

FORECASTS 1979

SLOW GROWTH, CONTINUED INFLATION, BUT NO RECESSION

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The views and opinions set forth in this article are those of the various forecasters. No agreement or endorsement by this Bank is implied.

The economy in 1979 will be plagued with slow growth, increased unemployment, and continuing high rates of inflation. This gloomy prognostication is not the woeful wailing of some modern day Cassandra, but the general conclusion reached by the leading business and academic economists who have published forecasts for the 1979 economy. While the consensus forecast provides little to cheer about, it does have a favorable side. The group offering quarter-by-quarter forecasts thinks that the rate of inflation will subside modestly during the year. Moreover, the consensus of this group is that there will be no recession (using the casual definition of a recession, two consecutive quarters of negative growth in real GNP). According to the consensus of forecasts received by this Bank, real GNP growth (measured in constant 1972 dollars) will decline to zero in the third quarter of 1979 before beginning a slow advance in the fourth quarter.

The major areas of concern to the forecasters this year include the homebuilding industry and the prospects for consumer spending in general. Heavy borrowings by consumers in 1978 imply heavy repayment burdens in 1979. Moreover, slower economic growth coupled with continuing high rates of price increase are expected to erode consumer purchasing power. The current high levels of mortgage and other interest rates, even if they rise no further, are expected to have a slowing effect on the housing industry and on other consumer purchases in 1979. Far fewer consumers than in 1978 are expected to re-finance their homes in order to finance current consumption expenditures. Reduced income taxes are seen as helping to sustain consumer spending, although higher social security taxes will offset some of this effect.

On the other hand, the forecasters generally expect nonresidential construction, and business fixed investment in general, to remain relatively strong.

Most of them think that inventories, having been accumulated cautiously during the current expansion, will not be subject to large swings in 1979.

These elements led the forecasters to conclude that real GNP will be 2.4 percent higher in 1979 than in 1978, the 1979 Consumer Price Index will average 8.2 percent higher, and the unemployment rate will average 6.6 percent compared to 6.0 percent in 1978.

Last year, the consensus prediction for real GNP growth, 4.3 percent, was close to the actual increase for the year as a whole, 3.9 percent. Last year's forecasters expected real GNP to increase most rapidly in the first quarter of 1978, with rates of growth tapering off after that. Because of the extended coal strike and adverse weather conditions, however, the economy actually had slightly negative real growth in the first quarter with a resurgence in the second. Then the economy experienced a general slowing in the third quarter, followed by what appears to be a growth resurgence in the fourth.

Many of last year's forecasters had expected an improvement in the foreign trade deficit, measured on a National Income Accounts basis. They were basing their predictions upon expectations of recovery abroad, as they are to some extent this year. Their predictions were, of course, not fulfilled. This year, the forecasters expect U. S. exports to benefit from the depreciation in the exchange value of the dollar that took place in 1978 and they expect imports to be dampened by slower growth in the U. S. economy as well as by the price effects of the dollar's decline.

This article attempts to convey the general tone and pattern of some 40 forecasts received by the Research Department of this Bank. Not all of these forecasts are comprehensive, and some incorporate estimates of future behavior of only a few key economic indicators. Some are made in terms of annual averages while others are made on a quarter-by-quarter basis, and a consensus drawn from one of these groups may differ from that drawn from the other. Moreover, the individual forecasts are based on varying assumptions and this should be taken into account in interpreting the consensus.

This Bank also publishes the booklet Business Forecasts 1979, which is a compilation of representative business forecasts with names and details of the various estimates. No summary article can ever be as informative as the actual forecasts themselves. Serious readers are urged to look at the individual forecasts in more detail in Business Forecasts 1979.

1978 FORECASTS IN PERSPECTIVE

The consensus forecast for 1978 current dollar GNP, published in last year's January/February *Economic Review*, predicted an increase of 10.4 percent over 1977. The rates of increase forecast ranged from 9.0 percent to 11.3 percent. Using the revised 1977 GNP total of \$1,887.2 billion, the consensus forecast for 1978 GNP would have been \$2,083.5 billion and the range from \$2,057.0 billion to \$2,100.4 billion. Increasing prices were expected to account for 5.9 percent of the gain in GNP, so GNP measured in constant dollars, or real GNP, was expected to rise 4.3 percent.

Current estimates by the U. S. Department of Commerce indicate that GNP in 1978 actually increased 11.7 percent. Prices, however, increased more than anticipated, so preliminary estimates put the increase in real GNP around 3.9 percent—less than the 4.3 percent increase predicted by the consensus of last year's forecasters.

The forecasters expected the unemployment rate to average 6.7 percent for the year. At present, preliminary estimates indicate an average of 6.0 percent.

