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WINTER 1980
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## 1980 FORECAST ISSUE

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ECONOMIC OUTLOOK USA is designed to aid private and public decision makers in achieving a better understanding of the economic and social environment in which they will be operating. The analysis in this publication incorporates direct measurements of the expectations, attitudes and plans of both consumers and business firms with the economic and financial variables traditionally used in forecast models. The philosophy of this publication is that a blend of anticipatory and traditional measures provides richer insights into prospective developments, insights which will produce more consistently reliable forecasts of both economic and social change.

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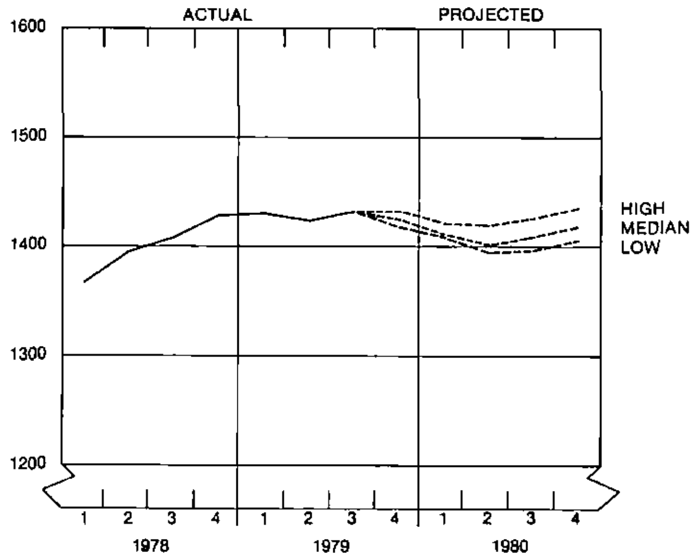
# ECONOMIC PROSPECTS

## Actual and projected; seasonally adjusted quarterly data at annual rates

### GROSS NATIONAL PRODUCT

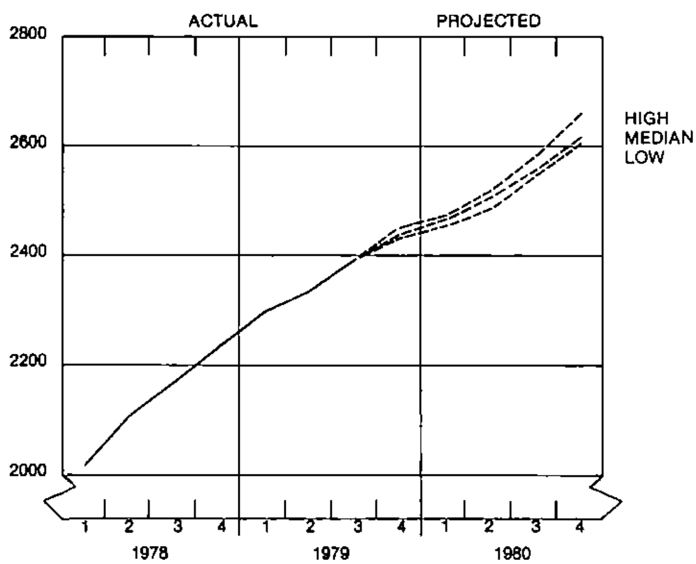
IN CONSTANT 1972 DOLLARS
Billions of Dollars




Sources Actual data, U S. Department of Commerce; projected data, ASA-NBER Panel of Forecasters.

### GROSS NATIONAL PRODUCT

IN CURRENT DOLLARS
Billions of Dollars




Sources: Actual data, U.S. Department of Commerce; projected data, ASA-NBER Panel of Forecasters.

**Frequently Used Abbreviations:**

| | |
|---|---|
| ASA | American Statistical Association |
| BEA | Bureau of Economic Analysis, U.S. Department of Commerce |
| NBER | National Bureau of Economic Research |
| SRC | Survey Research Center |
| 197*x*:*y* | *y*th quarter of 197*x* |

# The U.S. Economic Outlook for 1980

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**Department of Economics**
**The University of Michigan**

## Review of the 1979 Forecast

Although the unfolding of a series of unusual and sometimes puzzling economic events in recent years has made traditions in economic forecasting somewhat suspect, we will set the stage for our forecast of the coming year with a careful appraisal of last year's predictions. We recall first our predicted increase in real GNP of just over $28 billion, which compares to an increase which we now estimate at $29.6 billion for calendar 1979. Thus, in terms of the aggregate level of output of goods and services for 1979, our forecast was very accurate indeed. With respect to the two other key indicators of aggregate economic activity, the rate of price inflation and the unemployment rate, our forecasts were less accurate. A year ago we forecast a modest increase in the rate of inflation—measured by the GNP deflator—to a level of 7.7 percent for 1979 as a whole. This falls well short of our current estimate of an 8.9 percent rate of inflation for 1979. With respect to the unemployment rate, our forecast of a year ago anticipated an increase of 6/10 of a percentage point to a level of 6.7 percent. We now estimate a slight decrease in 1979 compared to 1978, to a level of about 5.9 percent for the year as a whole.

