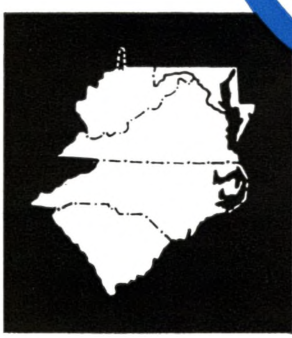
FEDERAL RESERVE BANK OF RICHMOND

ECONOMIC REVIEW



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THE DISTRICT ECONOMY IN PERSPECTIVE: 1973

During most of 1973 both the U. S. and Fifth District economies geared down from the hectic pace of 1972. Inflation, however, continued to plague the nation as prices rose higher and worldwide shortages of food and raw materials became a reality. The consumer price index rose 8.8 percent from December 1972 to December 1973, a growth substantially above the previous year's increase. The jobless rate was trimmed to 4.7 percent in November 1973, as major industries pushed capacity restraints to meet the booming demand.

As the year progressed, production growth slowed, in large part because of capacity limitations. Industrial production was up only 4.5 percent in December over the comparable 1972 figure. Total civilian employment, however, advanced rapidly during the past year, rising 3.2 percent from December 1972 to December 1973. The productivity of labor in the private nonfarm economy, as measured by the output per man-hour, changed little after a very rapid increase in the first quarter of 1973, and from late 1972 to late 1973 the increase amounted to less than 1 percent.

The growth of real output also slowed during 1973 after a healthy 7 percent rise in 1972. Real GNP rose at an annual rate of 5.5 percent through the first half of the year, slowed to 3.4 percent in the third quarter, and dipped to a 1.3 percent rise in the fourth quarter.

In contrast to slackened production growth during 1973, spending on goods and services surged as a result of rapid increases in prices. Personal consumption expenditures, after adjustment for seasonal variation, jumped 10 percent from fourth quarter 1972 to fourth quarter 1973, while business expenditures for new plant and equipment grew at a 14 percent seasonally adjusted annual rate, and government spending advanced at a 10 percent rate. The spending growth in 1973 was accompanied by a rise in outstanding credit, with commercial bank credit through October 1973 up 15 percent over a year earlier.

In most instances, economic developments in the Fifth District paralleled those of the nation at large. A closer look at the individual sectors of the Fifth District economy, however, provides a more complete perspective on District developments over the past year.

The Employment Picture Nonagricultural employment statistics showed moderate to substantial improvement in the nation and the District during 1973. Employment through the first 11 months of the year was up 3 percent over November 1972, with gains of 2 percent in manufacturing and nearly 4 percent in nonmanufacturing industries. A close look at the major categories of nonmanufacturing employment illustrates the relative strength of each.

Apart from manufacturing, government is the leading source of jobs in the District. In November, Federal, state, and local governments supplied 1,550,000 jobs or 21 percent of the District's total nonagricultural employment. The 2 percent expansion of government employment during 1973 was slightly below the 1972 increase. Individual advances in government employment by states were: 4 percent for South Carolina, 3 percent for North Carolina and Virginia, 2 percent for Maryland, and .1 percent for the District of Columbia. West Virginia experienced a slight .4 percent decline in government employment. The District of Columbia's fractional growth in government employment perhaps reflects an atttempt by the Federal Government to tighten employment rolls.

Both trade and services categories also posted sizable increases in employment during 1973. As the third largest source of nonagricultural employment, wholesale and retail trade accounted for 19 percent of the District's nonagricultural jobs in November, up almost 4 percent for the year. The most impressive gain was in South Carolina, which posted a 7 percent increase. Jobs in the service industries also rose 4 percent between November 1972 and November 1973, accounting for 15 percent of the nonagricultural employment in the District, with each category growing more rapidly than in 1972.

Results of the monthly survey[1] of District business conditions suggest that manufacturing employment declined slightly during the latter part of 1973. Throughout the year numerous respondents reported work disruptions resulting from raw material and labor shortages. Scattered lay-offs related to the energy crisis have recently been reported.

The number of workers employed provides one key to the growth of manufacturing industries in the District. After adjustment for seasonal variation, employment in manufacturing industries grew 2 percent in 1973, slightly below the 1972 growth. Each state shared in the manufacturing employment growth, with both South Carolina and Maryland posting impressive 3 percent gains.

Perhaps an equally important measure of growth in the manufacturing sector is man-hours. The District man-hour index was up 2 percent in November over a year earlier, with a 4 percent gain in durables and no growth in nondurable manufacturing man-hours. Although these figures are lower than the gains posted in 1972, they do reflect a substantial recovery over the man-hour declines that characterized 1971. Year-to-year, the man-hour index in November was up nearly 5 percent in Maryland, 2 percent in Virginia and South Carolina, and 1 percent in North Carolina. West Virginia and the District of Columbia showed no change over the 1972 index. Survey respondents in January reported decreases in hours worked per week during December, and troublesome labor shortages continued to plague textile and furniture manufacturers. The low unemployment rate in the District does not portend any immediate improvement in the labor shortage problem.

At 3.5 percent in November, the rate of unemployment in the District was below the national rate of 4.7 percent. Not only was the aggregate rate for the District below the U. S. figure; but each state posted a November 1973 rate of unemployment below the national average, with the exception of West Virginia. Overall, joblessness showed a marked decline in the District, with much of the improvement resulting from an easing of unemployment in West Virginia and Maryland. State unemployment rates in November were: West Virginia, 5.5 percent; Maryland, 3.9 percent; South Carolina, 3.4 percent; the District of Columbia, 2.9 percent; Virginia, 2.6 percent; and North Carolina, 2.5 percent.

