

BUSINESS FORECASTS 1978

A YEAR OF MODERATE ECONOMIC GROWTH

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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.

Economic expansion will continue in 1978, albeit at a somewhat slower pace than last year. This is the basic consensus reached by a group of leading business analysts whose forecasts have been compiled by the Federal Reserve Bank of Richmond. Many of these forecasts are based on the following assumptions:

1. Continued uncertainty about national energy policy;
2. Reductions in personal and corporate taxes to take effect in the fourth quarter;
3. Economic growth abroad somewhat less than in the U. S.

On the basis of these assumptions, the forecasters collectively expect a 4.3 percent rate of real growth in real Gross National Product compared with 1977's estimated growth of 4.8 percent. This somewhat lower growth in output is expected to be accompanied by a 5.9 percent rate of increase in prices and a 6.7 percent average unemployment rate.

A consensus forecast is published by this Bank each year, together with the individual forecasters' comments on the economic outlook, in the booklet *Business Forecasts*. The purpose of this article is to briefly review the accuracy of the consensus forecast made a year ago for 1977 and to summarize the consensus forecast of business activity for this year. The 1978 consensus is derived by taking the median of 18 individual forecasts of the probable course of economic activity. Also summarized is a 1978 quarter-by-quarter consensus forecast derived by taking the median value of eight individual forecasts. Only five of these eight forecasts enter into the annual consensus. Readers interested in the detailed reasoning upon which the individual forecasts rest are referred to *Business Forecasts 1978*.¹

¹The individual forecasts that comprise the consensus were all made last year. Given recent economic developments, it is not unlikely that some of these forecasts would be different if made today.

1977 CONSENSUS FORECAST REVIEWED

Data on 1977 GNP and its components are not yet final, but the accuracy of last year's forecast can be evaluated against preliminary statistics.

Last year's consensus proved quite accurate for both nominal and real GNP, the GNP price deflator, government purchases, and personal consumption expenditures. It was less accurate for private domestic investment. The only major forecasting error involved the net export sector.

The forecasters estimated that growth in nominal GNP would be 11.1 percent, only a little above the preliminary estimate for 1977 of 10.8 percent. Their estimate of the GNP implicit deflator was slightly low, 5.4 percent compared to the actual 5.6 percent. These two forecasting errors were partially offsetting, however. As a result, the 1977 forecasters only slightly overestimated the growth in real GNP. The consensus was for 5.0 percent while the latest estimate of actual growth is 4.9 percent.

Preliminary data show total personal consumption expenditures increased 10.6 percent in 1977 compared to a consensus prediction of 10.5 percent. Two components of personal consumption expenditures, consumer expenditures on durable goods and on services, were slightly underestimated. These underestimates were more than offset, however, by a substantial overestimation of consumer nondurable expenditures.

Gross private domestic investment, expected to rise by 16 percent in 1977, did significantly better than that and rose 21 percent, according to the latest estimate. Inventory accumulation, totaling \$18 billion according to preliminary data, occurred at a faster pace than the \$15.3 billion expected. Housing starts, another important factor explaining private investment, were forecast to increase 16.9 percent. This turned out to be a substantial underprediction of the actual rise of 28.6 percent. By contrast, the forecasters accurately projected that plant and equipment expenditures would increase 13.2 percent.

The consensus forecast of government purchases was 9.3 percent, identical to the estimated rise for the year.

One large exception to the forecasters predictive accuracy was their estimate of the level of net exports. They expected a 1977 export surplus of \$6.7 billion. In fact, however, preliminary data indicate that the net export sector showed a deficit of \$9 billion.

The industrial production index was predicted to increase 6.5 percent but actually grew 6.0 percent. The predicted average unemployment rate was 7.1 percent, very close to the actual 7.0 percent.

1978 CONSENSUS FORECAST IN BRIEF

Gross National Product Current dollar GNP, i.e., GNP unadjusted for the effects of inflation, is expected to increase by 10.4 percent in 1978. This expected change in the nominal value of goods and services produced is only slightly below that actually achieved in 1977. The rate of increase in the GNP implicit price deflator is expected to accelerate from last year's 5.6 percent to 5.9 percent. Accordingly, inflation absorbs over half of the predicted annual gain in 1978 nominal GNP. There is a widespread expectation among the forecasters that the year-over-year gain in real output for 1978 will come close to matching the solid record of 1977. Forecasters expect 1978 to be a year of moderate growth, with a consensus estimate that real GNP will increase 4.3 percent. This representative view, however, rests near the upper end of the range of forecasts from which it is derived. While the most optimistic forecast in the group sees real GNP increasing by only 4.7 percent, the most pessimistic sees it increasing by a low 2.9 percent. The consensus predictions of GNP and other key indicators in 1978, along with estimated results for 1977, are listed in Table I.

