

FORECASTS 1980

A CONSENSUS FOR A RECESSION

William E. Cullison

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

There have been few times in the history of forecasting the economy when there has been greater general agreement about the prospects for the economy. The fifty leading business and academic economists whose published forecasts have been received by this Bank are unanimous in predicting that the Eighties will begin with a recession. The major differences in the forecasts this year revolve around the type of recession (V-shaped or saucer-shaped) that is expected and the timing of the recovery. Most forecasters, however, are predicting a relatively severe V-shaped recession that bottoms out in the second quarter. They then anticipate slow but positive growth in the third quarter and a moderately vigorous recovery in the fourth. The forecasters who predict a different scenario are split into two groups, those who predict a shallow (saucer-shaped) recession and those who predict a sharp downturn of longer duration than two quarters. Opinion is roughly equally divided among the two competing alternative scenarios.

Consistent with the recession prediction, the unemployment rate is predicted to rise to almost 8 percent by the fourth quarter of 1980. Average corporate profits for 1980 are expected to be 7.6 percent below the 1979 average. The rate of inflation (measured by the implicit deflator for GNP) is expected to subside, but only very slightly, averaging 8.7 percent for the year. All of the forecasters expect private housing starts to decline sharply in the first quarter, and many expect the decline to continue in the second, but most of them think that the recovery will have begun by the third quarter.

The major areas of concern to the forecasters this year include the homebuilding industry and the prospects for consumer spending in general. Few forecasters expect the savings rate to continue at the low level registered in the second half of 1979, so they expect consumers to become more cautious in their spending. Sales of domestic autos are expected to continue to suffer from fuel price hikes, and the

housing industry is expected to be quite weak in the first half of the year because of high mortgage rates and scarcity of mortgage money.

All forecasters predict significant increases in oil prices in 1980. The recovery in the second half of the year is expected to come in response to lowered interest rates and increased defense spending, and a year-end recovery in consumer spending for durables led by a renewed interest in domestic automobiles.

Last year, the consensus prediction for real GNP growth, 2.4 percent, was remarkably close to the actual increase for the year as a whole. The quarter-by-quarter path for the economy, however, was considerably different from that predicted. The forecasters had expected a 3.1 percent annual rate of growth of real GNP in the first quarter, with growth rates falling to the 0.5 percent to 1.5 percent range in the remaining quarters of the year. Instead, the annual rate of growth of real GNP rose 1.1 percent in the first quarter, fell 2.3 percent in the second, and rose 3.1 percent and 1.4 percent in the third and fourth quarters. The decline in real GNP in the second quarter seemed to many observers to herald the beginning of a recession. The subsequent rises in real GNP, however, cast doubt on that view, although it is still not completely implausible. The decline in economic activity in the second quarter is now generally thought to have resulted primarily from fuel shortages and gasoline lines. At this writing, preliminary indications show fourth quarter real GNP to be higher than that registered in the third quarter. If, however, that preliminary figure is revised downward substantially, the beginning of the recession may yet be considered to be the second quarter of 1979. Forecasters last year expected the rate of increase in consumer prices to be considerably less than it actually was. They expected the Consumer Price Index (CPI) to rise 8.2 percent; it actually rose 11.3 percent. Most of them think that the CPI will rise 10.8 percent in 1980.

This article attempts to convey the general tone and pattern of some fifty forecasts received by the Research Department of this Bank. Not all of these forecasts are comprehensive, and some incorporate estimates of future behavior of only a few key eco-

conomic indicators. Some are made in terms of annual averages while others are made on a quarter-by-quarter basis, and a consensus drawn from one of these groups may differ from that drawn from the other. Moreover, the individual forecasts are based on varying assumptions and this should be taken into account in interpreting the consensus.

This Bank also publishes the booklet Business Forecasts 1980, which is a compilation of representative business forecasts with names and details of the various estimates. No summary article can ever be as informative as the actual forecasts themselves. Serious readers are urged to look at the individual forecasts in more detail in Business Forecasts 1980.