Construction Highlights Total new construction in the U. S. increased at a 9 percent rate from January to April 1973, showed no expansion during midyear, and declined sharply in the fourth quarter as a result of a decline in residential construction. Deposit outflows from thrift institutions contributed to reduced mortgage lending in the second half; and consumer resistance to escalating property and construction costs compounded the problem, resulting in a 35 percent plunge in U. S. housing starts during 1973. In spite of labor and material shortages, however, the index of construction contracts in the District posted a 7 percent increase in October over a year earlier. The jump was the result of a 43 percent increase in nonresidential contract awards combined with an 18 percent decline in residential awards. Only Maryland and the District of Columbia showed gains in the residential sector, while all District states showed substantial growth in nonresidential awards. Gains in the nonresidential category measured 109 percent in the District of Columbia, 101 percent in Virginia, 58 percent in South Carolina, 40 percent in North Carolina, 26 percent in Maryland, and 18 percent in West Virginia.

Agriculture The pages of history will mark 1973 as a banner year for Fifth District farmers. Their record earnings highlighted the year as estimated net farm income climbed to an unprecedented level.

Weather was generally cooperative during the growing and harvesting seasons, helping to assure an abundant harvest. As a result, production gains over 1972 ranged from slight to spectacular for most major crops, with output of soybeans, corn, and peanuts at record levels.

The bountiful harvest, soaring crop and livestock prices, and slightly smaller marketings of livestock and poultry products combined to bring about a phenomenal gain in cash farm income and to boost farmers' gross income to a new high.

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[1] The Fifth District Opinion Survey of Business Conditions is conducted monthly by the Research Department of the Federal Reserve Bank of Richmond. Respondents represent manufacturing and retail industries throughout the District.

But the year was not without its problems. Farm production expenses also soared to new heights. Much of the increase resulted from sharply higher prices of farm-originated production inputs, particularly feed and feeder livestock. These rising costs led, in turn, to cutbacks in livestock and poultry production. And before the fall marketing season ended, some farmers were feeling the crunch of the fuel crisis.

Market values of farm real estate continued to advance rapidly, moving upward throughout the five-state area. With the growing value of farm real estate assets and record farm earnings, farmers' financial positions improved greatly.

Banking Developments The 1973 statistics for member banks in the Fifth District clearly reflect the strong demand that characterized the year. Through November 1973, the bank debits index rose 22 percent for the District, exceeding last year's gain. Large increases were reported in each state, ranging from a low of 14 percent in North Carolina to a high of 37 percent in West Virginia. Unusually strong business loan demand resulted in a dramatic increase in loans and discounts by District member banks. At $21.2 billion in November, loans and discounts were up 23 percent over a year earlier. In the investments category, District bank activity was mixed, with holdings of U. S. Government obligations declining 10 percent to $2.0 billion and other security holdings climbing 9 percent to $5.6 billion. Total assets of member banks in the District were $33.9 billion in November, up 17 percent over 1972. By states, total assets on the last Wednesday in December posted the following year-end increases: South Carolina, 31 percent; North Carolina, 19 percent; Virginia, 16 percent; West Virginia, 15 percent; the District of Columbia, 13 percent; and Maryland, 12 percent.

District member banks also experienced sizable deposit expansion during 1973. Total member bank deposits in November were $27.5 billion, 12 percent above November 1972. Total deposit gains by state were 30 percent in South Carolina, 13 percent in North Carolina, 11 percent in West Virginia and Virginia, 8 percent in Maryland, and 7 percent in the District of Columbia. Time deposit volume in the District showed a sharp increase of 18 percent during 1973 while demand deposit balances rose only 5 percent. By state, time deposit expansion ranged from 50 percent in South Carolina to 15 percent in Virginia and the District of Columbia. Demand deposit balances grew in each District state, with the exception of a 2 percent decline in Maryland.

B. Gayle Ennis

Energy Shortages Cloud Outlook . . .

FORECASTS 1974

Each year the Federal Reserve Bank of Richmond compiles forecasts of the economy's performance in the coming year. This year the principal forecasting problem has been the extent and duration of the petroleum embargo. Our forecasts of the economy's performance in 1974 are all beclouded by energy considerations. The energy shortfall, projected by various forecasters to range between 1½ and 3½ million barrels of oil per day, has had a substantial impact on what was the standard forecast before the Arab embargo.

Prior to the Arab oil embargo most business and academic forecasters were predicting a rate of growth of GNP of 7.4-8.6 percent and a rate of increase in the implicit deflator (the price index for items included in GNP) of 5.0 percent, resulting in 2.4-3.5 percent real growth in the economy. After the petroleum shortage became known, the projected rate of growth of current dollar GNP was not changed significantly, but the predicted rate of price increase was raised to the 6.5-7.0 percent range. Thus, current forecasts are calling for a considerably lower increase in the rate of growth of real GNP—around 1.2 percent.

Energy considerations also induced the seers to forecast a higher average unemployment rate for 1974 than was forecast before the embargo. The consensus now is for a 5.5 percent average unemployment rate in 1974 as opposed to a 5 percent rate before the embargo.

The forecasts published after the embargo had varied assumptions regarding the petroleum shortfall and the length of the Arab boycott, so these considerations add another large measure of uncertainty to the already difficult problem of forecasting the year-ahead performance of the economy. At the time their forecasts were published, many of the forecasters had no clear conception of the extent of the shortfall. Moreover, since there was no scientific way to project the length and strength of the Arab embargo, the forecasts were necessarily more subjective than in past years.

Last year the forecasters underestimated the actual GNP total for 1973 by almost $27 billion. The previous year they underestimated the GNP total by more than $11 billion. Three years ago they did considerably better, overestimating GNP by only $3 billion. The additional uncertainty in the economic outlook introduced by energy shortages, however, may have reduced the probability of an accurate 1974 forecast from small to nil.