As with the aggregate GNP figure, the forecasters also under-predicted the components of GNP. Most of the under-prediction, however, can be attributed to underestimating the rate of inflation. Personal consumption spending was forecast to increase 9.3 percent, but it actually rose 11.0 percent.

Consumer purchases of durable goods, estimated to increase 6.7 percent, actually rose 10.8 percent. Consistent with the underestimate of consumer durables, purchases of nondurables were estimated to increase 8.6 percent, whereas the actual rate of increase was 9.8 percent. Consumption spending for services was forecast to increase 11.0 percent, so its actual 12.2 percent increase came in closer to the mark than the other component forecasts.

The forecasters expected a more moderate rate of increase in gross private domestic investment than the 21 percent rate of growth registered in 1977. Although the growth rate did, in fact, moderate to 15.7 percent, the forecasters had expected it to be

only 11.8 percent—a forecasting error of 3.9 percentage points. By contrast, the consensus prediction for inventory investment, which is a common source of error, was relatively accurate. The consensus expected inventory investment to remain constant. It actually rose \$0.1 billion from the revised \$15.6 billion averaged for 1977.

Net exports, which the forecasters often find difficult to estimate accurately, was overestimated by \$3.8 billion last year, although the actual figure, —\$11.8 billion, was well within the range of forecasts. The range was, as it often is, quite large, from +\$1.7 to —\$14.0 billion.

The forecasts of the last major component of GNP, government purchases of goods and services, centered around a rate of increase of 12.1 percent. Actual government spending is now thought to have risen 10.2 percent.

All in all, the last year's forecasters did well in predicting changes in real GNP, but because they underestimated the rate of price increase, they underestimated current dollar GNP and its components.

Regarding profits and industrial production, the forecasts for 1978 underestimated profits but predicted industrial production accurately. Before-tax corporate profits were predicted to rise 6.3 percent; most observers now think they increased about 14.1 percent. The index of industrial production rose 5.5 percent, exactly as predicted.

As with the implicit price deflator, the forecasters underestimated the rise in the Consumer Price Index. Consumer prices were expected to rise 6.1 percent, but current figures indicate a rise of 7.7 percent.

The consensus of the quarter-by-quarter forecasts for 1978 had current dollar GNP rising 10.7 percent in the first quarter, 9.8 percent in the second quarter, 10.2 percent in the third quarter, and 9.9 percent in the fourth, measured at annual rates. The realized quarterly increases, measured at annual rates, were 7.1 percent, 20.6 percent, 10.7 percent, and 14.7 percent. For real GNP, the consensus forecast called for annual rates of increase of 4.8 percent, 4.5 percent, 3.9 percent, and 3.5 percent for the four quarters, respectively. The realized increases for the first three quarters, were —0.1 percent, 8.7 percent, and 2.6 percent, while the preliminary number for the fourth quarter is now placed at 6.1 percent.

The forecasters, then, exhibited considerably less prescience about the quarterly path of the economy than they did about average figures for the year as a whole. They expected relatively greater growth during the first quarter of the year, with the growth rates tapering off throughout the year. Instead, the

economy experienced its slowest growth in the first quarter, with the rate fluctuating about throughout the year. It is true, however, that the slowness in the first quarter resulted from unforeseen circumstances—the coal strike and the unusually severe winter weather. The forecasters did rather well for the first half, taken as a whole.

The limits of forecasting prescience were equally apparent in the discrepancy between actual and predicted quarter-by-quarter behavior of the unemployment rate. The unemployment rate was expected to average 6.8 percent in the first quarter and to decline only to 6.6 percent by the fourth quarter. Instead, the unemployment rate surprised almost everyone by dropping sharply in the first quarter—from 6.6 percent in the fourth quarter of 1977 to 6.2 percent; and fluctuating around 5.9 percent for the remainder of the year.

1979 FORECASTS IN BRIEF

Gross National Product Forecasts for 1979 current dollar GNP center around \$2,322 billion. This consensus forecast indicates an approximate 10.2 percent yearly gain, less than the 11.7 percent increase apparently registered in 1978. Prices, as measured by the implicit deflator for GNP, are expected to increase 7.6 percent, about the same as the 7.4 percent rate of increase registered last year. As a result, GNP measured in constant dollars, or real GNP, is projected to rise only 2.4 percent, compared to 3.9 percent in 1978. Estimates for increases in current dollar GNP range from 9.0 percent to 11.0 percent. The consensus of quarterly estimates indicates a slowing of the economy during the year. It calls for increases of 10.5 percent in the first quarter of 1979, 7.8 percent in the second, 7.1 percent in the third, and 6.8 percent in the fourth.

