

FORECASTS 1972

Success for the New Economic Program?

Like the economy itself, economic forecasting has its peaks and troughs. Based solely on last year's forecasts for current dollar GNP, one would conclude that some recovery is under way in the forecasting accuracy cycle. A more comprehensive evaluation of last year's forecasts, however, calls this conclusion into question.

In general, last year's forecasts were close to predicting current dollar GNP accurately, but overly optimistic with regard to the rate of inflation. The forecasters did not expect cost-push inflation to continue in 1971 to the extent that it did. Thus, they overestimated the increase in both real GNP and the index of industrial production but underestimated the rise in the unemployment rate.

In retrospect, cost-push forces could have been expected for 1970 and 1971, since an extraordinarily large number of workers were due for contract renegotiation in those years. But the forecasters apparently did not think that cost-push forces would be sufficient to outweigh the excess capacity and easing employment markets that resulted from the 1970 recession.

This year the forecasters are relying upon President Nixon's New Economic Program to restore the economy to a healthier rate of real growth and a lower rate of price increase and to engender a decline in the unemployment rate. The large increase in residential construction spending in 1971 is expected to lead to rather substantial increases in consumption spending for major household goods and appliances in 1972. This rise in the demand for consumer home durables, coupled with an expected high level of domestic automobile sales due to the excise tax cut and the lessening of import competition, is expected to generate a 9.1% growth rate for total durable goods expenditures. Most of the forecasters are also predicting a good year for the steel industry because of strong durable goods demand, rebuilding of inventories, and lessened import competition.

The consensus of forecasts examined in this article indicates a 1972 GNP of around \$1,141.0 billion. Based upon current Department of Commerce estimates for 1971 GNP, this figure would represent a gain of approximately 9.0%, which is somewhat larger than the 7.5% rate in 1971. Economists are predicting a rather steady rate of

growth of GNP throughout the year with no major strikes expected. Inventory replenishment will be a notable source of strength if the recovery proceeds as expected.

The 1972 forecasts summarized here represent the best efforts of business and academic economists during the autumn and winter of 1971 to predict the performance of the U. S. economy in 1972. This article attempts to convey the general tone and pattern of some 60 forecasts reviewed by the Research Department of this Bank. Not all of them are comprehensive forecasts, and some incorporate estimates of the future behavior of only a few key economic indicators. Several represent group rather than individual efforts.

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

1971 FORECASTS IN PERSPECTIVE

The consensus forecast for 1971 GNP, published in last February's *Monthly Review*, was \$1,049.6 billion, an increase of 7.8% over 1970. The collection of forecasts ranged from a low of \$1,031.0 billion to a high of \$1,059.0 billion. After allowing for expected price increases, the growth of real GNP was predicted to account for more than half of the 7.8% rise. On the government side of the forecasting spectrum, the controversial forecast made by the Council of Economic Advisers from the now well-known Laffer model projected a GNP of \$1,065.0 billion for 1971. Latest estimates by the Department of Commerce indicate a 1971 GNP total of \$1,046.8 billion, which is reasonably close to the consensus forecast of the business and academic economists. Compared to 1970, when the seers overestimated the GNP by \$10.0 billion, and to 1969, when they underestimated it by \$18.0 billion, 1971 was a better year. At least so far as current dollar GNP is concerned.

In late 1970 and early 1971 forecasters were anticipating an increase in the implicit price deflator for GNP of around 3.6%, which would indicate a real growth rate for GNP of almost 4.2%. In fact, the implicit price deflator for GNP rose 4.6%, and

RESULTS FOR 1971 AND TYPICAL FORECAST FOR 1972

	Unit or Base	Preliminary 1971	Forecast 1972*	Percentage Change	
				1970/ 1971	1971/ 1972
Gross national product	\$ billions	1,046.8	1,141.0	7.5	9.0
Personal consumption expenditures	\$ billions	662.2	717.8	7.5	8.4
Durables	\$ billions	100.4	109.5	13.3	9.1
Nondurables	\$ billions	278.8	300.3	5.3	7.7
Services	\$ billions	283.0	307.9	7.8	8.8
Gross private domestic investment	\$ billions	150.9	167.5	11.5	11.0
Business fixed investment	\$ billions	108.2	116.3	6.0	7.5
Residential construction	\$ billions	40.6	44.3	33.6	9.1
Change in business inventories	\$ billions	2.1	6.9	—	—
Government purchases of goods and services	\$ billions	233.1	252.7	6.2	8.4
Net exports of goods and services	\$ billions	0.7	3.0	—	—
Plant and equipment expenditures	\$ billions	81.43	87.25	2.1	7.1
Corporate profits before taxes	\$ billions	84.9	97.6	12.6	15.0
Private housing starts	millions	2.03	2.07	42.0	2.0
Automobile sales	millions	10.1	10.5	20.2	3.9
Rate of unemployment	percent	6.0	5.4	—	—
Industrial production index	1967	106.3	113.2	-0.4	6.5
Wholesale price index	1967	113.7	116.1	3.0	2.1
Consumer price index	1967	121.3	125.1	4.3	3.1
Implicit price deflator	1958	141.5	146.0	4.6	3.2

* Figures are constructed from the typical percentage change forecast for 1972.

real GNP increased only 2.8%. Thus, although the forecasters predicted current dollar GNP relatively accurately, they underestimated the rate of inflation and overestimated the rate of real growth. This type of forecasting error is hardly a new phenomenon. The consensus predictions have substantially underestimated the rate of inflation for each of the last four years. The 1971 inflation forecast, in particular, would have been even less accurate if the wage-price freeze had not been ordered.

