

FORECASTS 1985

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The projections in this article are those of the various forecasters and should not be attributed to this Bank or the Federal Reserve System.

The Current Forecast

Moderate economic growth and moderate inflation are predicted for 1985 by economic forecasters, according to a survey of forecasts collected for this Bank's *Business Forecasts 1985*. Summaries of the forecasts are presented in Tables I and II ; however, a much more detailed summary can be found in *Business Forecasts 1985* itself.

An important feature of this year's survey is that only one of forty-eight forecasters predicts that a recession will begin in 1985. The median forecast calls for 3.4 percent growth of real gross national product (GNP) in 1985, as indicated in Table I. That rate of growth would be below recent growth rates, 6.3 percent in 1983 and 5.6 percent in 1984. Of course, such high rates of growth of real activity would be unusual for the third year of a cyclical expansion. Projected growth would indicate generally rising levels of income, production, and employment; however, little reduction in the rate of unemployment is predicted.

The predicted growth in nominal expenditure shown in Table I is somewhat uneven. Consumer spending is expected to rise by 7.6 percent, slightly below GNP growth. Business fixed investment is expected to rise by 8.2 percent, slightly faster than GNP, while residential investment is expected to be relatively strong, rising by 10.6 percent. As has frequently occurred in recent years, Federal spending is expected to rise more rapidly than GNP, increasing by 9.5 percent. Finally, net exports are expected to continue to decline, falling by almost \$20 billion from the end-of-1984 value.

Only moderate increases in inflation are expected in 1985. Consumer prices are expected to rise by 4.5 percent and producer prices by 3.5 percent. Those rates, although slightly higher than in 1984, would nevertheless remain well below the high rates experienced in the late seventies. The projected in-

crease in inflation would also be relatively moderate for the third year in a cyclical expansion.

Underlying this scenario, however, are two major imbalances in the economy. First, many observers argue that the nation's fiscal policy is unsustainable. One symptom is that interest on the national debt is rising much faster than the nation's ability to pay that interest. For example, over the last seven years, interest payments on the federal debt have risen at a 22 percent annual rate, while the gross national product has risen at only a 9.5 percent rate.

Another imbalance is the large foreign trade deficit, which grew by \$34.5 billion in 1984. Corresponding to that excess of imports over exports was a capital inflow into the United States, as foreigners accumulated U. S. financial assets. The rapid accumulation of those assets has led some analysts to believe that current trade and asset flows are unsustainable. For example, from the first quarter of 1983 to the third quarter of 1984, foreign holdings of U. S. financial assets rose by 29 percent, whereas total U. S. financial assets grew by only 18 percent. Again, some analysts maintain that such a trend cannot be sustained indefinitely.

Forecasters generally expect these imbalances to continue in 1985, but not to severely disrupt the economy. Some of the more pessimistic forecasters do see strains developing. For example, one predicted that rising interest rates due to the large federal deficit will choke off economic expansion. Others believe that a sharp reduction of net exports will stifle domestic demand. However, other forecasters looking at those same difficulties see reasons for optimism. Examples include the expectation that meaningful fiscal reform will occur, or that foreign economic growth will spur exports. Thus the median forecast conceals a wide range of possible outcomes, in large part due to the obvious fiscal and trade problems.

A notable omission from the forecasters' list of major uncertainties is monetary policy. Perhaps due to the Federal Reserve's success in hitting its announced targets for growth in the money supply

Table I
 MEDIAN QUARTERLY CHANGES FORECAST FOR 1985
 Percentage Changes at Annual Rates Unless Otherwise Noted

