

District's 2015 economic picture painted with optimism

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According to the Minneapolis Fed's business outlook poll, survey of manufacturers and forecasting models, the pace of economic growth in the Ninth District is expected to pick up in 2015. Poll respondents were particularly optimistic for the 2015 economy. Employment and income are expected to expand, and labor markets are predicted to continue tightening. Manufacturers are anticipating a solid 2015, while the agriculture sector expects continued low crop prices—not so good for crop producers, but good for livestock producers.

In 2014, employment growth was steady with a number of industries posting job gains, and unemployment rates dropped. Nevertheless, wage growth and inflation remained subdued.

Optimism is up

Business poll respondents posted record optimism, just above the high level in 2005, with 74 percent somewhat optimistic for their community's economy in the next 12 months and 14 percent very optimistic. In last year's poll, 66 percent were somewhat optimistic and 8 percent were very optimistic.

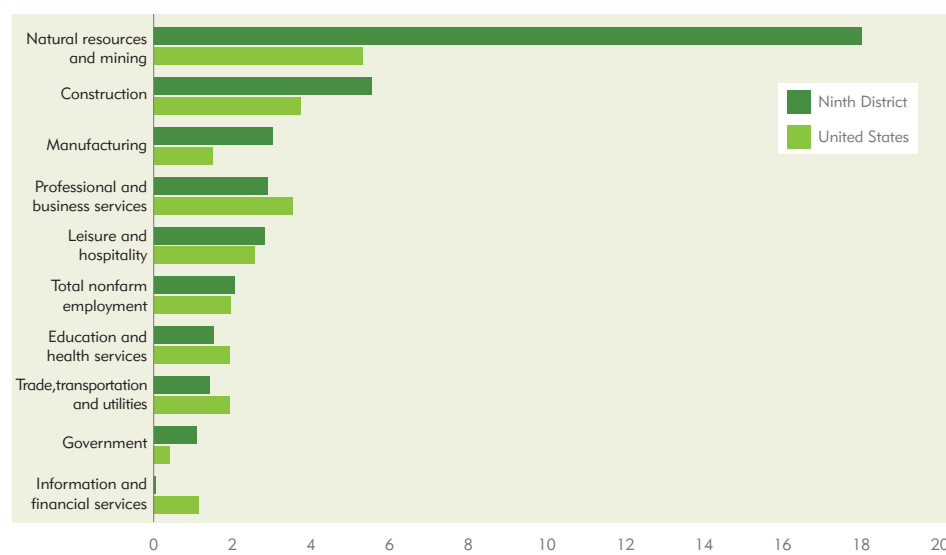
Employment gains in district states during 2014 helped set up a positive outlook for 2015. Employment growth from November 2013 to November 2014 ranged from a low of 0.8 percent in South Dakota to 4.9 percent in North Dakota, where jobs have grown briskly in the energy-producing areas of the western part of the state. Recent decreases in oil prices will slow drilling activity, but overall economic activity in the region is expected to remain relatively robust.

Overall employment growth in the district (2 percent) was about the same as in the United States, with all industries showing gains (see Chart 1). Natural resources and mining posted the strongest growth, with 18 percent higher employment in November compared with a year earlier, primarily due to the gains in oilfield jobs in North Dakota and Montana. Construction posted the next-strongest growth (5.4 percent), followed by manufacturing (3 percent), professional and business services (2.8 percent) and leisure and hospitality (2.7 percent). However, information and fi-

Chart 1

Nonfarm employment increases for all industries

Percent change from a year earlier, as of November 2014

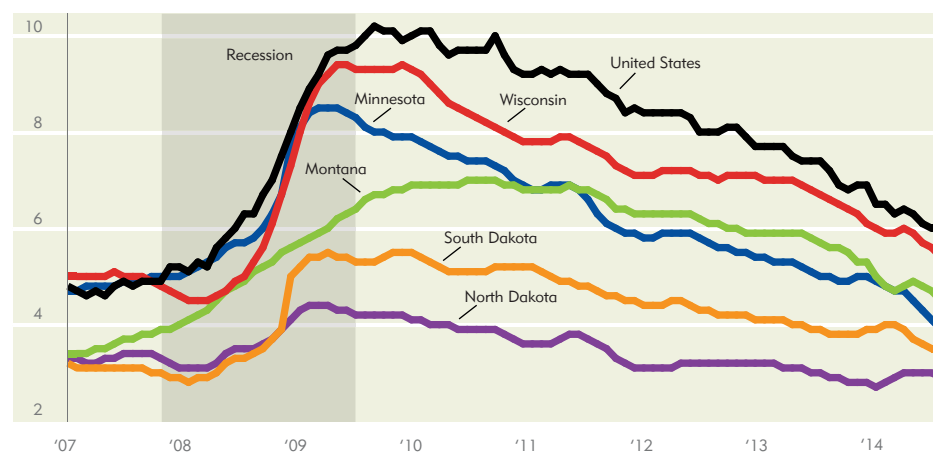


*Above 50 indicates expansion; below 50 indicates contraction.
Source: Federal Reserve Bank of Minneapolis, annual business outlook poll

Chart 2

Unemployment rates continue to fall in most areas

Percent, seasonally adjusted



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

ancial services employment increased only slightly from a year earlier.