1979 FORECASTS IN PERSPECTIVE

The consensus forecast published in last year's January/February *Economic Review* predicted 1979 current dollar GNP to increase 10.2 percent over 1978. The rates of increase forecast ranged from 9.0 percent to 11.0 percent. Using the revised 1978 GNP total of \$2,127.6 billion, the consensus forecast for 1979 GNP would have been \$2,344.6 billion and the range from \$2,319.1 billion to \$2,361.6 billion. Increasing prices were expected to account for 7.6 percent of the gain in GNP, so GNP measured in constant dollars, or real GNP, was expected to rise 2.4 percent.

Current estimates by the U. S. Department of Commerce indicate that GNP in 1979 actually increased 11.3 percent. Prices, as measured by the implicit deflator for GNP, however, increased 8.8 percent, considerably more than anticipated. As a result, preliminary estimates put the increase in real GNP around 2.3 percent—about equal to the 2.4 percent increase predicted last year. The forecasters expected the unemployment rate to average 6.6 percent for the year. At present, preliminary estimates indicate an average of 6.0 percent.

As with the aggregate GNP figure, the forecasters also under-predicted the components of GNP. Most of the under-prediction can probably be attributed to underestimating the rate of inflation.

Personal consumption spending was forecast to increase 9.8 percent, but it actually rose 11.7 percent. Consumer purchases of durable goods, estimated to increase 6.5 percent, actually rose 6.3 percent. Purchases of nondurables were estimated to increase 9.7 percent, whereas the actual rate of increase was 12.5 percent. Consumption spending for services was forecast to increase 11.3 percent, but it was also

underestimated. The actual 12.9 percent increase was surprisingly far from the mark, considering that consumer spending for services are usually the most predictable component of consumption spending.

The forecasters expected a more moderate rate of increase in gross private domestic investment than the 15.7 percent rate of growth registered in 1978. The growth rate did, in fact, moderate to 9.8 percent, but the forecasters had expected it to be only 7.1 percent. The consensus prediction for inventory investment, which is a common source of forecast error, was relatively accurate. The consensus expected inventory investment to remain constant. It actually fell \$3.9 billion from the revised \$22.3 billion averaged for 1978.

Net exports, with which the forecasters also often have difficulty, was underestimated by only \$2.0 billion last year. The actual figure, —\$3.5 billion, was well within the range of forecasts. The range was, as is often the case, quite large—from +\$5.6 to —\$8.5 billion.

The forecasts of the last major component of GNP, government purchases of goods and services, centered around a rate of increase of 11.0 percent. Actual government spending is now thought to have risen only 9.3 percent. Thus, the growth of government spending was the only major component of GNP to have been underestimated by last year's forecasters.

Regarding profits and industrial production, the forecasts for 1979 underestimated profits substantially but predicted industrial production fairly accurately. Before-tax corporate profits were predicted to rise 2.6 percent; most observers now think they increased about 14.8 percent. The index of industrial production rose 4.1 percent, slightly more than the predicted 3.4 percent rise.

The forecasters underestimated the rise in the Consumer Price Index by an even larger margin than the Implicit Price Deflator. Consumer prices were expected to rise 8.2 percent, but current figures indicate a rise of 11.3 percent.

The consensus of the quarter-by-quarter forecasts for 1979 had current dollar GNP rising 10.5 percent in the first quarter, 7.8 percent in the second quarter, 7.1 percent in the third quarter, and 6.8 percent in the fourth, measured at annual rates. The realized quarterly increases, measured at annual rates, were 10.6 percent, 6.7 percent, 11.0 percent, and 10.1 percent. For real GNP, the consensus forecast called for annual rates of increase of 3.1 percent, 1.4 percent, 0.4 percent, and 1.2 percent for the four quarters, respectively. The realized increases for the first three quarters, were 1.1 percent, —2.3 percent,

and 2.4 percent, while the preliminary number for the fourth quarter is now placed at 1.4 percent.