RESULTS FOR 1978 AND TYPICAL FORECASTS FOR 1979

	Unit or Base	Preliminary 1978*	Forecast 1979**	Percentage Change	
				1977/1978	1978/1979
Gross national product	\$ billions	2107.0	2322	11.7	10.2
Personal consumption expenditures	\$ billions	1339.7	1471	11.0	9.8
Durables	\$ billions	197.6	210	10.8	6.5
Nondurables	\$ billions	525.8	577	9.8	9.7
Services	\$ billions	616.3	686	12.2	11.3
Gross private domestic investment	\$ billions	344.6	369	15.7	7.1
Business fixed	\$ billions	222.1	249	16.6	12.2
Residential structures	\$ billions	106.8	109	16.2	1.7
Change in business inventories	\$ billions	15.7	14	—	—
Government purchases	\$ billions	434.2	482	10.2	11.0
Net exports	\$ billions	-11.8	-5.5	—	—
Gross national product (1972 dollars)	\$ billions	1385.0	1418	3.9	2.4
Plant and equipment expenditures	\$ billions	152.5 ^e	171	12.3	12.0
Corporate profits before taxes	\$ billions	198.5 ^e	204	14.1	2.6
Private housing starts	millions	1.98	1.71	-0.3	-13.9
Automobile sales (domestic)	millions	9.25	8.58	2.0	-7.2
Rate of unemployment	percent	6.0	6.6	—	—
Industrial production index	1967=100	145.0	149.9	5.5	3.4
Consumer price index	1967=100	195.4	211.2	7.7	8.2
Implicit price deflator	1972=100	152.0	163.6	7.4	7.6

* Data available as of January 18, 1979.

** Figures are constructed from the typical percentage change forecast.

^e Estimated.

Personal consumption expenditures are expected to total \$1,471 billion for 1979, up 9.8 percent from 1978. The estimates for consumption spending range from an increase of 9.1 percent to an increase of 10.5 percent. Forecasters estimate that expenditures for *durable goods* will rise 6.5 percent for the year, while expenditures for nondurables and services are projected to advance 9.7 percent and 11.3 percent, respectively. The slowdown in durable goods expenditures is expected to be felt primarily in sales of appliances, furniture, and automobiles as a result of generally heightened consumer caution.

Government purchases of goods and services are projected to total \$482 billion. This estimate represents a 11.0 percent increase over 1978, somewhat more than the 10.2 percent gain of the previous year. The 1979 forecasts for government purchases range from increases of 9.2 percent to 11.4 percent.

Gross private domestic investment is expected to rise by 7.1 percent in 1979, following a 15.7 percent increase in 1978. Inventory investment is expected to be at a somewhat lower level than in 1978, indicating a continuation of the cautious inventory policies seen in recent years. Residential construction, of course, is expected to be the weakest sector of the economy, increasing only 1.7 percent, compared to 16.2 percent in 1978. Business fixed investment spending will hold up reasonably well, if the forecasts are correct. That sector is expected to register a 12.2 percent gain compared to 16.6 percent last year. The array of forecasts this year, as is usually the case, diverge more from the consensus in the investment area than in any other. Expectations for residential construction range from decreases of 5.3 percent to increases of 3.2 percent. For business fixed investment, estimated increases range between 9.2 percent and 14.9 percent. Forecasts for investment in business inventories, for which the consensus was \$14.0 billion, range from \$2.0 billion to \$20.0 billion.

Industrial Production The typical forecast for the Federal Reserve index of industrial production (1967 = 100) in 1979 is 149.9, an increase of 3.4 percent. This prediction calls for more moderate expansion than in 1978, when the index increased 5.5 percent.

Housing The construction industry is expected to feel the effects of high mortgage rates and rising construction materials costs in 1979. Activity in this sector is expected to be almost 14 percent below the 1978 pace. Private housing starts—which totaled almost 2 million in 1978—are expected to total only

TYPICAL* QUARTERLY FORECASTS FOR 1979

Percentage Quarter-to-Quarter Annual Rates
Unless Otherwise Indicated

	Forecast 1979			
	I	II	III	IV
Gross national product	10.5	7.8	7.1	6.8
Personal consumption expenditures	9.9	8.9	8.5	8.6
Durables	5.3	4.7	1.9	1.4
Nondurables	10.5	9.2	7.6	8.2
Services	11.1	10.5	10.3	9.6
Gross private domestic investment	14.4	5.7	-5.9	-0.5
Business fixed investment	12.8	10.9	8.3	7.1
Residential construction	-2.2	-10.5	-12.5	-5.8
Change in business inventories†	17.9	15.0	11.7	6.4
Government purchases	9.6	9.4	8.3	10.2
Net exports‡	-2.2	-1.5	1.4	1.8
Gross national product (1972 dollars)	3.1	1.4	0.4	1.2
Plant and equipment expenditures	12.5	10.1	8.0	6.5
Corporate profits before taxes	-3.3	-5.1	-14.9	-0.5
Private housing starts	-33.8	-28.4	-22.9	15.6
Industrial production index	2.5	1.6	-3.1	0.0
Rate of unemployment‡	6.1	6.4	6.6	6.8
Consumer price index	8.7	7.6	6.8	6.9
GNP implicit deflator	7.7	7.2	6.5	7.0

