District businesses face some challenges. More than two-thirds of the respondents said that complying with government regulation was a challenge or serious challenge. In addition, 39 percent said that securing workers was a challenge. This labor concern varied across the district, with a high of 68 percent of the respondents from North Dakota and a low of 26 percent from Montana reporting difficulty.

Modest state, sluggish U.S. growth expected

Fewer leaders were optimistic about their state economies compared with 2011 (see Chart 2). Optimism is strong in the Dakotas, while respondents from greater Minnesota and western Wisconsin are somewhat pessimistic (see Chart 3). "Due to the Bakken oilfield, our state and region are experiencing unprecedented prosperity," commented a North Dakota transportation respondent. This optimism/pessimism also flows into the outlook for state economies.

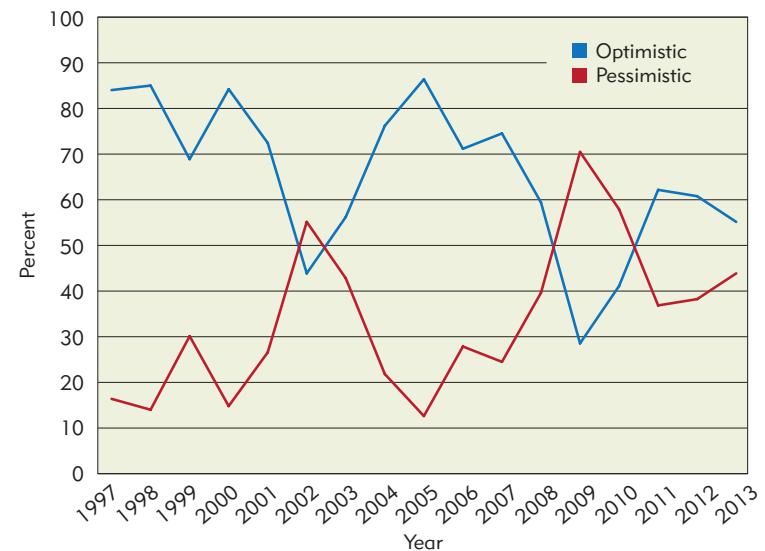
Expectations for local communities generally followed the same pattern. Respondents from the Dakotas were positive about employment, business investment and consumer spending. Respondents from greater Minnesota were negative, and even more so in the U.P. Most industry sectors were slightly posi-

Chart 1 With regard to your own company, how do you see operations changing during the next year?
Above 50 indicates expansion; below 50 indicates contraction



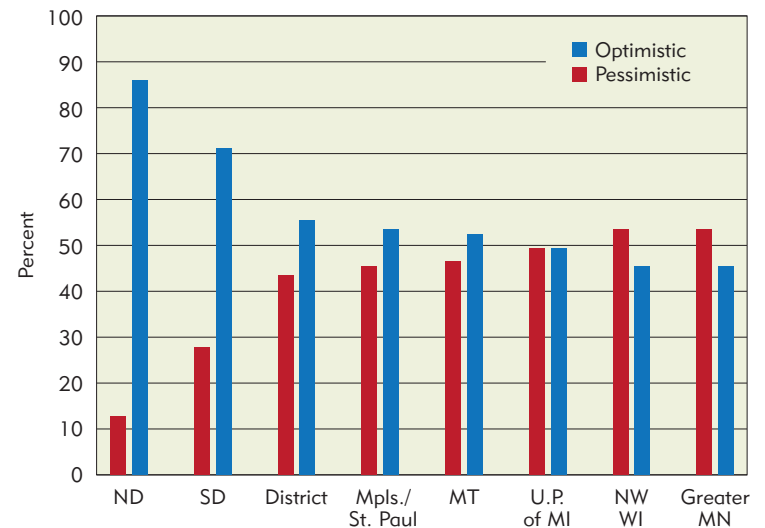
Source: Federal Reserve Bank of Minneapolis, annual business outlook poll

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



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

Chart 3 Overall, what is your outlook for your community's economy in the next 12 months?



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

District Forecast

Employment is expected to grow moderately. In 2012, nonfarm employment grew in all areas of the district after posting decreases or slow growth during 2011. North Dakota saw a strong growth rate of 4.7 percent in 2012, building on a 5.4 percent increase in 2011. The slowest growth during 2012 was in Wisconsin and the Upper Peninsula of Michigan, where nonfarm employment grew slightly. In 2013, nonfarm employment will grow moderately with stronger growth expected in North Dakota and Minnesota. Growth in North Dakota will ease to 3.6 percent, while growth in Minnesota will increase to 2.2 percent. Employment growth in the U.P. will remain sluggish.

Unemployment rates are expected to decrease. During 2012, unemployment rates decreased in all areas, but remained above historical averages, except in North Dakota and the U.P., where rates were below their historical averages. In 2013, rates will drop in all areas to historical averages or below, except in South Dakota, where the rate will remain slightly above its historical average. The unemployment rate in North Dakota will drop to 2.8 percent.

The forecast calls for the pace of growth in personal income to pick up somewhat. In 2012, personal income growth dropped from strong 2011 rates in Montana and the Dakotas. Personal income levels actually decreased in South Dakota. Meanwhile, personal income growth increased in Minnesota and Wisconsin after relatively mild growth during 2011. In 2013, personal income will grow faster in Minnesota, South Dakota and Wisconsin compared with 2012. Growth will be positive in Montana and North Dakota, but slightly slower than in 2012. Note that the confidence interval surrounding the North Dakota forecast is relatively wide, indicating a high degree of uncertainty.

Housing units authorized posted strong improvement during 2012, but the forecasting model is mixed regarding the 2013 outlook. During 2012, housing units authorized posted strong gains in all district states. Authorizations more than doubled in South Dakota. In 2013, housing units authorized will increase in Minnesota, increase only slightly in Wisconsin and decrease in Montana and the Dakotas. However, the confidence intervals for home-building predictions span a relatively wide range, indicating a much higher degree of uncertainty compared with forecasts for employment, unemployment rate and personal income.

Most areas of the district expect state-wide housing starts to increase in 2013 compared with 2012. The only exception is the U.P. Respondents from the construction, retail, services and finance, insurance and real estate sectors were very

optimistic about housing starts. Wages are also expected to rise modestly, with 62 percent seeing 2 percent to 3 percent increases, while 31 percent expect 0 percent to 1 percent increases. Respondents from North Dakota expect much more robust wage increases; 44 percent expect increases of 4 percent or more. Among industry sectors, con-

struction and manufacturing expect the largest wage increases, while the retail sector expects the lowest increases. Respondents are pessimistic about national economic conditions. About a quarter expect a recession, while 61 percent expect 1 percent to 2 percent growth in GDP in 2013. The national outlook remains highly uncertain due

to federal fiscal policy and implementation of new regulations, particularly in federal health care. Inflation is also a concern, as 26 percent expect CPI to increase by 4 percent or more, and a third expect inflation of around 3 percent. **f**