	Actual Change ^a 4Q 83- 4Q 84	Forecasts 1985*				4Q 84- 4Q 85
		I	II	III	IV	
Gross national product_____	9.3	7.6	7.8	8.1	8.0	7.9
Personal consumption expenditures____	7.6	7.5	7.4	7.7	7.8	7.6
Durables _____	8.3	8.6	8.7	6.4	6.3	7.5
Nondurables _____	6.0	5.2	5.7	6.4	6.1	5.9
Services_____	8.5	8.6	9.0	8.6	9.0	8.8
Gross private domestic investment _____	17.7	2.1	6.4	10.3	10.4	7.3
Fixed investment:						
Nonresidential _____	16.9	10.6	7.9	7.2	7.1	8.2
Residential _____	8.4	7.4	12.0	11.7	11.1	10.6
Change in business inventories ^b _____	31.1 ^c	34.7	33.0	34.9	38.8	
Net exports ^b _____	-64.3 ^c	-80.9	-81.2	-87.1	-84.0	
Government purchases _____	13.2	9.9	8.3	8.4	8.4	8.8
Federal _____	18.7	12.6	8.3	8.5	8.4	9.5
State and local _____	9.8	8.1	8.0	7.6	7.3	7.8
Gross national product (1972 dollars) ____	5.6	3.4	3.4	3.4	3.3	3.4
Corporate profits after taxes _____		4.6	10.0	11.2	6.2	8.0
Private housing starts _____	-8.2	10.0	8.3	0	1.2	4.9
Domestic automobile sales _____	0.1	12.2	2.4	4.8	3.9	5.8
Rate of unemployment ^d _____	7.2 ^c	7.3	7.2	7.2	7.2	
Industrial production index _____	6.3	4.0	4.4	3.1	3.5	3.8
Consumer price index _____	4.1	4.1	4.3	4.6	4.8	4.5
Producer price index _____	1.7	2.9	3.3	3.6	4.3	3.5
GNP implicit price deflator _____	3.5	4.2	4.3	4.5	4.5	4.4

* Median quarterly percentage change forecast for each quarter for each category, incorporating 30 forecasts.

^a National income and Product Account data for the fourth quarter of 1984 are preliminary and subject to revision.

^b Quarterly levels, billions of dollars at annual rates.

^c Level, 4Q 1984.

^d Quarterly levels, percent.

(M1) in 1984 and the last half of 1983, most forecasters predict that monetary growth in 1985 will be within the Fed's tentative range announced in July. The median projection for M1 growth is 6.1 percent, while the announced range for M1 growth is 4 to 7 percent.

Past Forecasts

As indicated in Table III, the median forecast was unusually accurate in 1984. Although real growth

was underestimated and inflation overpredicted, the misses were smaller than in recent years. Most striking, however, was that the interest rate paid on Treasury bills was forecast exactly for the fourth quarter of 1984.

While forecasts for the year as a whole were unusually accurate, the pattern of economic activity within the year was not predicted well. During 1984, real GNP was predicted to grow between 4.0 and 4.5 percent during each quarter. Yet during the first

Table II
MEDIAN ANNUAL AVERAGES FORECAST FOR 1985

	Unit or Base	Preliminary 1984*	Forecast 1985**	Percentage Change	
				Preliminary 1984/1983	Forecast 1985/1984
Gross national product _____	\$ billions	3661.3	3936	10.8	7.5
Personal consumption expenditures _____	\$ billions	2342.3	2523	8.6	7.7
Durables _____	\$ billions	318.4	344	13.8	7.9
Nondurables _____	\$ billions	858.3	905	7.1	5.4
Services _____	\$ billions	1165.7	1275	8.5	9.4
Gross private domestic investment _____	\$ billions	637.3	674	35.1	5.8
Fixed investment:					
Nonresidential _____	\$ billions	426.0	472	20.7	10.8
Residential _____	\$ billions	154.4	164	16.8	6.0
Change in business inventories _____	\$ billions	56.8	38	—	—
Net exports _____	\$ billions	-66.3	-84	—	—
Government purchases _____	\$ billions	748.0	823	9.1	10.0
Federal _____	\$ billions	295.5	331	9.6	11.9
State and local _____	\$ billions	452.4	492	8.8	8.7
Gross national product (1972 dollars) _____	\$ billions	1639.0	1693	6.8	3.3
Private housing starts _____	thousands	1745	1696	2.4	-2.8
Domestic automobile sales _____	millions	8.0	7.7	17.6	-3.8
Rate of unemployment _____	percent	7.5	7.2	—	—
Industrial production index _____	1967= 100	163.5	168.9	10.8	3.3
Consumer price index _____	1967= 100	311.1	324.5	4.3	4.3
Producer price index _____	1967= 100	291.2	298.5	2.1	2.5
GNP implicit price deflator _____	1972= 100	223.39	232.55	3.7	4.1