The forecasters, then, exhibited considerably less prescience about the quarterly path of the economy than they did about average figures for the year as a whole. They expected relatively greater growth during the first quarter of the year, with the growth rates tapering off through the third quarter and increasing slightly in the fourth. Instead, the economy experienced its slowest growth in the first half of the year, with the quarterly growth rate for the second half picking up slightly after a 2.3 percent second quarter decline.

The limits of forecasting prescience were equally apparent in the discrepancy between actual and predicted quarter-by-quarter behavior of the unemployment rate. The unemployment rate was expected to average 6.1 percent in the first quarter and to rise to an average of 7.9 percent in the third quarter.

Consistent with the expectations that economic growth would improve in the fourth quarter, the unemployment rate was predicted to decline to an average of 6.8 percent in the last quarter of 1979. Instead, the unemployment rate surprised almost everyone by remaining relatively stable, with monthly rates fluctuating narrowly in the 5.7 percent to 6.0 percent range.

1980 FORECASTS IN BRIEF

Gross National Product Forecasts for 1980 current dollar GNP center around \$2,541 billion. This consensus forecast indicates an approximate 7.3 percent yearly gain, less than the 11.3 percent increase apparently registered in 1979. Estimates for increases in 1980 current dollar GNP range from 5.3 percent to 9.2 percent. Prices, as measured by the implicit deflator for GNP, are expected to increase

RESULTS FOR 1979 AND TYPICAL FORECASTS FOR 1980

	Unit or Base	Preliminary 1979*	Forecast 1980**	Percentage Change	
				1978/1979	1979/1980
Gross national product	\$ billions	2368.3	2541.1	11.3	7.3
Personal consumption expenditures	\$ billions	1509.8	1647.2	11.7	9.1
Durables	\$ billions	212.9	215.4	6.3	1.2
Nondurables	\$ billions	597.0	650.7	12.5	9.0
Services	\$ billions	700.0	777.7	12.9	11.1
Gross private domestic investment	\$ billions	385.9	376.6	9.8	-2.4
Business fixed	\$ billions	254.2	268.7	14.9	5.7
Residential structures	\$ billions	113.3	105.5	5.0	-7.0
Change in business inventories	\$ billions	18.4	5.2	—	—
Government purchases	\$ billions	476.1	527.0	9.3	10.7
Net exports	\$ billions	-3.5	-1.2	—	—
Gross national product (1972 dollars)	\$ billions	1431.0	1412.0	2.3	-1.3
Plant and equipment expenditures	\$ billions	174.1 ^o	184.0	13.2	5.5
Corporate profits before taxes	\$ billions	236.6 ^o	219.0	14.8	-7.6
Private housing starts	millions	1.69	1.43	-16.3	-15.5
Automobile sales (domestic)	millions	8.23	7.48	-11.2	-9.1
Rate of unemployment	percent	6.0	7.6	—	—
Industrial production index	1967=100	152.1	146.6	4.1	-3.6
Consumer price index	1967=100	217.4	240.9	11.3	10.8
Implicit price deflator	1972=100	165.5	179.9	8.8	8.7

* Data available as of January 1980.

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

^o Estimated.

8.7 percent, about the same as the 8.8 percent rate of increase registered last year. By contrast, real GNP is projected to decline 1.3 percent, compared to a 2.3 percent rise in 1979.

The consensus of quarterly estimates indicates a contraction of the economy during the first half of the year and recovery in the second. It calls for real GNP measured at seasonally adjusted annual rates to decrease 4.6 percent in the first quarter of 1980 and 2.8 percent in the second, and to increase 1.4 percent in the third quarter and 3.1 percent in the fourth.

Personal consumption expenditures are expected to total \$1,655 billion for 1980, up 9.1 percent from 1979. The predictions for consumption spending range from increases of 7.0 percent to increases of 10.1 percent. Forecasters estimate that expenditures for durable goods will rise only 1.2 percent for the year, while expenditures for nondurables and services are projected to advance 9.0 percent and 11.1 percent, respectively. The slowdown in durable goods expenditures is expected to be felt primarily in sales of appliances, furniture, and automobiles as a result of a generally heightened consumer caution.