Personal consumption expenditures, the largest single component of GNP, are expected to grow by 9.3 percent, significantly less than the 10.6 percent gain for 1977. Moreover, important changes in consumption patterns for goods and services are expected to occur. The forecasters expect demand for consumer durable goods to rise by 6.7 percent, slightly greater than half the increase in 1977. An important factor underlying the predicted slower growth in expenditures on consumer durables is an anticipated weakening in domestic automobile sales. Unit automobile sales, which showed marked growth in the first two years of the current recovery, are expected to decline by 300 thousand units or 3.3 percent in 1978. Spending on nondurable goods, however, is expected to increase at a faster pace than last year and to compensate for the expected slowing

in durables spending. The nondurable component of personal consumption expenditures is seen as rising 8.6 percent, slightly greater than the growth that occurred in 1977. Projected growth in spending on services, on the other hand, is seen as falling below the actual percentage increase achieved during the past year.

The consensus forecast for gross private domestic investment calls for an 11.8 percent increase during 1978, a striking slowing from the estimated 21 percent gain recorded for 1977. Inventory investment is expected to remain unchanged, thereby making no contribution to the total expected rise in private investment. Also, after a vigorous increase during 1977, housing starts are expected to fall off slightly from the previous year's level. This suggests residential construction will make only a modest contribution to the overall increase in private investment. The 11.8 percent increase in private investment forecast for 1978, therefore, rests heavily on prospects for fixed investment by businesses. The consensus is that plant and equipment expenditures will increase 13.2 percent in 1978, the individual forecasts ranging from 14.1 percent to 5.5 percent.

Partially offsetting the forecast of slower growth in personal consumption and private investment is a predicted acceleration in the rate of government spending. Growth in purchases of goods and services by Federal, state, and local governments is expected to accelerate to 12.1 percent in 1978, well above the preliminary estimate of a 9.3 percent rise in 1977. Thus, it is anticipated that government spending will be an important factor in GNP growth in 1978.

According to the consensus forecast, net foreign spending should show a slight improvement in 1978 over 1977. In 1977, imports exceeded exports by an estimated \$9 billion on a national income accounts basis and thus exerted a drag on GNP growth. The consensus expectation is that this drag will continue in 1978 but will not be quite as great as last year. The distribution of individual forecasts making up this consensus, however, is unusually wide, ranging from a \$1 billion export surplus to a \$14 billion deficit. This suggests that there exists a good deal of uncertainty on the part of the forecasters about what to expect in the net foreign spending sector.

Corporate Profits Growth in before tax corporate profits is not expected to equal its 1977 pace. The individual forecasts unanimously predict that profit growth will be slower than the 8.8 percent registered in 1977. The forecasts range from increases of 1.7 percent to 8.5 percent, with the consensus calling for a 6.3 percent increase.

Industrial Production The Federal Reserve's industrial production index is expected to rise by 5.5 percent in 1978, somewhat below the 6.0 percent advance in 1977. This corresponds to the consensus forecast of a somewhat slower growth in real GNP in 1978 than in 1977. Individual estimates of the 1978 gain in the industrial production index range from 2.3 percent to 9.4 percent.

Unemployment Estimates of the average unemployment rate for 1978, which were made before the

December data and 1977 revisions were released, cluster closely around the consensus prediction of 6.7 percent. This would represent only a modest improvement over the 7.0 percent average for 1977.

Prices On the price front, individual forecasts for the wholesale price index range between 6.0 percent and 8.1 percent, with the consensus expectation at 6.0 percent. In 1977 this index rose 6.2 percent. The expected increase in the consumer price index, at 6.1 percent, is somewhat below the 1977 increase of

Table 1
RESULTS FOR 1977 AND CONSENSUS FORECAST FOR 1978

	Unit or base ¹	Preliminary 1977 ²	Forecast 1978 ³	Annual Percentage Change	
				1976/1977	1977/1978
Gross national product	\$ billions	1890	2087	10.8	10.4
Personal consumption expenditures	\$ billions	1210	1323	10.6	9.3
Durables	\$ billions	179	191	12.9	6.7
Nondurables	\$ billions	480	521	8.4	8.6
Services	\$ billions	551	611	11.8	11.0
Gross private domestic investment	\$ billions	294	329	21.0	11.8
Change in business inventories	\$ billions	18	18	—	—
Government purchases	\$ billions	395	443	9.3	12.1
Net exports	\$ billions	-9	-8	—	—
Gross national product (1972 dollars)	\$ billions	1338	1396	4.9	4.3
Plant and equipment expenditures	\$ billions	136	154	13.2	13.2
Corporate profits before taxes	\$ billions	171	182	8.8	6.3
Private housing starts	millions	1.98	1.97	28.6	-0.3
Automobile sales (domestic)	millions	9.10	8.80	5.8	-3.3
Industrial production index	1967=100	137	145	6.0	5.5
Rate of unemployment	percent	7.0	6.7	—	—
Wholesale price index	1967=100	194	206	6.2	6.0
Consumer price index	1967=100	181	192	6.5	6.1
GNP implicit deflator	1972=100	141.3	149.6	5.6	5.9

¹ Dollar amounts are shown in nominal terms unless otherwise indicated.

² Data available as of January 20, 1978.

³ The 1978 consensus forecast is the median of year-to-year percentage changes provided by eighteen individual forecasts. Not all of the individual forecasts provided the detail shown here. Some items, therefore, are derived from fewer than eighteen forecasts.