It might be desirable to begin the discussion of the forecasts by noting that a recession is predicted by almost all of the forecasters during the coming year. The average unemployment rate, 4.9 percent in 1973, is expected to increase by approximately 0.6 percentage points. The rate of real growth is expected to slow from 5.9 percent to 1.2 percent; and industrial production, which increased almost 9 percent in 1973, will increase only 1.1 percent in 1974. Corporate profits before taxes, after turning in a stellar performance and increasing 30 percent in 1973, are expected to fall between 7 and 10 percent in 1974.

On the other hand, most seers are expecting recovery from the recession to have begun by the second half of 1974. The consensus of our quarterly predictions is for real GNP to fall $0.9 billion in the first quarter and $0.5 billion in the second, but to rise $4.0 billion in the third, and $5.6 billion in the fourth quarter. Thus, the forecasters place much store in the basic resiliency of the U. S. economy. Most of them, also, expect the oil embargo to be over by mid-year 1974 although some expect it to last throughout 1974.

This article attempts to convey the general tone and pattern of some 50 forecasts received by the Research Department of this Bank. Not all of them are comprehensive forecasts, and some incorporate estimates of future behavior of only a few key economic indicators. The consensus is drawn this year only from those forecasts published after the imposition of the Arab oil embargo. Moreover, since there were varying assumptions in the individual forecasts regarding the duration of the embargo, the general tone and pattern may not necessarily be based upon the more accurate energy assumptions, but only the most prevalent. This Bank publishes also a *Business Forecasts* booklet, 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, so serious readers are urged to look at the individual forecasts in more detail in *Business Forecasts 1974.*

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

1973 Forecasts in Perspective The consensus forecast for 1973 GNP, published in last February's *Monthly Review,* was $1,261.5 billion, a projected increase of 9.5 percent over 1972. The forecasts ranged from a low of $1,250.0 billion to a high of $1,269.7 billion. After allowing for price rises, the growth of real GNP was predicted to account for about one-third of the 9.5 percent rise. Latest estimates by the Department of Commerce indicate a 1973 GNP total of $1,288.2 billion, which is $26.7 billion higher than the consensus forecast of business and academic economists and $18 billion higher than any forecast collected last year. In 1972, the forecasters also underestimated GNP, but by only $11 billion. This $26.7 billion error is one of the largest misses in recent memory, and the error is almost solely attributable to underestimating the increase in

RESULTS FOR 1973 AND TYPICAL FORECAST FOR 1974

	Unit or Base	Preliminary 1973	Forecast 1974*	Percentage Change 1972/1973	Percentage Change 1973/1974
Gross national product	$ billions	1,288.2	1,386.1	11.5	7.6
Personal consumption expenditures	$ billions	805.0	861.4	10.8	7.0
Durables	$ billions	131.1	131.6	11.7	0.4
Nondurables	$ billions	336.3	361.8	12.1	7.6
Services	$ billions	337.6	367.3	9.2	8.8
Gross private domestic investment	$ billions	201.5	211.2	13.0	4.8
Business fixed	$ billions	136.0	151.4	15.1	11.3
Residential structures	$ billions	58.0	52.1	7.4	–10.2
Change in business inventories	$ billions	7.4	9.0	—	—
Government purchases	$ billions	277.2	305.2	8.7	10.1
Net exports	$ billions	4.6	5.0	—	—
Gross national product (1958 dollars)	$ billions	837.3	847.3	5.9	1.2
Plant and equipment expenditures	$ billions	99.95	110.9	13.0	11.0
Corporate profits before taxes	$ billions	127.5	122.4	30.1	–4.0
Private housing starts	millions	2.04	1.65	–13.4	–19.0
Automobile sales	millions	11.44	9.7	4.6	–15.5
Rate of unemployment	percent	4.9	5.5	—	—
Industrial production index	1967=100	125.4	126.8	8.9	1.1
Wholesale price index	1967=100	135.5	146.7	13.8	8.3
Consumer price index	1967=100	133.1	142.2	6.2	6.8
Implicit price deflator	1958=100	153.9	163.7	5.3	6.4

*Figures are constructed from the typical percentage change forecast for 1974. All forecasts used for the consensus were made after the oil embargo.

prices. The implicit price deflator had been estimated to increase 3.3 percent, but that measure of prices of goods and services included in GNP actually rose 5.3 percent. Thus, real GNP was predicted rather accurately to total $837.1 billion, and it actually amounted to $837.3 billion.

The largest underestimate of the rate of price increase thus accounted for almost all of the $26.7 billion underestimate for 1973 GNP. In 1972, forecasters predicted a 3.2 percent rate of increase in the deflator, which actually rose 3.0 percent, but they had not anticipated Phases I and II of the President's price control program. Most observers would agree that if it were not for the price and wage controls, the rate of price increase in 1972 would have exceeded 3.2 percent. In any event, with the exception of the 1972 forecasting performance, the predictors have exhibited a definite tendency to underestimate the rate of price increase in recent years.

The consensus of quarter-by-quarter forecasts for 1973 was for current dollar GNP to rise by approximately $29.9 billion in the first quarter, $26.2 billion in the second quarter, $24.5 billion in the third quarter, and $23.9 billion in the fourth. The realized increases came to $43.3 billion, $29.5 billion, $32.5 billion, and $29.5 billion for the four quarters, respectively. The quarterly predictions of the implicit GNP deflator were for increases of 4.1 percent, 3.2 percent, 3.5 percent, and 3.7 percent. For the four 1973 quarters, the implicit deflator actually rose at annual rates of 6.1 percent, 7.4 percent, 7.0 percent, and 7.9 percent during the year.

