

Lecture II

ECONOMIC TRENDS

Outline of Lecture by

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*(Pencil notes
for 1957
Review)*

Economic Forecasting - More an art than a science and we have
no great artists!

Introduction

- A. Function: To promote thought and provide basis for discussion rather than make precise prediction for 1956⁷ although I shall do that incidentally
- B. Why I am a central banker
 - 1. Inherently an observer and analyst
 - 2. Less need to predict than others
 - 3. Conviction I owe society something for being part of it

I. The inevitability of forecasting To live is to forecast

- A. Implicit in every action taken
 - 1. Crossing the street
 - 2. Stocking up on inventory
 - a. To avoid shortage
 - b. To beat a price rise
 - 3. Building a plant
- B. Advantages of explicit, systematic forecasting, particularly knowing our assumptions

	<u>3rd</u>	→ Preliminary
G.N.P.	438.3	<u>Estimates</u> —
CONSUMER	<u>282.2</u>	new ones
Durables	35.1	<u>next week</u>
Nondurables	140.9	
SERVICES	106.2	
PRIVATE	<u>65.4</u>	
CONSTRUCTION	33.2	
Producers Goods	30.5	
INVENTORIES	1.7	
FOREIGN	<u>3.0</u>	
GOV'T	<u>87.8</u>	
Fed	51.5	
S. & L.	36.3	

Make separate card

II. Aspects of economic forecasting

- A. Even the strongest demand for an accurate forecast does not mean that it will - or can - be supplied
- B. Forecasting in the physical sciences and in human affairs
 - 1. In the physical sciences, the results often are independent of the forecaster
 - 2. In human affairs, they may not be

- a. Hypothetical illustration:

Suppose a forecaster had a perfect record but nobody believed him

(Walter Winchell
broadcast)

Then everybody discovers his wizardry and bases their action on his forecast

He predicts "General Motors common will go up 3 points next Wednesday."

III. Requirements for economic forecasting

- A. An understanding of how the particular economic system works
e.g. U.S.S.R. vs. U.S.A.
 - 1. We have a money and credit economy operating through markets
Each \$1 spent is a vote or directive to use \$1 of our resources for that purpose
Not wholly free - and Government spends too!
A profit and loss economy
- B. A framework
A systematic, internally consistent, whole into which all the parts fit - with none left out and none counted more than once.
The theory of G.N.P.
This doesn't solve anything. It is a method not a result - for the future.
- C. A judgment as to public policy
 - 1. Fiscal policy
 - 2. Debt management policy
 - 3. Monetary policy
- D. A method of relating
your theory A
your framework B
public policy C
to the current situation

1. The method of past relationships

- a. In general, the method of the physical sciences
- b. Its usefulness
- c. Illustrations of its inadequacy

(1) Soap - D. C. Melnicoff example

Excerpt from speech by David C. Melnicoff, Business Analyst, The Penna. Railroad Co., before National Conference of the American Marketing Association, Pittsburgh, Pa. 6/20/56

"A projection of the market for soap made in 1939 on the then reasonable assumption that it would grow in accordance with its past relationship to population and income, would show a market expansion for 1946 that was close to the actual increase. By 1953, however, this projection would have been well over double the actual market. Here a change in technology made the difference."

(2) Population forecasts

- (a) N. S. Pritchett - Washington University mathematician and astronomer

Method - 3^o parabola to census data
1790-1890 - excellent fit

Forecast - by 2900 U.S. population
would = 41 billion

Three errors

- (i) Population growth can be expressed in mathematical formula
- (ii) Population function of time only
- (iii) That shape of formula revealed by experience 1790-1890

- (b) Population projections of 1930's & 1940's

Woytinsky's judgment: "Their projections deserve a place of honor in the history of statistical methodology as specimens of unsurpassed skill and patience. Their only weak point is that they proved to be false."

Census actual:	1920	105.7	
	1930	122.8	+ 17 ⁺
	1940	131.7	+ 9 ⁻
	1950	150.7	+ 19

(b) (continued)

Highest estimates for 1952

1937 projection	146.8 (act.approx.129)
1943 "	147.3
1947 "	149.3

Actual July 1, 1952
Bureau of Census 157.0

(28 years proj. reached in 6 yrs.)