The consensus of the quarter-by-quarter forecasts for 1971 was that current dollar GNP was expected to rise by approximately \$30.0 billion during the first quarter, \$20.0 billion in the second, \$17.0 billion in the third, and \$18.2 billion in the fourth. GNP actually increased \$32.4 billion, \$19.2 billion, \$13.4 billion, and \$19.6 billion for the four quarters, respectively. Again, the estimates were remarkably close to the actual quarter-by-quarter figures.

The quarterly inflation predictions of 3.9%, 3.5%, 3.4%, and 3.1% made by the forecasters were too low for the first half of the year and too high for the price-controlled second half. During 1971 the

annual rate of price increase was 5.3% in the first quarter, 4.2% in the second, 2.5% in the third, and 1.5% in the fourth.

On the consumer side, 1971 personal consumption expenditures were expected to total \$663.4 billion, but they now appear to be \$662.2 billion. Gross private domestic investment was underestimated; that account was predicted to reach \$145.0 billion, but it actually totaled \$150.9 billion. Much of this underestimate is attributable to the greater-than-expected upsurge in residential construction. Forecasters had predicted that private housing starts would total only 1.7 million units in 1971, but they actually totaled over 2.0 million.

With respect to the public sector of the economy, government purchases of goods and services were predicted accurately. The consensus of forecasters expected these outlays to total \$233.9 billion. Actual spending was \$233.1 billion, according to the preliminary estimates.

Because it overestimated the rate of real growth of the U. S. economy, the consensus forecast for the average unemployment rate was overly optimistic.

The rate, predicted to average 5.5% for the year, was actually 6.0%.

The tendency to expect a more rapid recovery was also evident in the forecast for the index of industrial production. The predictors expected a 3.6% increase, but the index actually fell 0.4%.

Strangely enough, the seers, having *overestimated* the fall in the unemployment rate, the rate of real growth, and the index of industrial production, *underestimated* corporate profits. Pretax corporate profits, estimated to increase 8.0%, actually rose 12.6%. If their expectations for a stronger recovery had been correct, their corporate profits estimate would have been even farther from the mark.

The consumer price index rose 4.3% from its 1970 average, a figure close to the consensus forecast of a 4.0% rise. The wholesale price index, however, predicted to rise 2.0%, rose approximately 3.0%.

Many of last year's forecasters apparently thought that the U. S. economy in 1971 would recover from its recessionary and inflationary woes more vigorously than it did. On the other hand, the consensus of forecasters for the year before that, 1970, underestimated the extent of the downturn. Although this tendency to underestimate a downturn and to overestimate an upturn might tempt the analyst to accuse the business and economic forecasters of a maidenly optimism, the more likely explanation is that years of recession and recovery are much more difficult to project than those of more normal growth.

1972 FORECASTS IN BRIEF

Gross National Product Forecasts for 1972 current dollar GNP are concentrated around \$1,141.0 billion. This estimate represents an approximate 9.0% yearly gain, which is somewhat more than the 7.5% advance registered in 1971. However, price rises are expected to account for only about one-third of the anticipated increase, whereas they accounted for nearly two-thirds of the 1971 increase in current dollar GNP. The forecasts range from a low of \$1,135.0 billion to a high of \$1,155.0 billion. Most of those who made quarterly forecasts expect GNP, measured at seasonally adjusted annual rates, to increase by almost \$26.5 billion during the first quarter and by about \$25.5 billion in each of the three succeeding quarters.

Personal consumption expenditures are estimated to total \$717.8 billion in 1972, an 8.4% increase compared with the 7.5% rise registered during 1971. The forecasters expect relatively more of the 1972 increase to stem from expenditures for durable goods

TYPICAL* QUARTERLY FORECAST FOR 1972

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

	I	II	III	IV
Gross National Product	26.5	25.4	25.8	25.6
Personal Consumption Expenditures	15.1	14.0	15.0	15.0
Gross Private Domestic Investment	5.0	4.5	5.5	4.9
Net Exports	1.0	0.5	0.2	0.6
Government Purchases	5.6	5.0	6.1	5.1
Implicit Price Deflator†	3.4	3.0	3.3	3.3
Rate of Unemployment (%)	5.7	5.5	5.3	5.1

* Median.

† Percentage changes at annual rates.

than from nondurable goods spending. The forecasts call for a 9.1% increase in durables spending and a 7.7% rise in outlays for nondurables.