* Data available as of January 1985.

** These data are constructed using preliminary 1984 data and the median annual percentage change forecast for each category, incorporating 45 forecasts.

two quarters the economy boomed, with real GNP growing at 10.1 and 7.1 percent annual rates. Then real activity decelerated, with real GNP rising by only 1.6 percent in the third quarter. Neither the boom nor the deceleration was generally forecast. In addition, the intrayearly patterns of inflation and interest rates differed from the median forecasts.

In many ways, therefore, 1954 furnishes a good

illustration of both the benefits and the hazards of economic forecasts. Relatively accurate forecasts for the year as a whole were undoubtedly valuable for many users. But even in such a relatively good year, forecasters were generally unable to predict short-run changes. Users looking for guidance on the exact timing of particular events, such as the onset of a recession, should keep that record in mind.

Table III

THE RECORD OF MEDIAN FORECASTS

	Real GNP (Growth Rate)			Inflation Rate (GNP Deflator)			Treasury Bill Rate		
	Actual	Predicted	Error	Actual	Predicted	Error	Actual	Predicted	Error
1971 _____	4.7	3.8	0.9	4.7	3.6	1.1			
1972 _____	7.0	5.6	1.4	4.3	3.2	1.1			
1973 _____	4.3	6.0	-1.7	7.0	3.3	3.7			
1974 _____	-2.7	1.2	-3.9	10.1	5.5	4.6	7.3	6.0	1.3
1975 _____	2.2	-0.6	2.8	7.7	7.1	0.6	5.7	7.1	-1.4
1976 _____	4.4	6.0	-1.6	4.7	5.4	-0.7	4.7	7.1	-2.4
1977 _____	5.8	5.0	0.8	6.1	5.7	0.4	6.1	5.8	0.3
1978 _____	5.3	4.2	1.1	8.5	5.9	2.6	8.7	6.5	2.2
1979 _____	1.7	1.5	0.2	8.1	7.1	1.0	11.8	8.1	3.7
1980 _____	-0.3	-0.8	0.5	9.8	8.2	1.6	13.7	8.6	5.1
1981 _____	0.9	2.4	-1.5	8.9	9.1	-0.2	11.8	10.8	1.0
1982 _____	-1.7	2.8	-4.5	4.4	7.1	-2.7	8.0	11.2	-3.2
1983 _____	6.1	3.9	2.2	4.1	5.4	-1.3	8.8	8.1	0.7
1984 (preliminary) _____	5.6	4.3	1.3	3.5	4.9	-1.4	9.0	9.0	0
Mean Absolute Error ____			1.7			1.6			1.9

Note: Predictions are from Business Forecasts, published annually by the Federal Reserve Bank of Richmond. The error is the actual value minus the predicted value. Real GNP and the GNP deflator are expressed as percentage changes from the fourth quarter of the previous year to the fourth quarter of the stated year. The Treasury bill rate is the average yield on three-month bills in the fourth quarter.

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The Federal Reserve Bank of Richmond is pleased to announce the publication of *Business Forecasts 1985*, a compilation of representative business forecasts for the current year. A consensus forecast for 1985 also is included. Copies may be obtained free of charge by writing to Public Services Department, Federal Reserve Bank of Richmond, P. O. Box 27622, Richmond, Virginia 23261.