Federal Reserve Bank of San Francisco

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Mature Boom

The national economy will continue strong throughout the remainder of 1973, according to the latest staff forecast of the Federal Reserve Bank of San Francisco. GNP should rise to $1,268 billion (in current-dollar terms) for a 10-percent gain—even larger than last year's increase. This expansion will help bring about further declines in the unemployment rate, but it will be accompanied by continued inflationary pressures as well.

At the same time, a welcome deceleration in the growth trend is in prospect, after the over-rapid gains of the recent past. Real GNP probably grew at about a 6½-percent annual rate in the quarter just ended, compared with close to 8 percent in the preceding quarter, and a further slowdown in the growth trend is likely to persist throughout 1973 and into 1974.

The expected deceleration will occur largely in investment sectors, which generated much of the boom atmosphere of the past year. For example, residential construction may have reached its cyclical peak in the first quarter of 1973, and inventory accumulation is expected to peak around the third quarter of the year. In addition, the rate of growth in outlays for consumer durable goods should begin to slow down after the very rapid pace maintained during the past several quarters.

Several key policy assumptions underlie this staff forecast of a slowdown in the growth trend: that fiscal policy will become less expansionary because of the imposition of expenditure ceilings in the Federal budget; that monetary policy will be relatively firm, as the money stock expands at a slower pace than in 1972; and that the Administration's wage-price policies will tighten, moving perhaps toward comprehensive coverage of the Phase II variety, and away from the problem-industry approach of the early Phase III period.

Deceleration in growth sectors

Outlays for producer-durable equipment, one of the most expansive elements in the present cycle, should grow at a somewhat slower pace in 1973, with a 12-percent gain as against last year's very rapid 16-percent increase. A slowdown seems imminent because of the record length of the present expansion, especially for such products as trucks and business-owned autos. This forecast is consistent with the latest Commerce Department survey of capital spending plans, particularly when weighted for the survey's recent tendency for anticipations to exceed actual spending figures.

Investment in business structures should rise 15½ percent this year as against 1972's 10-percent gain; here again, though, the most rapid growth probably was reached in the period just ended. Moreover, current dollar outlays probably will represent only a modest increase in

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terms of real bricks and mortar, because of continued increases in prices.

Staff experts see the present inventory buildup continuing until the third quarter, before beginning to taper off. Inventory accumulation was very low relative to final sales throughout most of the 1970-72 period. It strengthened late last year, however, and this strength is likely to continue to a peak of about 14½ billion (annual rate) sometime this summer.

The government sector, unlike the cyclical investment sector, is expected to grow at a relatively steady pace in coming quarters, but with state-local government spending growing twice as rapidly as Federal spending. For the year as a whole, Federal expenditures for goods and services may rise only 2 percent, as against last year's 8-percent gain, but this differential mostly reflects late '72 Federal budget cutbacks. States and municipalities should show a 13-percent spending gain for the year, against 1972's 9½-percent increase, as increased revenues from their own taxes and from revenue-sharing funds are pumped into the spending stream.

Actual decline in housing

Residential construction, the main support of the early stages of the boom, promises to be one of the weakest sectors as 1973 progresses. For the year, housing expenditures should rise 4½-percent, compared with the 27-percent gain of 1972. However, dollar outlays are expected to peak at about $57½ billion (annual rate) in the first quarter, and then decline to about $55½ billion in the final quarter of the year.

Housing starts are expected to fall at an even steeper rate than the 5-percent rate of decline in expenditures, but at least some of the drop in numbers will be offset by a rise in construction costs. The rate of homebuilding has outstripped increases in basic demand almost continuously for the past 2½ years. Consequently, the present inventory of unsold single-family homes equals eight months' supply at present rates of completion.

Consumer spending for durable goods is expected to slow down after scoring its largest gain of the cycle during the January-March period; thus, the total gain for the year is projected at 10 percent, as against the 12-percent gain of 1972. Auto sales set new records during the early months of the year, outpacing even the industry's own forecasts, and they should remain quite high with the help of the substantial tax refunds now reaching consumers. Furniture and appliance sales are likely to benefit from the same stimulus, as well as from the recent high level of housing completions.

A slowdown in the growth trend for consumer durable goods seems to be a reasonable expectation in view of the accelerated sales pace of recent quarters. On the other hand, continued strength in nondurable goods and services, which make up 85 percent of the consumer's market-basket, will cushion the slower growth of durable-goods spending. Total spending for non-durable goods and services could rise 9 percent in 1973, compared with last year's 8-percent increase, partly because of the much steeper prices now being paid for food, but also because of normal increases in consumer demand.

Improvement in job markets

Despite the deceleration in the economy's growth trend, labor markets should continue to tighten. Normally, real growth of 3½ percent or more is sufficient to reduce the unemployment rate, so 1973's projected growth of 6½ percent in real GNP should mean a significant decline in joblessness and a tightening of labor markets.

The unemployment rate declined hardly at all during the rapid growth of first-half 1972, chiefly because of an abnormally large increase in the labor force, but the rate then dropped sharply as the economy expanded further in the second half of the year. This trend is expected to continue this year, permitting a drop in the jobless rate from 5.2 percent in the fourth quarter of 1972 to 4.6 percent in the fourth quarter of 1973.

The price outlook is less cheery, mostly because of the recent up-surge in farm prices, but also because of substantial increases in industrial commodity prices and the pressures created by tight labor markets. With strong demand impinging on the economy, the possibility must be recognized that the rate of inflation in 1973 could move higher than the 1972 pace of 3 percent, instead of reaching the announced goal of a lower rate.

The greatest bunching of price increases already has occurred, in all likelihood, since the early-year easing of controls was followed by the imposition of meat-price ceilings and by the tightening of controls in other problem areas, such as lumber and petroleum. This stiffening of Phase III regulations should offset some of the impact of supply pressures on price indexes.

William Burke

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