The consensus 1973 forecast projected personal consumption expenditures for the year at $784.6 billion. As might have been expected from the underestimation of the rate of price increase, current estimates place personal consumption expenditures much higher, at $805.0 billion. Gross private domestic investment, on the other hand, was predicted quite accurately, at $201.5 billion. Thus, considering price increases, real investment spending in 1973 did not come up to the forecasters' expectations. Of the components of investment spending, the forecasters underestimated residential construction expenditures by $4 billion but overestimated the investment in business inventories by almost the same amount. As usual, the forecasters were very close to the mark on government purchases of goods and services, underestimating them by only $0.5 billion.

The forecasters also underestimated, but by a substantial margin, the net exports turnaround in 1973. Net exports in 1972 had exerted a $4.6 billion drag—but the actual figure showed a surplus of exports over imports of $4.6 billion. Not one of last year's forecasters expected so large a recovery in the balance of trade in 1973.

Consistent with the forecasters' accuracy on predicting the rate of real growth of GNP, however, was their accurate prediction of the rate of unemployment. The unemployment rate, estimated to average 5.0 percent in 1973, actually averaged 4.9 percent.

In other areas, the 1973 forecasters underestimated the index of industrial production. The index rose 8.9 percent for the year, against a forecast of a 7.0 percent gain. Corporate profits before taxes were also substantially underestimated. Predicted to increase 12.8 percent, profits actually rose by a whopping 30.1 percent for the year, to $127.5 billion. The consumer price index, like the implicit price deflator for GNP, was substantially underestimated. Consumer prices were expected to increase 3.4 percent; they actually rose 6.2 percent.

1974 FORECASTS IN BRIEF

Gross National Product Forecasts for 1974 current dollar GNP center around $1,386.1 billion. This typical forecast represents an approximate 7.6 percent yearly gain, which is considerably less than the 11.5 percent increase registered in 1972, again primarily because of the expected energy shortfall. Prices, on the other hand, are expected to increase by 6.4 percent and thus to account for approximately five-sixths of the rise in GNP this year. GNP measured in constant dollars, or real GNP, is expected to increase only 1.2 percent in 1974, compared to almost a 6 percent rise in 1973. Estimates for increases in current dollar GNP ranged from a low of 5.6 percent to a high of 9.3 percent. The typical quarterly estimates indicate that GNP should increase $19.8 billion in the first quarter of 1974 and $19.0 billion in the second. The economy is then expected to recover, and the increases in the third and fourth quarters are expected to be $24.5 billion and $28.1 billion, respectively.

Personal consumption expenditures are expected to total $861.4 billion for 1974, up 7.0 percent from 1973. Forecasters estimate that expenditures for durable goods will remain approximately constant, showing an increase of only 0.4 percent for 1974, while expenditures for nondurables and services will increase 7.6 percent and 8.8 percent, respectively. The large slowing in the rate of expansion of durable goods expenditures is expected to stem primarily from a slowdown in automobile purchases, which are again related to energy considerations. The increases in nondurables and services expenditures are expected to reflect mostly price increases.

Government purchases of goods and services are projected to total $305.2 billion. This estimate represents a 10.1 percent increase, which is somewhat larger than the 8.7 percent gain of 1973. The 1974 forecasts range from increases of 8.6 to 11.6 percent.

Gross private domestic investment is expected to rise by about 4.8 percent in 1974. This estimate also represents a considerable slowing from the 13.0 percent 1973 pace. Much of the slowdown, however, can be attributed to residential construction, which is expected to continue its pullback from the record 1972 pace. Expenditures for residential construction, in fact, are expected to decline 10.2 percent from the 1973 level, even though price increases are expected for housing. Business fixed investment is only expected to slow moderately from its 15.1 percent 1973 pace to an 11.3 percent rate of increase in 1974. Many forecasters expect energy considerations to cause considerable investment expenditures in the automotive and petroleum industries and in the utilities, which will at least partially offset possible pullbacks elsewhere. The forecasters, however, were probably less consistent in their investment forecasts than in any other aggregate. The predictions for residential structures range from a 22.5 percent decline to a 2.7 percent decline. Those for business fixed investment range from increases of 7.4 percent to 13.4 percent. And investment in business inventories, which had a consensus of sorts of $9.0 billion, had a range of forecasts from —$3.0 billion to $10.3 billion.

TYPICAL* QUARTERLY FORECAST FOR 1974

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

	I	II	III	IV
Gross National Product	19.8	19.0	24.5	28.1
Personal Consumption Expenditures	12.0	14.8	15.4	17.0
Gross Private Domestic Investment	−0.2	1.3	3.0	4.9
Net Exports	−0.5	−1.0	0.1	−0.4
Government Purchases	8.0	7.0	7.5	8.3
Gross National Product (1958 dollars)	−0.9	−0.5	4.0	5.6
Implicit Price Deflator†	6.3	5.8	4.9	4.8
Rate of Unemployment (%)	5.1	5.5	5.7	5.8

† Percentage changes at annual rates.
* Median.

Industrial Production The typical forecast for the Federal Reserve index of industrial production (1967=100) is 126.8, an increase of 1.1 percent, which is substantially less than the 8.9 percent gain in 1973. Anticipated gains are in production of machinery; declines are in the production of automobiles and, to some extent, steel.

Housing The construction industry is expected to continue its slowing from the record 1972 pace. Private housing starts, which totaled 2.38 million in 1972 and slowed to 2.04 million in 1973, are expected to total 1.65 million units in 1974. An anticipated decline in the demand for vacation homes explains a substantial portion of the expected housing decline, although continued expectations of high mortgage rates and other financing difficulties lead the forecasters to predict a decline in the number of primary dwellings started in 1974.