* Median

† Levels, billions of dollars

‡ Levels, percent

1.7 million units in 1979. According to preliminary estimates, housing starts ran at average annual rates of 2.1 million in October and November of 1978, so the predicted number for 1979 represents a considerable decline from the year-end 1978 rate. Still, forecasters expect the downturn in construction to be relatively mild. Credit is expected to be available, although at high cost to home builders and buyers.

Corporate Profits All the forecasters expect little increase in pretax profits this year. The most pessimistic forecaster expects no increase in corporate profits. The most optimistic predicts a 9.0 percent rise. The consensus forecast calls for an increase in

pretax profits of 2.6 percent, to \$204 billion. This would follow a gain of approximately 14.1 percent in 1978. Hence, corporate profits are expected to reflect the slower growth of the economy, but they are not expected to decline precipitously as they normally do in recession years.

Unemployment Most forecasters are predicting an increase in the rate of unemployment during 1979. The typical forecast for the year's average is around 6.6 percent. This will be only 0.6 percentage points above the 1978 average, but considering that the unemployment rate at year-end 1978 stood around 6.0 percent, a 6.6 percent average for 1979 indicates that the unemployment rate will be considerably higher by year-end. The quarterly consensus forecast, in fact, puts the unemployment rate at 6.9 percent in the fourth quarter.

Prices This year the forecast indicates that the rate of price increase will remain at about last year's rate. The implicit GNP deflator, which rose 7.4 percent in 1978, is expected to increase 7.6 percent in 1979. The Consumer Price Index, however, is expected to rise 8.2 percent, slightly higher than the 1978 average increase of 7.7 percent.

Net Exports The nation's trade position, measured on a National Income Accounts basis, was approximately \$11.8 billion in deficit in 1978 and is expected to improve moderately in 1979 to show an average deficit of only \$5.5 billion for the year. The forecasters expect import growth to moderate as the economy slows, and they also foresee an increase in exports from the continuing recovery abroad and as a result of more competitive export prices. The estimates for net exports varied between -\$8.5 billion and +\$5.6 billion.

Quarter-By-Quarter Forecasts Fifteen forecasters made quarter-by-quarter forecasts for 1979. As indicated by the accompanying table, the forecasters expect generally slow rates of growth in each quarter of the year. Translated into percentages and annualized, the expected median growth rates of real GNP are 3.1 percent, 1.4 percent, 0.4 percent, and 1.2 percent for the four quarters, respectively.

These rates are median forecasts, however, and there is considerable variation among the forecasters. The forecasts for increases in real GNP in the first quarter range from 0.3 percent to 5.3 percent; second quarter expectations range from decreases of 2.0 percent to increases of 3.0 percent; third quarter from -2.1 percent to +4.8 percent; and the fourth from -3.0 percent to +3.0 percent.

If the median forecasts are realized, the 6.8 percent unemployment rate for the fourth quarter will represent a considerable worsening of the current employment picture. With a civilian labor force of around 97 million persons, an increase of 0.8 percentage points in the average unemployment rate means an increase in unemployment of 776 thousand persons. Several of the forecasters expect the unemployment rate to be as high as 7.2 percent by year-end 1979.

The forecasters expect the rate of increase in the prices of items included in GNP to move somewhat erratically during the year. The consensus forecasts were for increases of 7.7 percent, 7.2 percent, 6.5 percent, and 7.0 percent for the four quarters, measured at seasonally adjusted annual rates. Price increases forecast ranged from 7.2 percent to 7.7 percent in the first quarter, 6.1 percent to 8.0 percent in the second, 5.2 percent to 7.1 percent in the third, and 4.8 percent to 7.4 percent in the last quarter of 1979.

BUSINESS FORECASTS 1979

The Federal Reserve Bank of Richmond is pleased to announce the publication of *Business Forecasts 1979*, a compilation of representative business forecasts for the coming year. Copies may be obtained free of charge by writing to Bank and Public Relations, Federal Reserve Bank of Richmond, P. O. Box 27622, Richmond, Virginia 23261.