

FORECASTS 1976

Recovery But No Bicentennial Boom

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Recovery, led by strong consumer spending, will continue throughout 1976, but the recovery will not be at as rapid a pace as has been the case following past recessions. Such, at least, is the general conclusion reached by leading business and academic economists who have published forecasts for the 1976 economy.

This general conclusion, as is the case with all forecasts, is not really an attempt to foresee the future. Professional forecasters can only evaluate the implications of certain trends, and—given certain assumptions about future events—extend these trends into the future. If unforeseen events occur, the “prediction” does not come about.

Each year the Federal Reserve Bank of Richmond compiles various forecasts of the economy's performance for the coming year. This year the forecasters based their forecasts on the following assumptions: (1) extension of the 1975 tax cut without President Ford's proposed spending limit, (2) little, if any, increase in oil prices (revocation of the \$2 per barrel oil tariff will offset the rise in OPEC prices), (3) a good crop year, (4) sluggish recovery abroad, and (5) continued difficulties for many municipalities in selling their bonds. On the basis of these assumptions, the forecasters expect approximately a 6 percent rate of real growth for GNP. This higher rate of growth is expected to be accompanied by a 6 percent rate of inflation.

Last year the consensus prediction overestimated the actual GNP total by approximately \$34 billion. Real GNP, or GNP measured in 1958 dollars, likewise was overestimated, and by \$23-\$24 billion. Forecasters had expected real GNP to decline 0.6 percent; it actually fell approximately 2.9 percent. Much of the difficulty stemmed from their mistaken appraisal of the first quarter. Although almost all of the forecasters who made quarterly forecasts expected first quarter real GNP, measured at annual rates, to decline, none anticipated a decline as large as \$24 billion. The most pessimistic anticipated a decline of only about half that amount.

In any event, and perhaps as a result of their misstep on the first quarter, most forecasters were expecting real GNP to bottom out in the second quarter and recover slowly in the second half. As is common knowledge now, real GNP in 1975 hit its low point in the first quarter and showed a good rate of recovery in the second half of the year.

This year the forecasters expect a steady, although not ebullient, rate of recovery throughout 1976. Personal consumption spending, particularly for durables, is expected to be strong and to exhibit its greatest growth in the first half of the year. The experts also expect the economy to benefit from inventory rebuilding and a pickup in the construction of single-family dwellings. Business spending for plant and equipment is expected to increase only modestly in the first half of the year, but as the recovery continues and as production increases, businessmen are expected to reactivate previously postponed capital spending plans. Thus, plant and equipment spending is expected to accelerate in the second half of the year.

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. The consensus of the annual forecasts may differ from the consensus drawn from the quarterly forecasts, since different forecasters were applying their skills. Also, since there were varying assumptions in the individual forecasts regarding events in 1976, the general tone and pattern may not necessarily be based upon the more realistic assumptions, but only those most prevalent.

This Bank also publishes the booklet *BUSINESS FORECASTS 1976*, which is a compilation of representative business forecasts with names and details of the various estimates. No summary article can begin to be as informative as the actual forecasts themselves. Serious readers are urged to look at the individual forecasts in more detail in *BUSINESS FORECASTS 1976*.

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

1975 FORECASTS IN PERSPECTIVE

The consensus forecast for 1975 GNP, published in last year's January/February *Economic Review*, called for an increase of 8.2 percent over 1974. The forecasts for increases in GNP ranged from a low of 5.1 percent to a high of 10.8 percent. Using the revised 1974 GNP figure of \$1,397.3 billion, the consensus forecast for 1975 GNP would have been \$1,512.0 billion and the range from \$1,468.2 billion to \$1,548.2 billion. Increasing prices were predicted to account for all of the 8.2 percent gain in GNP, and slightly more. GNP measured in constant dollars, or real GNP, was expected to fall 0.6 percent.

All of the forecasts that have been collected were made before the revised GNP figures were released. Since it would be of little use to evaluate the 1975 forecasts on the basis of the new revisions, the Research Department of this Bank estimated fourth quarter 1975 on the old basis. The fourth quarter estimates were made by determining a consensus of the forecasts published in December 1975 and early January 1976.