Corporate Profits The consensus forecast indicates that this year should be slightly less profitable for corporations than 1973, with pretax corporate profits expected to decline 4.0 percent to $122.4 billion. Considering their other forecasts, however, an expected decline of only 4.0 percent in profits from the record $127.5 billion registered in 1973 means that forecasters expect businesses to continue what is a relatively good profit performance by historical standards. Corporate profits before taxes, after all, increased over 30 percent in 1973. The most pessimistic forecaster expects a 10.8 percent profit decline; the most optimistic a 2.7 percent fall.

Unemployment Most forecasters are predicting an increase in the rate of unemployment for 1974. The typical forecast for the year is around 5.5 percent, which is 0.6 percentage points above the 4.9 percent average for 1973. The forecasters expect the unemployment rate to increase to a 5.8 percent average for the fourth quarter of 1974, with the largest jump from 5.1 percent to 5.5 percent coming during the second quarter.

Prices This year the forecast indicates an increase in the rate of advance of prices. The implicit GNP deflator, which rose 5.3 percent in 1973, is expected to increase 6.4 percent. The consumer price index is also expected to increase more rapidly, 6.8 percent compared to 6.2 percent in 1973. The wholesale price index, on the other hand, is expected to rise by 8.3 percent, which is considerably less than the 13.8 percent rate of advance registered in 1973.

Net Exports The nation's trade position, which showed a $4.6 billion surplus in 1973, is expected to remain close to the same level ($5.0 billion) in 1974. Most of the forecasters, however, were not expecting the increase in crude oil prices to be as large as they now appear to be. If that information had been available to them at the time that they made their forecasts, it would undoubtedly have affected to some extent their forecasts for 1974 net exports. The estimates for net exports ranged between $2.5 and $9.7 billion.

Quarter-by-Quarter Forecasts Fifteen forecasters made quarter-by-quarter forecasts for 1974. As indicated by the accompanying table, these forecasters generally expected the economy to slow in the first half of the year and to recover during the second. Recovery was predicted to come about because of an end to the Arab oil boycott and because the automobile industry, having converted more of their facilities to the production of smaller cars, would experience a recovery in sales from first half levels. To illustrate the diversity of the quarterly estimates, however, the typical forecast for real GNP in the first quarter, a decline of $0.9 billion, was drawn from forecasts that ranged from a decline of $7.4 billion to a rise of $2.6 billion. Six of the fifteen forecasters predicted two consecutive quarters of negative growth in real GNP, which is considered by many to be a sufficient condition for defining a recession. Three of the fifteen predicted positive growth rates for real GNP in all of the 1974 quarters. Only one expected to see a declining real GNP for as long as three consecutive quarters in 1974.

Summary Forecasters this year have had a particularly difficult problem put before them. In addition to their normal difficulties in coming up with an accurate forecast of the economy's performance in the coming year, they have had to guess at the very political question of the Arab oil embargo and the prices expected to be announced by what amounts to a foreign oil cartel. The announcement of the embargo and the subsequent estimate of a substantial petroleum shortfall from projected demands led the consensus forceast for real GNP to be reduced from one of a growth of somewhat less than 3.0 percent, to an increase of only 1.2 percent. The energy considerations also changed the prediction for the rate of price increase from 5.0 percent to 6.4 percent. Since most of the forecasters expected the oil boycott to last until mid-year 1974, any change in the duration of the embargo could substantially affect their predictions.

Those forecasters who predicted a recession in 1974 apparently expect to see, at worst, one of mild proportions that will have what are by historical standards relatively minor effects upon business profits and the unemployment rate. The price effect of the expected petroleum shortage, however, is another matter. The combination of price rises in petroleum products and certain nondurables with the large number of workers covered by contracts scheduled for re-negotiation in 1974 has led the forecasters to predict a substantial rate of price increase in 1974.

Thus, if the forecasters are correct, and the 1974 economy is one in which rising unemployment combines with rising prices to yield a growth in real GNP of only 1.2 percent, the year will be discouraging indeed. But again, if the forecasters are correct about recovery beginning in the second half and a slowing in the rate of price increase in the second half, the stage will be set for a much better economic performance in 1975.

William E. Cullison

Clouded by Uncertainties . . .

THE AGRICULTURAL OUTLOOK FOR '74

Leading economists of the U. S. Department of Agriculture outlined their views of 1974's prospects for the nation's agriculture at the National Agricultural Outlook Conference in mid-December. Below, in capsule form, is a summary of their forecasts.

American farmers can probably look forward to another good year in 1974, although not quite as good as the banner year just completed. Realized net income will likely slip below the history-making level chalked up last year but will still be the second highest on record. The expected decline will result from a combination of lower realized gross income and higher production expenses.

Keys to the outlook are expectations for a continued strong domestic demand, despite a slowdown in economic growth, and for a continuation of the booming export demand. Farm exports, which jumped 60 percent to an all-time high of $12.9 billion in fiscal 1973, may well reach $19 billion this fiscal year.

Economists faced more uncertainties than usual in appraising the outlook for 1974. Weather's impact on crop production, a major unknown, was on the list as always. Other questionable factors included: the availability and prices of fuel and fertilizer; farmers' response to new farm legislation designed to encourage significantly expanded production of food and fiber crops; foreign production of farm products; rates of inflation; a cooling domestic economy; and the international monetary situation.

Farm Prices, Costs, and Income Farm prices may average about the same as last year, remaining strong until midyear but probably trending downward in the second half. With some upturn in livestock marketings likely, livestock receipts could be somewhat higher. Receipts from crops could show either a slight gain or a slight loss, the exact level depending on the weather, farmers' response to the new farm program, and export levels. Direct Government payments to farmers will be down sharply. So, some decline in realized gross income seems probable.