As employment grew, unemployment rates decreased (see Chart 2). In November, unemployment rates were below 4 percent in Minnesota and the Dakotas, with rates dropping throughout the year in other areas of the district. As unemployment rates decreased, the difficulty employers have had finding qualified workers increased. According to the business outlook poll, 68 percent of respondents expected securing workers to be a chal-

lenge or serious challenge in 2015, up from 57 percent in last year's poll and at the highest level since 1999.

While there are some signs that employers are starting to offer higher wages to attract workers to their companies, overall gains in wages and expectations for wage growth were tempered. For example, wages for district manufacturing workers grew 1.3 percent for the three-month period ended in November compared with the same period a year earlier. According to the business outlook poll, 15 percent of respondents expect wage

and salary gains of 4 percent or greater, double the 7 percent of respondents in last year's poll.

The Minneapolis Fed's forecasting model indicates that employment growth will continue into 2015, although at a somewhat slower pace than in 2014. Predicted growth rates range from 0.9 percent in South Dakota to 4.6 percent in North Dakota. Meanwhile, unemployment rates are expected to decrease in 2015 compared with 2014. (See forecast on page 15.)

Positive signs for consumer spending

Consumer spending represents about two-thirds of the economy. Going into the holiday shopping season, district retail businesses were cautiously optimistic. Respondents to a survey of holiday shoppers in the Minneapolis-St. Paul area by the University of St. Thomas indicated that per household spending would increase by about 4 percent over the previous year. During the holiday season, retailers generally noted steady traffic and sales, suggesting that activity may pass the previous year's levels.

One encouraging sign for consumers is that lower gas prices have freed up funds to spend elsewhere. Average Minnesota gasoline prices were down a dollar per gallon in late December compared with a year earlier. This size of decrease in gasoline prices could increase families' disposable income by \$70 or more per month, depending on how much they typically drive.

Other consumer prices have remained relatively level. In November, the personal consumption expenditures price index was 1.2 percent above the previous year. Looking into 2015, the business outlook poll suggests that price pressures for goods and services will be relatively similar to last year, while the survey of manufacturers indicates slightly stronger price pressures.

The forecasting model suggests that consumers will have more income in 2015, with growth rate predictions for personal income ranging from 4.4 percent in Wisconsin to 5.5 percent in North Dakota.

Possible headwinds from overseas

While the district and U.S. economies are chugging along, economic growth elsewhere in the world has been sluggish. In China, growth slowed to a five-

year low during the third quarter. Recent growth in the eurozone was only slightly positive, and Japan posted two consecutive quarters of contraction. As growth in foreign countries slows, so do prospects for district exports. Furthermore, over the past year, the U.S. dollar has strengthened against several foreign currencies, making U.S. exports more expensive abroad. During the first 10 months of 2014, U.S. manufactured exports grew 2 percent and district manufactured exports grew only 1 percent from the same period a year earlier.

Despite slow growth in manufactured exports, overall manufacturing in the United States and the district has been positive. At the national level, industrial production and capacity utilization in the manufacturing sector increased over the past year. The value of U.S. manufacturers' new orders was up 4 percent for the first 10 months of 2014 compared with 2013, although orders decreased during each of the last three months of the year.

Manufacturing also expanded during the first 11 months of 2014 in Minnesota and the Dakotas, although the pace of expansion decelerated somewhat during the last few months, according to a survey of purchasing managers by Creighton University. According to results from the manufacturing survey, respondents expect gains in orders, employment and investment in 2015, while profits are expected to be about the same as in 2014.

Housing units authorized, an indicator of future residential building, were mixed in the district during 2014. Year-to-date through November, housing units authorized were up 37 percent in North Dakota and 11 percent in Wisconsin compared with the same period a year earlier, while authorizations decreased in Montana and South Dakota.

There are signs that residential real estate activity is softening in some areas.

For example, the number of closed sales in Minnesota decreased 6 percent year-to-date through November compared with a year earlier, according to the Minnesota Association of Realtors. However, home prices continue to increase. During the third quarter, existing home sale prices were up 9 percent in Fargo, N.D., compared with a year earlier, 8 percent in Bismarck, N.D., 5 percent in Minneapolis-St. Paul and 3 percent in Sioux Falls, S.D.

