Federal Reserve Bank of San Francisco

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Business & Financial Letter

The Official Forecast

The news evidently hasn't reached the deeper canyons of Wall Street yet, but the Council of Economic Advisers now has made official what most economists have been saying for months—1973 will be a vintage year in the nation's annals. According to the annual **Economic Report,** real GNP will grow by 6¾ percent during the year, or slightly ahead of the 1972 pace, thus making for the strongest back-to-back performance of the past two decades. In terms of current dollars, the GNP increase will be 10 percent, from $1,152 billion to $1,267 billion.

The President's advisers believe that the script for the first half-year has already been written, with the forces which generated the 1972 boom remaining actively at work within the business system. But they have another story for the second half: "It is both probable and desirable that the rate of expansion will and should abate toward its sustainable long-run path." Still, practically all parts of the system will be synchronized in a broadly distributed growth pattern throughout the year.

Old-fashioned boom

The foundation for the strong 1973 forecast is an old-fashioned investment boom, with business fixed investment in particular rising 14 percent for the second year in a row. The expanding economy already has generated increased needs for production facilities, and also has provided business with a substantial part of the funds required for capital-goods purchases. In addition to rising profits, the actual and potential availability of funds has been augmented by liberalized depreciation provisions, the investment tax credit, and the ceiling on dividend increases—plus (at least to date) favorable financial conditions in the markets for debt and equity capital.

The forecast for a sharp expansion in fixed investment, moreover, is based on such evidence as the strength in forward investment commitments and the substantial buildup in unfilled-order backlogs held by producers of capital goods. Also favorable is the recent step-up in contract awards for factory buildings, which had been lagging earlier.

Stockroom activity

Another component of the investment forecast is a very strong buildup in inventories, the most expansive since the early stages of the Vietnam war. In the Council's estimates, inventories will rise by about $12½ billion in 1973—roughly in line with the late '72 surge but several times faster than the earlier '72 pace. This year's inventory increase, like last year's, will be supported by a strong expansion of final sales.
Today, unlike a year ago, stock-sales ratios are quite low in manufacturing and trade—indeed, lower than at any other time of the past half-decade. A structural factor also

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favors stockbuilding, that is, the increased demand for heavy equipment with long production lead times. Besides, with delivery delays much more common now than they were a year ago, purchasing agents may accelerate their stockbuilding in some cases and provide more fuel to the inventory boom.

Other supports

The Council visualizes consumer spending rising 9½ percent in 1973 —even faster than in 1972—on the basis of the very sharp increase in disposable income generated by rising payrolls and social-security benefits, plus the windfall gains resulting from the income-tax refund. This income gain should be so large as to permit both a spending boom and a substantial increase in consumer savings.

The President's advisers, like everyone else, expect little if any change in residential building, as a consequence of the industry's spectacular success in meeting the heavy demand for housing during the last two years. But they see few signs of a significant downturn, with new household formations and replacement demand both providing strong underpinnings for the market, and with substantial amounts of mortgage funds still available.

Unemployment—how low?

The CEA forecast embodies a decline in the unemployment rate to 4½ percent by the end of the year, in line with the expected rapid growth of real GNP. This forecast is quite realistic, since it suggests no more of a drop in the next eleven months than we've seen in the past three. Indeed, the forecast may be overly conservative, in view of impending labor-force developments (cited by the Council itself) which will shift certain factors that have kept the jobless rate so high and so rigid for such a long time.

Until 1972, the growth of the civilian labor force far outpaced its 1¾-percent long-term trend line. For half a decade, labor-participation rates remained unexpectedly high, partly because of a boom in labor demand generated by the Vietnam war, and partly because of a large supply of women jobseekers, which reflected a sharp drop in fertility rates in the late 1960's. But with these factors now stabilizing or declining in importance, the growth of the civilian labor force should return to trend, so that further gains in employment would impact immediately on the unemployment rate.

Prices—how slow?
The Council admits that its forecast of a 3-percent rise in the general price level is on the low side of the range favored by most private forecasters. It bases its forecast on a slowdown in food prices, a tight limitation on Federal spending, and a high level of compliance with Phase III controls. If anything goes wrong in any of those areas, then its forecast will begin to look rather wobbly.

Arresting the rapid rise in food prices is a key element in the 1973 stabilization program, partly because of the direct importance of food for family budgets, and also because of the link between the rate of increase of food prices and the size of wage increases demanded in labor contract negotiations. One major solution, aside from cursing the foul weather that cut so deeply into 1972 supplies, is to modify agricultural policy. In the past, policy has leaned strongly in the direction of limiting output and stocks relative to the rising domestic and foreign demand for food.

Favoring a price slowdown is the improved position of many workers today as compared to the period of accelerating inflation in the late 1960's. Workers covered by the major collective-bargaining contracts expiring this year appear to have maintained or even improved their relative position in the wage structure, whereas in the earlier period they found themselves trying to catch up with the accelerating trend of prices.

Zone of potential
The Council appears certain that "The economy will approach the zone of its potential by the end of the year." Thus, the key point is not whether, but how rapidly, output and employment (and prices) will expand. A year ago, the Council saw the economic problem in terms of accelerating the expansion; today it must deal with the mirror image, the task of deceleration. The policy goal is an approach to a steady rate of increase in GNP, consonant with the potential growth rate of the economy and with reasonable price stability.

This problem involves a slowdown from the very rapid 8½-percent annual rate of growth of real GNP recorded in the fourth quarter of 1972, back towards the normal 4¼-percent annual rise in GNP potential. The Council is betting that the task can be handled successfully, despite what the doubters in Wall Street are saying.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 1/24/73	Change from 1/17/73	Change from year ago Dollar	Change from year ago Percent
Loans adjusted and investments*	68,593	—138	+7,294	+11.90
Loans adjusted—total*	50,285	+ 2	+7,089	+16.41
Commercial and industrial	17,755	+ 98	+2,005	+12.73
Real estate	15,152	+ 24	+2,391	+18.74
Consumer instalment	7,733	+ 24	+1,261	+19.48
U.S. Government securities	7,134	—129	+ 260	+ 3.78
Other securities	11,174	— 11	— 55	— 0.49
Deposits (less cash items)—total*	66,807	—298	+6,196	+10.22
Demand deposits adjusted	20,365	—900	+1,516	+ 8.04
U.S. Government deposits	1,109	+430	+ 30	+ 2.78
Time deposits—total*	44,145	+134	+4,413	+11.11
Savings	18,170	— 9	+ 425	+ 2.40
Other time I.P.C.	17,238	+158	+2,834	+19.68
State and political subdivisions	6,439	— 2	+ 608	+10.43
(Large negotiable CD's)	6,927	+ 20	+1,776	+34.48

	Weekly Averages of Daily Figures Week ended 1/24/73	Week ended 1/17/73	Comparable year-ago period
Member Bank Reserve Position			
Excess reserves	0	— 5	63
Borrowings	96	209	2
Net free (+) / Net borrowed (—)	—96	—214	+ 61
Federal Funds—Seven Large Banks			
Interbank Federal funds transactions			
Net purchases (+) / Net sales (—)	+366	+223	+238
Transactions: U.S. securities dealers			
Net loans (+) / Net borrowings (—)	— 81	+150	+277

*Includes items not shown separately.

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