The story on farm production expenses is the same one farmers have heard for many years—they'll be higher. Extent of the increase, if in the neighborhood of 5 percent as projected, will be much smaller than the soaring 29 percent rise that took place in 1973. Unlike a year ago, expenses for nonfarm inputs will account for all of the upturn. Expenses for inputs of farm origin may remain approximately the same as last year.

Supplies of a number of important nonfarm inputs —items such as fuel, fertilizer, certain chemicals, and labor—will most likely be tight. But demand is expected to continue strong. With this situation, prices of farm inputs—especially fuel and fertilizer—could well be sharply higher.

The likelihood of a downturn in realized gross income and prospects for a further rise in production expenses indicate some decline in realized net income, possibly as much as 8 to 20 percent below a year ago. But even if a 20 percent decline materializes, realized net farm income in 1974 would still top any year except 1973.

Farm Credit Situation Farmers in general were in very good financial positions as they began the new year. By and large, they carried over large cash balances and time and savings deposits from 1973 and had unsold crop and livestock inventories on hand.

With the outlook for farm prices and incomes in 1974 relatively bright and with a new farm program that encourages larger plantings, farmers are likely to invest heavily in equipment, farmland, and other production inputs. Because farmers will use larger quantities of purchased inputs, many such as fuel and fertilizer at substantially higher prices, and because they will face the likelihood of a further rise in farm real estate prices as they attempt to expand their operations, farmers' needs for loan funds can be expected to increase. A strong demand for farm loan funds is anticipated this year, in fact. Farm borrowings actually are expected to be used to finance more additions to capital in 1974 than in 1973.

Farmers can expect to find adequate supplies of credit this year. Some shifts among lenders may well occur, however, if farm borrowers take advantage of the changed lending policies of some of the major lending institutions.

Much uncertainty surrounds the exact level of interest rates in the farm sector this year. Views of the Department of Agriculture's analysts indicate, however, that 1974 interest rates on new farm loans will likely average near 1973's fourth quarter levels.

Food Outlook[1] American housewives, weary from struggling with last year's reduced food supplies and the most rapid rise in food prices in over a quarter century, may find some comfort in the outlook for 1974. Retail food prices are likely to rise further, but the increase, unlike 1973, will probably be moderate. Grocery store food prices can be expected to advance during the first quarter of the year as red meat supplies decline and prices of most other food categories rise. But average grocery prices may stabilize in the second quarter and hold comparatively steady the rest of the year as larger meat supplies, more poultry and eggs, and slightly increased supplies of crop food commodities become available. Rising food marketing costs appear likely, however, and for the year are apt to offset generally falling farm prices. Similarly, declining meat and poultry prices for the year overall may offset price increases for most other items of food.

Food consumption patterns changed and consumption per capita dropped sharply last year in response to skyrocketing prices and smaller supplies of food. But with larger food supplies and more moderate price increases in prospect for 1974, per capita food consumption is expected to rebound from last year's reduced level. Most of the increased consumption will probably consist of livestock products—more red meat, poultry and eggs, but smaller quantities of dairy products.

Consumers' expenditures for food increased faster than their disposable income in 1973. As a result, the share of income spent for food rose to 15.9 percent—up from 15.7 percent in 1972 and the first such upturn in 15 years. This year, however, with a more moderate increase in food expenditures in sight and a further gain in disposable income anticipated, spending for food as a proportion of income may average approximately the same as in 1973.

Commodity Prospects A digest of the Department of Agriculture's outlook for major Fifth District commodities follows:

Soybeans and Peanuts Soybean supplies for 1973-74 are about one-fifth above last year and record large. Demand continues strong, however, with crushings probably rising 7 percent over last season and exports increasing some 15 percent. Despite the projected upturn in demand, a sharp buildup in soybean stocks (more than four times last fall's carryover) is likely next September. Nevertheless, soybeans probably will average around $5.25 per bushel for the entire marketing season, or one-tenth above 1972-73. Soybean acreage may be down 3 percent from last year if growers' intended plantings are realized.

Peanut supplies are at record levels, some 7 percent above a year ago. Consumption of peanuts in all food products during 1973-74 is expected to rise some 5 or 6 percent. The gain in edible uses, however, will not be nearly large enough to offset the 1973 production increase, and roughly one-third of the crop will be acquired by the Commodity Credit Corporation under the price support program. Acreage allotments for 1974 have again been set at the minimum level permitted by law. But administrative changes aimed at lowering the cost of the 1974-crop peanut program include, among other things, a provision that could reduce acreage slightly.

Tobacco Both cigarette output and domestic cigarette consumption are on the upswing, and indications are that each will rise further to new record levels in 1974. Domestic tobacco use in the current marketing year is expected to be larger than last year's total. Leaf exports are likely to continue near the sizable shipments made last season, but they may drop some because of tighter supplies. With total disappearance expected to be about the same as last season and larger than the 1973 crop, another decline in carryover is in prospect.

Price supports for eligible 1974-crop tobaccos are expected to be 8 or 9 percent above 1973 levels and nearly 50 percent higher than the 1959 base. The basic flue-cured tobacco marketing quota, originally set at 1,178.4 million pounds, has been increased 10 percent to help meet expected higher export demand. The burley quota has been raised to 608 million pounds, about 8 percent above the basic quota for 1973. The increase was made to comply with legislation requiring that the burley quota for any year cannot be less than 95 percent of estimated domestic use and exports.