Government purchases of goods and services are projected to total \$527 billion. This estimate represents a 10.7 percent increase over 1979, somewhat more than the 9.3 percent gain of the previous year. The 1980 forecasts for increases in government purchases range from 9.0 percent to 12.3 percent.

Gross private domestic investment is expected to fall by 2.4 percent in 1980, following a 9.8 percent increase in 1979. Inventory investment is expected to be at a lower level than in 1979, which is consistent with a contractionary economy. Residential construction is expected to continue to be a weak sector of the economy, falling 7.0 percent, after a modest 5.0 percent rise in 1979. Business fixed investment spending will also be sluggish if the forecasts are correct. That sector is expected to register a 5.7 percent gain compared to 14.9 percent last year. The array of forecasts this year, as is usually the case, is quite broad in the investment sector. Expectations for residential construction range from decreases of 17.4 percent to increases of 0.2 percent. For business fixed investment, estimated increases range between 2.3 percent and 9.9 percent. Forecasts for investment in business inventories, for which the consensus was \$5.2 billion, range from -\$2.3 billion to +\$11.3 billion.

Industrial Production The typical forecast for the Federal Reserve index of industrial production (1967=100) in 1980 is 146.6, a decrease of 3.6 per-

TYPICAL* QUARTERLY FORECASTS FOR 1980

Percentage Quarter-to-Quarter Annual Rates
Unless Otherwise Indicated

	Forecast 1980			
	I	II	III	IV
Gross national product	4.9	5.4	8.6	10.4
Personal consumption expenditures	6.5	7.0	9.1	10.9
Durables	-2.2	-1.0	9.3	12.5
Nondurables	7.8	7.8	10.0	11.0
Services	10.6	8.7	9.6	11.5
Gross private domestic investment	-9.9	-11.4	2.7	16.1
Business fixed investment	4.2	1.2	2.6	6.7
Residential construction	-23.8	-16.0	7.9	40.3
Change of business inventories†	5.0	5.8	5.9	10.0
Government purchases	8.3	8.9	8.2	11.5
Net exports‡	-2.9	-1.9	-2.6	-2.2
Gross national product (1972 dollars)	-4.6	-2.8	1.4	3.1
Plant and equipment expenditures	4.0	1.0	1.0	8.4
Corporate profits before taxes	-28.7	-23.4	-4.7	20.2
Private housing starts	-62.6	-12.3	31.9	46.0
Industrial production index	-9.2	-5.4	1.6	6.2
Rate of unemployment‡	6.8	7.4	7.9	7.8
Consumer price index	10.0	9.6	8.4	8.4
GNP implicit deflator	9.1	8.5	7.6	7.5

* Median.

† Levels, billions of dollars.

‡ Levels, percent.

cent. This prediction again indicates the recession expected in 1980.

Housing The construction industry is expected to feel the effects of high mortgage rates, scarcity of mortgage money, and rising construction materials costs in 1980. Activity in this sector is expected to be almost 15.5 percent below the already slow 1979 pace. Private housing starts, which totaled almost 2 million units in 1978, totaled only 1.7 million units in 1979 and they are expected to total only 1.4 million units in 1980. Forecasters expect construction to recover in the second half of the year when credit is expected to be available and mortgage rates are expected to be somewhat lower.

Corporate Profits All but one of the forecasters expect pretax profits to decline this year. The most

pessimistic forecaster expects corporate profits to fall 13.2 percent. The most optimistic predicts only a 2.0 percent rise. The consensus forecast calls for a decline in pretax profits of 7.6 percent, to \$219 billion. This decline follows a gain of approximately 14.8 percent in 1979. Hence, corporate profits are expected to reflect the slower growth of the economy, although they are expected to decline somewhat less sharply than they normally do in recession years.