Government purchases of goods and services are expected to total \$252.7 billion in 1972. This projected increase of 8.4%, larger than the 1971 gain of 6.2%, reflects the probability that defense spending will again begin to rise.

Gross private domestic investment is expected to rise by about 11.0% to \$167.5 billion, which is only slightly smaller than the 11.5% increase during 1971. However, compared to the 3.1% decline in 1970, the projected gain for 1972 represents a continuation of the substantial recovery achieved in 1971. The forecasters' estimates for gross private domestic investment ranged from \$163.0 billion to \$178.0 billion. No clear-cut consensus emerged, so a median figure was chosen for use in the accompanying table. Fully half of the forecasters' estimates, it should be noted, were between \$166.0 billion and \$169.5 billion.

The leading growth component of gross private domestic investment during 1971 was residential construction, which increased 33.6% from its depressed 1970 level. Residential construction is expected to rise approximately 9.1% in 1972, a reduced but still healthy rate. Business fixed investment expenditures are projected to rise 7.5%, an improvement over the 6.0% growth registered for 1971. Finally, businessmen are expected to rebuild their inventories in 1972. Of the expected \$16.6 billion increase in gross private domestic investment, \$4.8 billion stems from inventory buildup. The estimates for inventory investment ranged from \$5.1 billion to \$10.1 billion.

Industrial Production Most predictions call for the Federal Reserve index of industrial production (1967=100) to average 113.2 during 1972, an increase of 6.5% over the previous year. This compares with a 0.4% actual decline for 1971 and a 3.0% drop for 1970. The forecasters are expecting increases in automobile production, steel production, and an expansion in the production of consumer household durables.

Construction The value of new construction put in place is expected to total around \$117.0 billion or \$118.0 billion in 1972, an increase of around 9.0% or 10.0% over 1971. Both private residential construction and private nonresidential construction are expected to do well in 1972. Private residential construction is predicted to increase 9.1% for the year. This forecast is considerably below the 33.6% increase actually registered during 1971, because much of the pent-up demand for housing appears to have been satisfied. Private nonresidential construction is expected to increase 5.0% to 6.0% over its 1971 total. Private housing starts are commonly expected to increase only a slight 2.0% over the very large 1971 total of 2.03 million units. The prediction that they will remain as high as the 1971 level, however, implies that the housing industry will have another good year.

Business Fixed Investment Most forecasts indicate that firms will put \$116.3 billion in fixed investment spending in 1972. This figure represents an increase of 7.5% over 1971. This projected increase over the 6.0% rate realized in 1971 stems from an expected moderate resurgence of investment spending during the second half of the year. Most of the forecasters based their predictions on the assumed passage of President Nixon's investment tax credit.

Corporate Profits Forecasters are far from unanimous about the future for corporate profits, and predictions for the growth of corporate profits before taxes range from around 8.0% to 20.0%. Most of the estimates, however, center around a 15.0% growth, which would raise the total to \$97.6 billion for the year. Such a growth of corporate profits suggests a more profitable year for businesses than either 1970 or 1971. In 1971, pretax profits grew approximately 12.6%; in 1970 they fell 9.4%.

Unemployment The unemployment rate is projected to average 5.4% by most of the observers of the 1972 scene. Individual forecasts range between 5.0% and 5.7%. The unemployment rate reached 6.1% in December 1971 and averaged 6.0% for all of 1971. Hence, forecasters are predicting a moderate fall in the rate.

Prices This year all forecasters are predicting a more moderate rate of price increase. The most common prediction is that the implicit deflator for GNP will increase by only 3.2%—well below the 4.6% increase of last year. The most pessimistic of the forecasters predicts an increase of 4.0%. The consumer price index is expected to rise 3.1% during the year. Predictions of the increase in this index ranged from 2.0% to 3.5%. Wholesale prices are expected to increase by a smaller amount, approximately 2.0%, during the year.

Quarter-by-Quarter Forecasts Fourteen forecasters made quarter-by-quarter predictions for 1971. As indicated by the quarterly table, these forecasters call for a fairly steady rate of increase of around \$25.0 billion per quarter in GNP measured at annual rates and adjusted for seasonality. Prices are expected to rise at an annual rate of about 3.4% in the first quarter, 3.0% in the second, 3.3% in the third, and 3.3% in the last. The rate of unemployment is expected to fall steadily from an average of 5.7% in the first quarter to an average of 5.1% in the fourth.

Summary The forecasters for 1971 were relatively close to the target in predicting current dollar GNP for the year. However, they rather substantially underestimated the rate of inflation, thereby overestimating the rate of real growth. The unemployment rate, expected to average 5.5%, actually averaged 6.0%.

The 1972 consensus forecast indicates a healthy rate of real growth, an abatement of inflation, and a decline in the unemployment rate. These forecasts seem to be based on the presumption that President Nixon's program will continue to show results on the inflation front. They can be termed "generally optimistic." If these expectations are realized, the economy should show more health and vigor in 1972.

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