In commercial construction and real estate, the Minneapolis-St. Paul area is expected to add 1.2 million square feet of new industrial space in 2015 and 210,000 square feet of new office space, but not much retail space construction, according to a report by CBRE. The vacancy rate for industrial space is expected to fall to 6.4 percent from 7.4 percent in 2014, while the office vacancy rate is predicted to increase to 17 percent from 16.6 percent in 2014.

Another year of tough weather and falling crop prices

For the second consecutive year, 2014 was marked by weather extremes. After a winter that was both brutally cold and long, farmers got a late start on planting, and a relatively cool summer had many worried that yields would take a big hit. Despite losses in some areas due to an early frost, crops were in mostly good condition by the end of the growing season, with harvests hitting records in some cases. However, large supplies coupled with slower global demand led crop prices to fall further, and forecasts indicate that this is expected to continue in 2015. Animal product prices, by contrast, have been strong and are expected to remain so.

The decline in crop prices that began in 2013 after markets recovered

Manufacturing survey: Continued growth

By TOBIAS MADDEN
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Strength in the manufacturing sector should continue into 2015, according to a survey of manufacturers conducted by the Federal Reserve Bank of Minneapolis and the Minnesota Department of Employment and Economic Development in November and early December.

Manufacturers reported increased production, but flat profits in 2014. Orders were up for 52 percent of survey respondents and down for 26 percent. Thirty-eight percent reported increased employment, while 19 percent reported reduced staffing. Manufacturers also reported higher prices and productivity, but profits were mixed, with virtually identical levels of respondents reporting that profits rose, fell or remained unchanged (about one-third each). The largest shares of firms that reported growth in 2014 were in South Dakota and Minnesota. A higher proportion of large and medium-sized firms reported growth in activity compared with smaller firms. Wages and benefits grew about 3 percent.

More manufacturers across the district expect growth in 2015. Orders, total production and exports are expected to increase. Companies are expecting more capital investment, productivity and profits, as well as higher selling prices.

Thirty-seven percent of respondents expect manufacturing employment to grow in 2015, while 8 percent expect job cuts. Wages are expected to increase by 2.5 percent, while benefits are expected to increase by 2.6 percent. Based on numerous comments, the lack of available labor may be affecting business decisions. About a fifth of respondents indicated that oil activity in North Dakota is having a positive effect on their sales. Very few respondents are planning to expand or build at a new location in North Dakota.

This industry optimism spills into a positive outlook many have for their state economies. More respondents than not expect increases in state economic growth, employment, business investment, consumer spending and corporate profits. Inflation is also a concern, as 46 percent expect higher inflation, while 3 percent foresee lower inflation.

from the effects of the 2012 drought accelerated in 2014. The bright spot has been strong harvests of some crops. For example, South Dakota and Wisconsin had record corn harvests, and production in Minnesota and North Dakota was only slightly below 2013's strong numbers. The solid harvests came despite fewer corn acres planted. Due to weather and prices, farmers planted many more acres of soybeans this year, and the soybean harvest hit a record in all four of the previously mentioned states. Total district corn production was nearly unchanged in 2014, while soybean production increased 22 percent. Wheat production increased 21 percent and dry bean production increased 20 percent, while the sugarbeet harvest fell 10 percent.

The story was the reverse for animal product producers again last year. Lower crop prices translated to lower feed costs in 2014, while output prices for cattle, hogs and dairy all increased, pushing up profit margins.

Good harvests and strong livestock and dairy markets have not offset the overall hit to agricultural incomes. According to the Minneapolis Fed's third-quarter (October) agricultural credit conditions survey, over half of respondents reported decreased income, while only 14 percent reported that incomes increased. Capital investment fell similarly, while farm household spending mostly stayed flat, as 64 percent of lenders reported it unchanged. Agricultural lenders are also pessimistic for farm profits in the final quarter of 2014, with 52 percent expecting income to fall and only 12 percent expecting increases.

The outlook for 2015 is for these trends to continue. According to U.S. Department of Agriculture forecasts, prices for corn, soybeans and wheat are expected to decrease (see table). Hog prices are also expected to retreat slightly to still-high levels, while milk prices are projected to fall more steeply. Cattle prices should continue to climb. **f**

Crop, dairy and hog prices expected to decrease, cattle to increase in 2015

Average farm prices

	2011/2012	2012/2013	Estimated 2013/2014	Projected 2014/2015
(CURRENT \$ PER BUSHEL)				
Corn	6.22	6.89	4.46	3.20-3.80
Soybean	12.50	14.40	13.00	9.00-11.00
Wheat	7.24	7.77	6.87	5.80-6.20
	2012	2013	Estimated 2014	Projected 2015
(CURRENT \$ PER CWT)				
All Milk	18.52	20.05	24.05-24.15	18.45-19.25
Steers	122.82	125.89	155.29	160.00-172.00
Hogs	60.88	64.05	76.22	63.00-68.00

Source: U.S. Department of Agriculture, estimates as of December 2014