Unemployment Most forecasters are predicting an increase in the rate of unemployment during 1980. The typical forecast for the year's average is around 7.6 percent. This will be 1.6 percentage points above the 1979 average. Considering that the unemployment rate at year-end 1979 stood around 6.0 percent, the 7.6 percent prediction for 1980 indicates that the unemployment rate is expected to move somewhat higher than 7.6 percent during the course of the year. The quarterly consensus forecast, in fact, puts the unemployment rate at 7.9 percent and 7.8 percent in the third and fourth quarters, respectively.

Prices This year the forecast indicates that the rate of price increase will remain at about last year's rate. The implicit GNP deflator, which rose 8.8 percent in 1979, is expected to increase 8.7 percent in 1980. The Consumer Price Index is expected to rise 10.8 percent, slightly less than the 11.3 percent increase averaged in 1979. Forecasts for increases in the implicit deflator range from 7.2 percent to 9.6 percent, while forecasted increases in the Consumer Price Index range between 9.2 percent and 11.8 percent.

Net Exports The nation's trade position, measured on a National Income Accounts basis, was approximately \$3.5 billion in deficit in 1979 and is expected to improve moderately in 1980, showing an average deficit of only \$1.2 billion for the year. The forecasters expect import growth to moderate as the economy slows, but increases in oil prices are expected to nullify much of the improvement in net exports that might otherwise have been expected. Most of the forecasts were published before grain sales to the Soviet Union were embargoed. The estimates for net exports varied widely, between -\$17.2 billion and +\$4.0 billion.

Quarter-by-Quarter Forecasts Fourteen forecasters made quarter-by-quarter forecasts for 1980. As indicated by the accompanying table, the forecasters expect negative rates of growth in the first half of the year, but positive rates of growth in the second half. Translated into percentages and annualized, the expected median growth rates of real GNP

are -4.6 percent, -2.8 percent, +1.4 percent, and +3.1 percent for the four quarters, respectively.

These rates are median forecasts, however, and there is considerable variation among the forecasters. The forecasts for the decline in real GNP in the first quarter range from 5.4 percent to 1.1 percent; second quarter expectations range from decreases of 6.4 percent to increases of 2.2 percent; third quarter forecasts range from -6.5 percent to +3.1 percent; and expectations for the fourth quarter vary from -0.3 percent to +6.9 percent. This considerable range of quarterly forecasts in each of the quarters stems from differences in the forecasters' expectations about the timing of the anticipated recession. Although the largest majority expects the trough of the recession to fall in the second quarter of 1980 and recovery to begin in the third quarter, two forecasters expect recovery to begin in the second quarter, two expect it to begin in the fourth quarter, and one expects the economy to contract throughout 1980. Of the forecasters who expect the recovery to begin in the third quarter, the most pessimistic expects real GNP to fall at an annual rate of 4.6 percent in the first quarter and 6.4 percent in the second with a relatively strong recovery in the second half. The least pessimistic of the forecasters—those who expect recovery to begin in the second quarter—predict only a 2.2 percent decline in real GNP in the first quarter, but they expect real GNP to grow rather slowly throughout the rest of the year. The gloomiest outlook of all—that real GNP will contract in every quarter—calls for annual rates of decline of 1.1 percent, 4.8 percent, 6.5 percent, and 0.3 percent for the four quarters, respectively.

If the median forecasts are realized, the 7.8 percent unemployment rate for the fourth quarter will represent a considerable worsening of the current unemployment picture. Since the civilian labor force is around 104 million persons, an increase of 1.8 percentage points in the average unemployment rate means an increase in unemployment of almost 1.9 million persons. Several of the forecasters, moreover, expect the unemployment rate to be over 8.0 percent by year-end 1980.

The forecasters expect the rate of increase in the prices of items included in GNP to decline somewhat during the year. The consensus forecasts were for increases of 9.1 percent, 8.5 percent, 7.6 percent, and 7.5 percent for the four quarters, measured at seasonally adjusted annual rates. Price increases forecast ranged from 6.6 percent to 10.1 percent in the first quarter, 6.5 percent to 9.3 percent in the second, 6.1 percent to 8.1 percent in the third, and 6.3 percent to 10.3 percent in the last quarter of 1980.