1947 projection gave "probable" of 160.6
in 1975 - reached in September 1953

Extrapolated decline in natality in
1930's is permanent

Didn't anticipate the courage-foolhardiness
of the G.I.

(c) Population projections for 1960
(World Population - Woytinsky, p. 252)

	<u>Low</u>	<u>High</u>
1937 Nat'l Resources Committee	137.6	155.3
1943 Nat'l Resources Planning Board. . .	147.7	156.5
1944 Bureau of Census.	149.8	158.6
1950 Bureau of Census.	161.2	179.8

Diff. 1937 H - L = 17.7)
1950 = 18.6) but both H + L are +24 over 1937

Actual - p. 44	1900	76.0
	1910	92.0
	1920	105.9
	1930	122.9
	1940	131.4
	1950	151.7

(3) The Harvard Economic Service - Bullock-Persons
started with 50 series to get consistency of
cycle behavior

The A, B and C curves

A - Speculation - preceded B by 4-10 months
New York bank clearings
Shares traded
Industrial stock prices

B - Business - preceded C by 2-8 months
Outside N.Y. bank clearings
Bradstreet's index commodity prices

C - Banking
Rate on 4-6 month paper
Rate on 60-90 day paper

2. The method of current behavior
 - a. That it will continue unchanged
 - b. That recent trend will continue
 - c. But the only "constant" in life is change
- will always be after the event
3. The method of securing expressions of current opinion
- of informed observers
e.g. builders, car dealers, purchasing agents
4. The method of expressions of current intentions
e.g. capital expenditures surveys,
survey of consumer finances

E. Assumptions - implicit or explicit

No rabbits in the hat

You cannot get more out of your projection
than the assumptions you put into it

1. As a whole
2. In detail

F. The element of "judgment"

IV. The national product accounts

A. A quick look at the breakdown

1. G.N.P.
2. Personal consumption expenditures
 - a. Non-durables
 - b. Services
 - c. Durables
3. Gross private domestic investment
 - a. Construction
 - (1) Housing
 - (2) Other
 - b. Equipment
 - c. Inventories
4. Net foreign investment
5. Government expenditures for G. + S.
(exclude transfer payments, O.A.S.I., interest, etc.)
 - a. Federal
 - (1) Defense
 - (2) Other
 - b. State and local

B. What has happened recently?

1. The Korean build-up

a. From QII 1950 to QII 1953

b. Major changes

(1)	G.N.P. from	275 to 370	+95	35%
(2)	Gov't	40 to 85	+45	
	(a) Federal	21 to 61	+40	200%
	(b) Local	19 to 24	+ 5	25%
(3)	Consumption	189 to 231	+42	
	(a) Non-dur.	100 to 120	+20	20%
	(b) Services	62 to 81	+19	30%
	(c) Durables	27 to 31	+ 4	15%
(4)	Private invest- ment	48 to 55	+ 7	15%

2. The breathing spell

a. From QII 1953 to QII 1954

b. Major changes $3\frac{1}{2}\%$!

(1)	G.N.P. from	370 to 358	-12	
(2)	Gov't	85 to 76	- 9	
	(a) Federal	61 to 49	-12	
	(b) State	24 to 27	+ 3	
(3)	Consumption	231 to 235	+ 4	
(4)	Private invest.	55 to 47	- 8	

c. Why the big hullabaloo over a 3% drop?

Political

Fear of cumulative

- (1) Essentially, because we made a concurrent shift in what we bought
 - (a) Consumers shifted from durables to services and non-durables -2
 - (b) Business cut down on equipment on inventories 4.5 to -2.7 -7
 - (c) Government cut down on hard goods except planes
- (2) This hit the output of DURABLES AND MINES and Employment

3. The past two years

a. From QII 1954 to QII 1956

b. Major changes

(1) G.N.P.	from 358 to 408	+50	14%
(2) Gov't	76 to 79	+ 3	
	(a) Federal	- 3	
	(b) State & local	+ 6	
(3) Consumption	235 to 264	+29	
	(a) Durables	29 to 33 + 4	
	(b) Non-dur.	120 to 133 +13	
	(c) Services	86 to 98 +12	
(4) Investment	47 to 65	+18	
	(a) Construs.	27 to 33 + 6	
	(b) Equipment	22 to 27 + 5	
	(c) Inventories	-3 to + 4 + 7	
(5) Net foreign			(no change)