Cotton Strong demand and tight supplies, especially for some of the medium and longer staples,

[1] The Department of Agriculture revised its projected increase in retail food prices for 1974 just as this *Review* was going to press. Now, instead of a more moderate rise than in 1973, the Department predicts that grocery store food prices could soar as high as 16 percent and match last year's advance. The climb in the first quarter is expected to average 20.7 percent above a year ago; in December, the outlook called for a 15 percent upturn.

highlight the 1973-74 outlook for cotton. Because of limited supplies and high prices, domestic mill use will probably be down moderately. Export prospects are bright, however, and may total about 6 million bales, up from last year's 5.3 million and a 13-year high. The gain in exports will more than offset the downturn in domestic mill consumption and lift total disappearance to about 13.5 million bales. Total prospective use, at this level, would exceed 1973 production by about half a million bales and reduce the August 1 carry-over slightly.

The 1974 cotton crop will be produced under provisions of the new farm program. Special features applicable to cotton include: a guaranteed "target price" of 38 cents per pound for normal production on allotted acres; elimination of any set-aside cropland; and the limitation of Government payments to $20,000 per person from all three programs—cotton, wheat, and feed grains—rather than $55,000 per person for each program.

Poultry and Eggs This year's output of broilers, eggs, and turkeys is expected to increase after lagging in 1973. Broiler expansion is likely to be moderate, rising a little less than 5 percent. There may also be some further slight increase in the average liveweight of broilers marketed. Turkey production could be substantially larger than in 1973 if producers carry out their plans to hold 15 percent more breeder hens for the 1974 hatching season. Indications point to a rapid buildup in laying flocks by this spring, paving the way for a big step-up in egg production by mid-1974.

Poultry and egg prices are not expected to average as high as they did last year. They will tend to be supported throughout 1974 by relatively high red meat prices and strong consumer demand for high-protein foods.

Milk Total milk production may drop again this year, with most of the decline coming in the first half. The possibility of moderating feed prices later in the year, plus higher milk prices, could improve milk-feed price relationships and encourage heavier feeding rates. Should the milk-feed price ratio be boosted to more favorable levels, milk output per cow may resume its upward climb. But the resultant gains may only partially offset the expected reduction in milk cow numbers.

Farm milk prices in the first half of 1974 will likely continue well above year-earlier levels. Prices after the first quarter could be affected by the dairy price support level set for the 1974-75 marketing year. Under the new farm legislation, milk prices during the upcoming marketing year must be supported at between 80 and 90 percent of parity.

Meat Animals The livestock outlook points toward the expansion of red meats. Smaller beef supplies and higher fed cattle prices are expected this winter because of disruptions in last year's livestock economy that discouraged placements of cattle on feed. But the large number of feeder cattle available for feedlot placement last fall and the prospective easing in feed prices could open the gates for a large expansion in beef production by spring and summer, probably accompanied by falling prices. Fed cattle marketings for the year could exceed year-ago levels by a sizable margin.

Lower hog marketings and prices well above a year earlier are in prospect for the first half of 1974. Second half marketings may be slightly larger than last year's low levels, with little net change in hog production for the year as a whole. All in all, the situation seems to add up to a relatively firm hog market in 1974.

On balance, a modest gain in total per capita supplies of red meats is likely this year. Larger beef supplies will more than offset smaller supplies of lamb, mutton, and veal. Pork output will change little.

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FINANCIAL FORECASTS: 1974

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

It is now fairly apparent that the 1974 economy will experience a sharply slower pace of real growth than in previous years. The consensus[1] opinion is that gross national product in current dollars, after expanding 11.5 percent in 1973, is forecast to increase only 7.6 percent in 1974. Personal consumption expenditures will rise to $861 billion or 7.0 percent, with most of the gain in the nondurable and service sectors. A sharp decline in residential structures is expected to result in a $210 billion level for gross private domestic investment. In terms of real GNP, 1974 economic growth appears even more dampened. After expanding nearly 6 percent in 1973, real GNP is projected to increase only 1 percent, if at all, in 1974. Predicted declines in corporate profits, housing starts, and auto sales, combined with slowed industrial production growth, make the outlook for 1974 appear rather gloomy. The final factor, prices, further clouds the picture, with the implicit price deflator predicted to rise at a 6.4 percent annual rate during the coming year.

The Arab oil embargo makes any forecast, financial or otherwise, uncertain at best. Fiscal and monetary policies will be geared to adjust to energy developments as the year unfolds. The need to take into account not only the pace of economic activity but also the rate of inflation and the dollar's position abroad presents a challenging proposition. The key for policymakers in 1974 will be flexibility.

Funds Raised in 1974 The total volume of funds raised, without regard to maturity length, is expected to register roughly $175 billion in 1974, markedly lower than the $185 billion in 1973 (Table I). The decline is attributable to a substantial drop in the volume of short-term funds, from $85 billion in 1973 to an anticipated $59 billion in 1974. Some downward pressure on short-term rates should result. On the other hand, funds raised in the long-term market are predicted to jump to $116 billion in 1974 from a 1973 level of $100 billion, foreshadowing some upward pressure on long-term rates.

[1] The "consensus" figures represent a modal average of approximately 30 individual forecasts.

There are four categories that must be examined in any discussion of the funds markets: banks, businesses, consumers, and government. The past year saw an almost unprecedented demand for bank credit. Total bank loans were roughly $31 billion, substantially higher than in 1971 or 1972. This strong demand is expected to abate in 1974 with the increase in bank credit returning to a more traditional $14 billion. The prime rate is projected to return to a level more in line with other short-term market rates; and as the economy slows, the demand for working capital funds should diminish.