Including these fourth quarter estimates, a 1975 current dollar annual GNP total of \$1,477.1 billion is indicated; that figure is almost \$34 billion short of last year's consensus forecast. Only one of last year's forecasters predicted a current dollar GNP total less than what now seems to have been the actual figure. Prices increased somewhat more slowly than predicted, 8.8 percent versus 9.0 percent, but even so, real GNP appears to have been overestimated by all

RESULTS FOR 1975 AND TYPICAL FORECAST FOR 1976

	Unit or Base	Estimated 1975 [†]	Forecast 1976*	Percentage Change	
				1974/1975	1975/1976
Gross national product	\$ billions	1,477.1	1,653.5	5.7	12.0
Personal consumption expenditures	\$ billions	953.6	1,057.8	8.8	11.0
Durables	\$ billions	134.2	153.2	5.2	15.0
Nondurables	\$ billions	416.2	460.7	9.4	10.7
Services	\$ billions	403.2	443.9	9.2	10.1
Gross private domestic investment	\$ billions	170.3	220.0	-18.7	28.4
Business fixed	\$ billions	144.6	159.5	-3.1	10.3
Residential structures	\$ billions	39.7	52.9	-13.7	33.3
Change in business inventories	\$ billions	-14.0	7.6	—	—
Government purchases	\$ billions	341.0	370.7	10.3	8.7
Net exports	\$ billions	12.2	5.0	—	—
Gross national product (1958 dollars)	\$ billions	797.6	845.4	-2.9	6.0
Plant and equipment expenditures	\$ billions	113.5	121.7	1.0	7.2
Corporate profits before taxes	\$ billions	123.8	151.7	-12.0	22.5
Private housing starts	millions	1.2	1.6	-13.0	35.0
Automobile sales	millions	8.6	9.5	-2.7	11.5
Rate of unemployment	percent	8.5	7.8	—	—
Industrial production index	1967=100	113.4	123.9	-9.1	9.3
Wholesale price index	1967=100	174.9	187.1	9.2	7.0
Consumer price index	1967=100	161.2	171.7	9.1	6.5
Implicit price deflator	1958=100	185.2	195.6	8.8	5.6

[†]Because of revisions in the national income and product accounts, the fourth quarter published GNP data are not comparable with the unrevised earlier figures. Thus, comparable GNP totals for the fourth quarter had to be estimated. See the discussion in the text for a description of the estimating procedure.

*Figures are constructed from the typical percentage change forecast for 1976.

forecasters save one. Real GNP in 1975, expected to fall 0.6 percent, declined approximately 2.9 percent, from \$821.2 billion in 1958 dollars to \$797.6 billion. The one pessimist thought real GNP would fall 3.6 percent, to \$791 billion. As might be expected from their underestimate of the extent of the recession, the majority of the experts also underestimated the unemployment rate for the year. The rate of unemployment in 1975, which averaged 8.5 percent, was predicted at 7.3 percent.

For the past few years, forecasters seemed to have erred more in predicting the rate of price increase than in estimating the performance of the GNP accounts in real terms. Last year, however, was different, and the large errors were made in estimating the components of real GNP. There were particularly large errors in predicting investment and net exports. Business fixed investment, forecast to increase 8.2 percent to \$161.2 billion, is estimated to have actually fallen by 3.1 percent to \$144.6 billion. Inventory investment, which was expected to *rise* \$3 billion, is thought to have actually fallen \$14.0 billion.

The net exports account total, which the forecasters missed badly, actually provided the forecasters with an offsetting error within their GNP estimate. Net exports, predicted to be $-\$5$ billion, was the only account to do better than the forecasters expected. It totaled somewhere around $+\$12.2$ billion, thus helping out the consensus forecast for GNP with a \$17 billion offsetting error. The forecasters, as usual, were close to the mark for government purchases of goods and services, missing the actual figure by less than \$1.0 billion.

The consensus of quarter-by-quarter forecasts for 1975 was for current dollar GNP to rise \$26.0 billion in the first quarter, \$31.0 billion in the second quarter, \$38.0 billion in the third quarter, and \$40.0 billion in the fourth. The realized changes in quarterly GNP were $-\$14.0$ billion, $+\$24.3$ billion, $+\$62.7$ billion, and (approximately) $+\$46.2$ billion for the four quarters, respectively. The quarterly projections for real GNP were for changes of $-\$1.0$ billion, $+\$3.0$ billion, $+\$7.0$ billion, and $+\$9.0$ billion. For the four 1975 quarters respectively, however, GNP in constant dollars actually fell by \$24.0 billion, then rose \$3.6 billion, \$24.7 billion, and what appears to have been \$9.6 billion. The forecasters were thus correct in predicting a stronger second half for the year and reasonably close to the increases registered for the second and fourth quarters. They went wrong in underestimating the depth of the economic decline in the first quarter and the vigor of the "bounce-back" in the third quarter. Even the one forecaster who predicted a lower annual figure for real GNP

than the actual missed on the quarterly changes. He expected real GNP to decline in both the first and second quarters and to recover very slowly in the second half.