Revised for 1957

V. Where do we go from here?

A. Assumption on public policy will in general be directed to stable growth

B. Recent past shows amazing flexibility

1. Increase in efficiency to meet rising wage rates

2. Illustrations:

a. Reduction in residential construction of \$2 billion from QIII 1955 to QII 1956 more than offset by rise in commercial construction of \$1 billion and in durable equipment \$2.5 billion and inventories \$1 billion, so total investment rose.

b. Decline in auto sales and other durables of \$4 billion offset by increase in non-durables

C. Arrange accounts in order in which we know something about their probable behavior

Common sense: The ideally distributed economic good!

Look at charts (Board pp. 46-47)

Remember the general total ~~400~~ 430

D. Highly probables

1. Personal services

(98) 105

a. Nature of item

Rents and imputed rents tend to make more stable utilities

Financial services

b. Up \$4½-5 billion a year regularly since end of war

2. State & local government

(33) 36

a. Up \$2 billion a year since end of war

When will it stop?

- Schools
- Highways
- Sewers

131 141

3. Conclusion: + ²⁻¹⁰ \$6 to \$7 billion a year

E. Probables

1. Non-durables

(133) 139

a. Nature

Food - clothing
 Non-postponable if income holds up
 Seldom start decline
 Rarely accelerate much
 Exceptions:

- Korea and QII 1951
- Some decline 1949

b. Up ⁵⁻⁶ \$4-5 billion a year

2. Federal Government

(46) 51

a. Nature

Big changes over time
 But usually with clear-cut change
 in circumstances or policy

- Korea
- And inertia in short run

b. Some increase probable
Highways

179 190

3. Conclusion Plus item D.3

+ \$5-6
~~+ 6-7~~
 + \$11-13

+ 6
 8-10
 +14-16

(310) 331

F. Possibles

1. Private fixed investment

(60) 65

a. Construction

- (1) Housing
 - QIII 1955 17.2
 - QII 1956 15.2
 Now looks like ¹⁴ million higher priced
 Repairs - long run 1965 on

have probably reached bottom

- (2) Commercial Other
 - Industrial, Mining
 - QIII 1955 10.4
 - QII 1956 11.5
- QIII 1955 16.4 } + 2.5
 QII 1957 18.9

b. Durable equipment

QIII 1955 25.0)
 QII 1956 27.5) + 2.5
 or 1957 30.5

c. Conclusion - not much change - some cautions

d. Have now covered 370 - probably up, say, 12
 390-400 - 14

G. The Great Unknowns

1. Consumer durables

3335

a. Nature

Can accelerate or postpone

e.g. Korea 1950

QI 26.5
 QII 34.0
 QIII 30.0

e.g. 1955-56

QI 1955 34.7
 QIII 37.2
 QII 1956 33.4

b. The automobile - white goods - household

~~c. The steel strike~~

d. Conclusion

Some decline in 3rd quarter followed by pick-up - rather rapid

2. Inventories

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a. Nature

Role in the business cycle

b. Inadequacies of the data

Voluntary vs. forced

c. Turn around in a year

817 billion QIV 1949 (-6) to QIV 1950 (+11)

d. \$ billion -4 to +5

QIII 1954 to QII 1955

Handled for 1957

e. Conclusion

Some decline in 3rd quarter followed by rapid pick-up in 4th

Now +4 to say -3 = net of -7 then to +1 or 2

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H. General conclusions

- 1. Highly probables
- 2. Probables
- 3. Possibles
- 4. Great unknowns

	per yr.
131	+6 to 7
179	+5 to 6
60	-
37	✓
407	

	per yr.
141	+ 8-10
190	+ 6-7
65	
37	✓
433	

VI. Some gratuitous comments

- A. Willingness to stick out neck - to provoke thought
- B. Economic possibilities of our grandchildren