The volume of business loans will vary more dramatically in composition than in amount during 1974, with the emphasis shifting from short-term to long-term business financing. In 1973, the business sector borrowed nearly $20 billion in the long-term markets; this figure will rise to $33 billion during 1974, with the major emphasis on the corporate bond

Table I

CONSENSUS FUNDS FORECASTS*

(billions)

	1973	1974
Funds Raised in the Short-Term Market	$ 85.3	$ 59.2
Bank loans	30.5	14.0
Consumer credit	19.9	11.5
Open market paper	5.7	10.8
U. S. Government	7.9	8.5
Agencies	21.3	14.4
Funds Raised in the Long-Term Market	99.7	116.2
Mortgages	68.4	68.7
Corporate bonds	10.8	20.2
Corporate stocks	9.0	12.8
State and local	11.5	14.5
Total Funds Raised	185.0	175.4

*These numbers represent an estimation of the consensus forecasts of many well-known economists.

market. A subsequent decline in short-term business borrowing is anticipated. From a 1973 level of $36 billion, short-term financing is forecast to dip to $25 billion in the coming year as a result of the major decline in bank loans.

Consumer net borrowing in 1974 is expected to amount to $80 billion, only slightly below the 1973 level. The decrease is wholly attributable to an anticipated $8 billion decline in short-term consumer credit—installment loans—as automobile and consumer durable sales decline. The demand for mortgage funds is forecast to remain strong at $69 billion, partly because a large amount of construction begun in 1973 was carried over to 1974 and mortgage money should be more readily available in the second half of 1974. It is the consensus opinion, however, that housing activity is headed downward for 1974 as a whole.

The volume of funds raised by the government sector is predicted to advance slightly in 1974 to $23 billion. The U. S. Treasury is expected to maintain its modest level of borrowing at almost $9 billion, an increase of less than $1 billion over 1973. State and local governments are forecast to increase their financing more dramatically to nearly $15 billion, with the volume of security issues up substantially. The agency market during 1974 is predicted to reduce its financing needs sharply to $14 billion from $21 billion last year. A decline in the volume of funds needed to support the housing industry is anticipated, although recent data indicate the drop-off may not be as large as originally predicted.

The Interest Rate Outlook Interest rates are undoubtedly the most volatile part of any financial forecast. The past year was a bitter experience for rate forecasters, and as a result, most predictions for 1974 mention interest rates in the briefest fashion. The consensus view, as shown in Table II, is that short-term rates will decline from the very high levels reached in August and September 1973. The decline will be moderated by the atmosphere of inflationary expectations that pervades the money markets, but such factors as a decreased demand for short- and intermediate-term credit combined with the expectation of a less stringent monetary policy should exert a downward thrust on short-term rates. On the other hand, rates in the long-term sector are predicted to be almost unchanged from 1973; however, stronger-than-anticipated demand for funds in the long-term markets along with intensified inflationary expectations could push long-term rates to new highs in 1974. A closer look at the anticipated behavior of some individual rates may produce a clearer picture of 1974 predictions.

Table II

CONSENSUS INTEREST RATE FORECASTS*

(percent)

	Year 1973	Second half avg. 1973	Year 1974
Treasury Bills†	7.07	8.05	6.35
Commercial Paper†	8.11	9.39	7.30
Prime Rate	8.01	9.45	7.34
Aaa Corporate Bonds	7.63	7.62	7.75
Aa Utility	7.76	8.14	7.87

*These numbers represent an estimation of the consensus forecasts of many well-known economists.

†Three-month maturity.

Short-term rates As Table II indicates, the consensus rate on three-month Treasury bills is expected to decline some 60 basis points by the close of 1974 to a level of 6.35 percent. This figure is over 125 basis points below the average rate for the second half of 1973. Relatively modest Treasury needs combined with a reduced demand for short-term funds account for the downward pressure on bill rates. In the market for prime, three-month commercial paper the rate declines are predicted to be more dramatic. By the close of 1974 the commercial paper rate should be down just about 80 basis points from 1973 at 7.30 percent, over 200 basis points below the average rate for the second half of last year. Closely related to the commercial paper rate is the rate charged prime bank borrowers—the prime rate. After rising to 10 percent on several occasions during 1973, the prime rate is forecast to drop below 7½ percent by late 1974, or over 200 basis points below the average rate for the entire second half of 1973. The consensus forecast places the prime rate in closer proximity to the commercial paper rate than the traditional 50-75 basis point spread, but corporate financing patterns among other things will dictate a tight parallel between the commercial paper and prime rates during 1974.

Long-term rates The consensus forecast for 1974 shows long-term rates rising slightly over 1973 levels. The rate on new issue Aa utility bonds is expected to be at 7.87 percent at the close of 1974, up just over 10 basis points. The heavy bond calendar for the coming year is the primary stimulus behind the upward shift in the utility rate. As cash flows fail to keep pace with investment spending and inflationary expectations strengthen, the rate on Aaa corporate bonds should rise during 1974, though not dramatically. The consensus forecast shows the corporate rate at 7.75 percent in 1974, up 12 basis points. The rate could move sharply higher if forecasters have underestimated the volume of long-term financing needed by the business sector in the coming year.

Monetary Policy The course of monetary policy plays an important role in shaping conditions in the financial markets. The conflicting forces of slowed economic growth, a high inflation rate, an improved international monetary situation, and a relatively low level of anticipated Treasury financing will be pulling against each other in the coming year, each trying to influence the course of monetary policy. The consensus of the forecasts shows that a policy of relative ease is anticipated with moderate growth in the aggregates. A 5.7 percent M_1 growth rate is forecast for 1974. The monetary authorities are expected to be moving toward a policy that allows the aggregates to expand at a pace consistent with balanced economic growth and long-term price stability, carefully avoiding unnecessarily sharp movements in interest rates.

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