District Conditions

The long-awaited recovery may have begun, according to many U.S. forecasters. As evidence they point to the nation's real (inflation-adjusted) gross national product (GNP), which rose at a 1.7 percent annual rate in the second quarter of 1982. At the same time, however, these forecasters think the recovery will be relatively slow; on average, they project a 3 to 4 percent annual rate of expansion in real GNP in the second half of this year. Such growth would be modest by historical standards, well below the average growth for comparable periods in the previous five recoveries.

If the U.S. economy does recover as these forecasters predict, most of the Ninth District economy will probably recover right along with it.* Overall, however, the district is unlikely to do better than the nation, and it may do worse. This is because of three industries which are relatively more important to the district's economy than to the nation's: farming, metal mining, and lumbering. Through midyear, these three industries have been very weak, both locally and nationally, due to circumstances which will not be materially mitigated by a recovery as slow as that forecasted (at least not by the end of the year). Since these industries are more important locally than nationally, they may slow the district's recovery more than the nation's.

The District Has Been Weakened by Three Industries. . .

Farming, metal mining, and lumbering are each more important to the Ninth District economy than to the U.S. economy as a whole. Agriculture accounts for 8 percent of personal income in the district and only 2 percent nationwide. Mines in the district produce 90 percent of U.S. iron ore, and the district's proportion of total employment in metal mining is about five times the nation's. The Ninth District contains 8 percent of the nation's forest area, and the district's proportion of employment in the lumber and forest products industry is about double the national average.

Nationwide, activity and earnings in these industries have dropped off sharply this year. From the first half of 1981 to the first half of 1982, farm proprietors' income fell about 25 percent. Employment dropped about 17 percent in the metal mining industry and about 10 percent in the lumber industry (in logging camps, sawmills, and planing mills, for example).

At the same time, total employment in the United States fell 0.8 percent, whereas total employment in the Ninth District fell 1.3 percent. At least part of this discrepancy must be attributed to the district's heavier concentration in farming, mining, and lumbering.

. . .Which Probably Won't Recover Soon

We expect the district's heavier concentration in these three industries to continue to make it trail the nation, for none of them is expected to grow significantly the rest of 1982.

Farming

The prospects for agriculture are not bright. Forecasters have predicted that U.S. net farm income could fall to $16 billion in 1982 from its already low level of $25 billion in 1981 and the prerecession peak of $32 billion in 1979. The expected slump in farm income stems mainly from the crop sector, where income should decline because of abundant supply and sagging export demand. Thanks to a record-high 1981 crop harvest, the U.S. supply of major crops was much greater than a year before in the first half of 1982, and it is expected to remain substantial in the second half. The U.S. Department of Agriculture (USDA) expects this summer's harvest of winter wheat to approach record levels; and spring wheat, corn, and soybeans have benefited from good growing conditions.

Abundant supply alone might be sufficient to reduce farm income. This is true because consumption of crops tends to be fairly insensitive to price changes. As a result, when supply is as large as it is expected to be in 1982, crop

*The Ninth Federal Reserve District consists of Minnesota, Montana, North and South Dakota, northwestern Wisconsin, and the Upper Peninsula of Michigan. For a discussion of the historical relationship between the national economy and the Minnesota economy, see "As the Nation's Economy Goes, So Goes Minnesota's," an article by Robert B. Litterman and Richard M. Todd in this *Quarterly Review*.

prices must drop to low levels to persuade buyers to consume or store the entire supply. Prices must drop so low, in fact, that the dollar volume of sales, that is, farmers' gross income, declines.

Farm income is also expected to be reduced by demand factors this year. The USDA estimates that the dollar volume of agricultural exports will decline 4 percent in 1982, partly because good crops and weak economies overseas have boosted foreign supplies and cut foreign consumption. The USDA says high interest rates in the United States may also restrain exports. That is because, when interest rates are higher in the United States than elsewhere, foreign demand for dollar-denominated financial assets increases. This is one factor which tends to drive up the price of the dollar, making U.S. exports more expensive for foreign buyers. When this happens, foreign demand for U.S. agricultural products declines.

Metal Mining

Second half prospects for the metal mining industry are not bright, either. U.S. industry analysts say that, if present plans are adhered to, only 40 million tons of iron ore will be produced in 1982, compared to 74 million tons in 1981 and 86 million tons in 1979 when production peaked. A large decline is expected for copper production too.

These expected cutbacks in iron and copper output primarily reflect weak demand for new houses and autos (important end products using iron and copper). Although sales of these consumer goods may slowly improve in the second half, they are expected to remain slow enough to keep 1982 housing and auto production below 1981's weak levels. Moreover, metal inventories are large relative to forecasted demand. Thus, even if the demand for new houses and autos is stronger than expected, iron and copper production will be slow the rest of 1982.

The outlook for U.S. iron ore production is further clouded by structural changes which may be reducing demand over the longer run. These changes include the trend toward small, lightweight autos (which require less steel), the growth in auto and steel imports, and the development of large iron ore deposits overseas.

Lumbering

Prospects for the lumber industry over the remainder of 1982 are also darkened by the expected continuation of weak housing production and by large inventories. Forecasters had been looking for a drop in mortgage rates to spark an upturn in U.S. housing starts sometime in 1982. However, since mortgage rates declined only slightly in the first half, projections for second half starts have been reduced. At midyear, only slow growth in homebuilding is anticipated, so that 1982's housing starts may not even match 1981's anemic total of 1.08 million. A level of housing construction this low will obviously not boost activity in the lumber industry. Should construction pick up more than expected, though, lumber production would still be restrained by the existence of large stockpiles.

Summary

The nation's economy will probably grow slowly the rest of 1982, and many sectors of the Ninth District economy should match this pace. However, weak demand for new houses and autos and agricultural exports will constrain the recovery of farming, metal mining, and lumbering, three sectors that are more significant in this district than in the nation. Large inventories of grain, ore, and lumber, together with demand-reducing structural changes in iron mining, further diminish the chances that these industries will recover much in 1982. Because these industries will probably lag the aggregate recovery, the district's economy may grow more slowly than the nation's.