The consensus 1975 forecast projected personal consumption expenditures for the year to increase 9.8 percent to \$963.1 billion. Current estimates place personal consumption expenditures almost \$10 billion lower, at \$953.6 billion, an increase of only 8.8 percent. Gross private domestic investment, forecast to *increase* 1.4 percent to \$212.2 billion, accounted for the largest error among the GNP components. It actually *fell* approximately 18.7 percent to \$170.3 billion. In addition to the overestimates for inventories and business fixed investment mentioned earlier, the forecasters had predicted a recovery for residential construction in the second half of the year with the result that outlays for residential structures for the year were expected to total \$43.8 billion, a decline of \$2.1 billion from the 1974 level. The actual total, however, fell approximately \$6 billion.

All in all, it would appear that last year's forecasts were off the mark by an unusually large margin. Much of the inaccuracy, moreover, was attributable to errors in forecasting the first quarter, surprisingly not the more distant fourth quarter. Turning points are always difficult to forecast, however, and past attempts have not usually been spectacularly successful. Also, for the past several years, the forecasters have tended to predict a better performance for the economy than the one that actually materialized.

In other areas, the 1974 forecasters also overestimated the strength of economic activity. The index of industrial production fell 9.1 percent, against a forecast of a 0.3 percent decline. Corporate profits before taxes were predicted to fall 9.7 percent to \$127.3 billion; they actually fell 12.0 percent to \$123.8 billion. The consumer price index, like the implicit price deflator, was predicted fairly accurately. Consumer prices were expected to increase 9.5 percent; they actually rose 9.1 percent.

1976 FORECASTS IN BRIEF

NOTE: *None of the forecasts for 1976 reflect the revisions in the national income and product accounts released in January 1976.*

Gross National Product Forecasts for 1976 current dollar GNP center around \$1,653.5 billion. This consensus forecast represents an approximate 12.0 percent yearly gain, which is considerably more than the 5.7 percent increase apparently registered in 1975.

Prices are expected to increase only 5.6 percent. GNP measured in constant dollars, or real GNP, is expected to rise 6 percent in 1976, which is indicative of the modest recovery expected for the economy, but which is a considerable improvement over the almost 3 percent decline in 1975. Estimates for increases in current dollar GNP range from a low of 9.0 percent to a high of 13.4 percent, but the great majority are close to 12 percent. The consensus of quarterly estimates indicates that recovery will continue at about the same rate throughout the year. It projects increases of \$41.8 billion in the first quarter of 1976, \$46.7 billion in the second, \$46.0 billion in the third, and \$50.5 billion in the fourth.

Personal consumption expenditures are expected to total \$1,057.8 billion for 1976, up 11.0 percent from 1975. Forecasters estimate that expenditures for durable goods will show an increase of 15 percent for the year, while expenditures for nondurables and services will rise 10.7 percent and 10.1 percent, respectively. The faster rate of expansion of durable goods expenditures is expected to stem primarily from recovering automobile sales, but sales of large appliances and furniture are also expected to pick up as a result of generally higher levels of consumer confidence and a moderate housing recovery. The forecasters assume that consumers are now in a good financial position and are predicting that the saving rate will fall unless inflation strikes again.

Government purchases of goods and services are projected to total \$370.7 billion. This estimate represents an 8.7 percent increase over 1975, considerably smaller than the 10.3 percent gain of the previous year. The 1976 forecasts for government purchases range from increases of 7.1 to 10.4 percent.

Gross private domestic investment is expected to rise substantially, by 28.4 percent in 1976. This estimate represents dramatic evidence that recovery is expected, since investment in 1975 registered an approximate 18.7 percent decline. Inventory rebuilding, heading the investment recovery, is expected to add \$20 billion to the economy. Residential construction is not far behind, increasing by \$13.2 billion or 33 percent over 1975. Business fixed investment, a more moderate source of strength, is expected to increase 10.3 percent. The forecasts, as is usually the case, cluster less closely around the consensus in predicting investment than in any other prediction. The increases predicted for residential structures range from 12.6 percent to 50.0 percent. For business fixed investment, estimated increases range from 6.5 percent to 15.3 percent. And forecasts for gains in investment in business

TYPICAL* QUARTERLY FORECAST FOR 1976

Quarter-by-Quarter Changes in Billions of Dollars
Unless Otherwise Noted

	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>
Gross National Product	41.8	46.7	46.0	50.5
Personal Consumption Expenditures	24.4	27.0	28.0	27.3
Gross Private Domestic Investment	11.3	12.8	11.0	11.0
Net Exports‡	8.4	6.3	5.7	6.6
Government Purchases	7.0	8.2	7.0	10.8
Gross National Product (1958 dollars)	11.3	11.2	11.8	10.9
Implicit Price Deflator†	5.2	5.6	5.2	5.6
Rate of Unemployment (%)‡	8.1	7.9	7.6	7.4

*Median.

‡Actual estimate.

†Percentage changes at annual rates.

inventories, for which the consensus was \$7.6 billion, range from \$3.5 billion to \$16.0 billion.