6.5 percent. Coupled with the expected 5.9 percent rise in the GNP implicit deflator for 1978, these predictions suggest little or no progress with the inflation problem for the year.

Quarterly Consensus A quarterly consensus forecast for 1978 based on eight individual quarterly forecasts is shown in Table II. The consensus for each item is the median of the individual forecasts of that item. The number of forecasters supplying quarterly predictions is considerably less than the number supplying average annual predictions. In this sense the quarterly consensus is less representative than the annual consensus, and the two forecasts, while similar, are nevertheless not directly comparable. The quarterly consensus is particularly useful, however, in giving some idea of the probable profile of the economy's growth during 1978.

The quarterly consensus calls for slower growth in nominal GNP during the second half of the year than during the first half. The rate of change in the GNP implicit deflator is expected to increase steadily from an annual rate of 5.4 percent in the first quarter to 6.6 percent in the fourth. Thus, the forecasters see inflation as accelerating as the end of the year approaches. The second quarter increase in real GNP is forecast as 4.5 percent at an annual rate, a moderate decline from the first quarter's expected 4.8 percent annual rate. Real GNP is predicted to grow at annual rates below 4 percent in the last two quarters of the year.

Growth in expenditures for personal consumption is expected to remain fairly steady in the first half of the year, accelerate in the third quarter, and decline in the fourth quarter. Predicted growth in expenditures on durables jumps markedly from a 5.4 percent annual rate in the first quarter to an 8.0 percent annual rate in the second quarter before falling back to a 7.1 percent annual rate in the fourth quarter. Predicted growth in expenditures on nondurables also rises in the second and third quarters but falls back in the fourth quarter. Expected growth in expenditures on services slows somewhat in the second quarter but accelerates in the third before slowing again in the fourth quarter.

Growth in gross private domestic investment is expected to rise in the second quarter but fall back sharply in the second half. The higher second quarter growth rate is explained by an increase in the growth of plant and equipment expenditures. Between the second and third quarters, growth in private domestic investment is expected to fall by 5.3 percentage points, even though inventory accumulation has a predicted increase. The explanation for the third

Table II
CONSENSUS QUARTERLY FORECAST FOR 1978

Percentage Quarter-to-Quarter Annual Rates
 Unless Otherwise Indicated

	Forecast 1978 ¹			
	I	II	III	IV
Gross national product (nominal dollar)	10.7	9.8	10.2	9.9
Personal consumption expenditures	9.1	9.0	9.6	8.9
Durables	5.4	8.0	7.7	7.1
Nondurables	8.8	9.6	9.9	9.0
Services	10.2	10.0	10.6	10.4
Gross private domestic investment	11.9	13.7	8.4	9.4
Change in business inventories ²	17	17	18	18
Government purchases	9.6	10.1	10.1	12.4
Net exports ³	-10	-10	-7	-5
Gross national product (constant dollar)	4.8	4.5	3.9	3.5
Plant and equipment expenditures	11.2	13.8	12.4	13.7
Corporate profits before taxes	0.9	6.7	13.4	11.3
Private housing starts	-4.4	-4.6	-6.0	-6.6
Automobile sales (domestic)	-2.4	2.2	-3.3	-10.4
Industrial production index	5.8	5.6	4.9	4.0
Rate of unemployment ⁴	6.8	6.7	6.6	6.6
Wholesale price index	6.2	5.5	6.0	6.3
Consumer price index	6.0	6.4	6.1	6.4
GNP implicit deflator	5.4	5.6	6.0	6.6

¹ The 1978 consensus forecast is the median of quarter-to-quarter percentage changes provided by eight individual forecasts. Not all of the individual forecasts provided the detail shown here. Some items, therefore, are derived from fewer than eight forecasts.

² Billions of dollars.

³ Levels, billions of dollars.

⁴ Levels, percent.

quarter decline seems to rest with weaker growth in plant and equipment expenditures and an accelerated rate of decline in housing starts. Between the third and fourth quarters, private domestic investment growth increases somewhat, from an 8.4 percent annual rate to a 9.4 percent annual rate, largely due to a faster rate of growth in plant and equipment expenditures.

According to the forecasters the drag on GNP due to the net export deficit weakens significantly in the second half of 1978. Moreover, government purchases are expected to grow very rapidly in the second half of the year relative to the first half.

The advance in the industrial production index, according to the quarterly consensus, slows through the year. While the expected slowing is moderate in the first half, it becomes more pronounced in the third quarter and drops significantly in the fourth quarter.

The quarterly forecasters expect the unemployment rate to ease slightly through 1978, falling from 6.8 percent in the first quarter to 6.6 percent in the fourth.

According to the quarterly consensus the wholesale price index will finish the year by growing at a 6.3 percent annual rate, only slightly above the 6.2 percent annual rate of the first quarter. Growth in the consumer price index is expected to increase substantially from 5.4 percent in the first quarter to 6.6 percent in the fourth quarter.

BUSINESS FORECASTS 1978

The Federal Reserve Bank of Richmond is pleased to announce the publication of *Business Forecasts 1978*, 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.