Industrial Production The typical forecast for the Federal Reserve index of industrial production (1967 = 100) is 123.7, an increase of 9.3 percent. If realized, this performance will be much better than the decline of 9.1 percent in 1975. The projected increase for 1976 would still leave this index below its 1974 level of 124.7. The 1976 recovery is expected to be attributable mainly to gains in the production of automobiles and construction-related items.

Housing The construction industry is expected to register a moderate recovery from the very low levels of 1974 and 1975. But activity in this sector is expected to remain low relative to 1971, 1972, and 1973. Private housing starts, which totaled over 2 million in 1971, 1972, and 1973, 1.3 million in 1974, and 1.2 million in 1975, are expected to total 1.6 million units in 1976. Considering that housing starts closed the year 1975 at about a 1.3 million unit annual rate, 1.6 million units in 1976 represents only a modest expectation for improvement. Forecasters expect the recovery to be limited mainly to single-family dwellings. While home financing is expected to be easier, forecasters note important negative factors in housing markets, chiefly (1) the large inventory of unsold houses on hand, (2) high current prices for new homes, and (3) the distressed financial conditions of many builders.

Corporate Profits The consensus forecast indicates that this year should be much more profitable for corporations than 1975, with pretax corporate profits expected to increase 22.5 percent to \$151.7 billion. This compares with an approximate 12.0 percent decline registered last year.

The projected 22.5 percent increase in corporate profits may seem inordinately large at first glance. However, the corporate profit situation has been generally poor over the past few years. In an inflationary period, firms can show profit on the book value of inventories held, but the profit is largely illusory because firms must pay higher prices to replace the inventory. If one adjusts profit figures for changes in inventory valuation and measures the adjusted profit figure in constant dollars, the projected 1976 figure for corporate profits turns out to be lower than the profits earned ten years ago. All of the forecasters expect a much better pretax profit figure than was realized last year. The most pessimistic forecaster expects a 14.7 percent profit increase; the most optimistic a 32.5 percent rise.

Unemployment Most forecasters are predicting only a modest decline in the rate of unemployment during 1976. The typical forecast for the year's average is around 7.8 percent, only 0.7 percentage points below the 1975 average. Considering that the unemployment rate at year-end 1975 stood around 8.3 percent, a 7.8 percent average for 1976 indicates that employment growth is expected to outpace labor force expansion by only a small amount.

Prices This year the forecast indicates a general improvement in the outlook for prices. The implicit GNP deflator, which rose 10.2 percent in 1974 and an estimated 8.8 percent in 1975, is expected to increase only 5.6 percent in 1976. The consumer price index is also expected to increase much less rapidly, 6.5 percent compared to last year's 9.1 percent. The wholesale price index is expected to increase at a

higher rate than the other indexes, 7.0 percent, but considerably slower than the 9.2 percent rate of advance registered in 1975 and far better than 1974's 18.9 percent wholesale price increase.

Net Exports The nation's trade position, which was approximately \$12.2 billion in surplus in 1975, is expected to continue in surplus in 1976, but at a lower \$5 billion level. The forecasters expect imports to continue to increase as consumer spending picks up, but they foresee a smaller rate of increase for exports, since the recovery abroad is expected to be slower than the U. S. recovery. The estimates for net exports varied between +\$2.0 billion and +\$10.0 billion.

Quarter-by-Quarter Forecasts Twelve forecasters made quarter-by-quarter forecasts for 1976. As indicated by the accompanying table, these forecasters generally expected about the same rates of growth in the first half of the year as in the second. While the quarterly estimates generally clustered rather closely around the median, one forecaster expected a different pattern of recovery—a slow first quarter, moderate second and third quarters, and a rapid fourth quarter.

With this one exception, the forecasters are predicting that by the fourth quarter of the year real growth will range from \$9.7 billion to \$13.9 billion. The quarterly consensus for the unemployment rate shows a pattern that is consistent with the consensus GNP forecast—the rate declines by about the same amount throughout the year.

If the forecasts are realized, the 7.4 percent unemployment rate at year-end 1976 will mean that finding work will have become somewhat easier in the bicentennial year than in 1975. But it will also mean that the bicentennial was not a particularly happy year for almost 7 million others. The forecasts for the unemployment rate at year-end 1976 ranged from 7.0 to 7.9 percent.

BUSINESS FORECASTS 1976

The Federal Reserve Bank of Richmond is pleased to announce the publication of *Business Forecasts 1976*, a compilation of representative business forecasts with names and details of estimates for the coming year. The booklet is available free of charge from this Bank. Please address requests to Bank and Public Relations, Federal Reserve Bank of Richmond, P. O. Box 27622, Richmond, Virginia 23261.