The sources of these forcast errors as well as the overall nature of our forecast for 1979 can be better appreciated by considering the data presented in Table 1. As indicated by these data, our forecast correctly predicted the sharp slowdown in the rate of growth of real GNP from the 4.4 percent experienced in 1978 to about 2 percent for 1979. Our forecast error with respect to the rate of inflation can largely be attributed to our failure to anticipate the very sharp increases in farm prices, import prices, and crude materials prices. These latter increases, of course, are dominated by the sharp increases in crude oil prices. A year ago we anticipated that OPEC actions would produce an increase of only 10 - 12 percent in world oil prices. In fact, it now appears that the price of our oil imports rose by about 65 percent from 1978:3 to 1979:3. Our overprediction of the unemployment rate, despite our accurate prediction of the level of production, can be traced to our overestimate of productivity. A year ago we forecast a modest increase of 1.3 percent in output per hour in the private non-farm sector. We now anticipate, however, a *decrease* of 1.0 percent for the current year. This poor productivity performance allowed the creation of more jobs than we anticipated in conjunction with the correctly forecast level of aggregate production.

Our overall forecast for 1979, discussed in the Winter 1978-79 issue, could also be classified as "mainstream." At the end of last year most private forecasters were predicting that the rate of growth of real GNP would decline to the range of 1.5 - 2.5 percent. The corresponding forecasts of the unemployment rate ranged from 6⅓ percent to 7¼ percent—all too high—and nearly all underpredicted inflation with forecasts between roughly 7½ percent and 9 percent. An interesting contrast, on the other hand, is available when our forecast is compared with those published by the Congressional Budget Office and the Council of Economic Advisers. In January of this year, the CBO forecast anticipated that real GNP would increase by 3 - 5 percent from 1978:4 to 1979:4, and the CEA Annual Report estimated 2 - 2½ percent growth for the same period. Our own forecast was for real growth of one percent from 1978:4 to 1979:4, and we now estimate that the rate of growth of real GNP will amount to about 4/10 of one percent for the year ending in 1979:4.

**Table 1. REVIEW OF MQEM FORECAST FOR 1979: GNP, PRICES, AND UNEMPLOYMENT**

| Economic Indicator | 1978 Actual | 1979 Actual[a] | 1979 Projected[b] |
|---|---|---|---|
| Rates of Growth (percent): | | | |
| Real Gross National Product | 4.4 | 2.1 | 2.0 |
| Inflation: | | | |
| GNP Deflator | 7.3 | 8.9 | 7.7 |
| Import Deflator | 5.4 | 14.3 | 7.9 |
| Farm Prices | 21.6 | 15.6 | 6.6 |
| Crude Materials Prices | 12.9 | 23.0 | 12.2 |
| Productivity, Private Nonfarm Sector | 0.3 | -1.0 | 1.3 |
| Change in Unemployment Rate (percent) | -1.0 | -0.15 | 0.6 |

[a]Source for first three quarters of 1979 and calendar 1978, *Survey of Current Business,* October 1979. Date for the fourth quarter of 1979 represent the current MQEM forecast.

[b]Projected as of November 1978.

## The Current State of the Economy and Input Assumptions

The basic framework within which our forecast of 1980 is generated is set by the following three broad factors:

- *The specification and parameter estimates embodied in the Michigan Quarterly Econometric Model (MQEM).* It is these factors which both summarize relevant previous history and process current information and projections of economic policy to determine the short term economic outlook.
- *The current state of the economy.* Our initial or starting position clearly impacts directly on the likelihood of alternative paths of development of economic activity in the next year.
- *Projections regarding the stance of government economic policy and other key variables not explained by our model.* In addition to projecting the status of key monetary and fiscal policy variables we must also "inform" our model concerning expected developments in world trade, farm and crude materials prices, and other factors.

The structure of MQEM is continually being evaluated and modified as part of our ongoing research and forecasting program. This review and modification of our model is guided by an assessment both of the model's forecasting performance and the needs of forecast users. In the past year and a half, the results of two important pieces of research have been incorporated into the model's structure. About a year ago we introduced a substantially enlarged monetary sector designed not only to better articulate the economic mechanisms determining interest rates and monetary aggregates, but also to introduce into the model the important relationship between the Federal deficit and the bond market.These changes were incorporated into the model used for last year's forecast. More recently we have developed a more detailed determination of business investment expenditures in producers' durable equipment. Our model now contains a three-sector disaggregation of this component of aggregate demand (agricultural equipment, production equipment, and all "other" producers' durable equipment) rather than the single aggregate relationship used in recent years. These new relationships are in use at the present time, and the additional sectoral detail is contained in the forecast for 1980.

We turn now to an assessment of the current state of the economy and our input assumptions for 1980 and beyond. After rising at a rate of 4.6 percent during the last half of 1978, real GNP grew little at all in the first quarter of 1979 and then declined sharply in the second quarter of this year. Although the slowdown was certainly "led" by durable goods and construction expenditures, it was broadly based among almost all components of aggregate demand. In the second quarter, only inventory investment showed substantial growth in real terms. Perhaps surprisingly, real GNP turned up in the third quarter, wiping out the entire decline of the previous quarter. Although the third quarter experienced a sharp drop in the rate of inventory accumulation, net exports and consumer expenditures expanded briskly with the latter reducing the saving rate to 4.1 percent. A year ago we had forecast that the middle two quarters of 1979 would be characterized by virtually no growth in real GNP. Current estimates for this period confirm the net result of that forecast although the actual quarter-to-quarter movements in GNP growth rates were considerably more volatile, registering -2.3 percent and +2.4 percent percent for the second and third quarters, respectively. This unanticipated volatility can be explained in large part by the direct and indirect effects of the sharp changes in price and availability of gasoline in the Spring and Summer quarters of the year. Despite this rather weak overall performance of the economy from 1978:4 through 1979:3, the unemployment rate remained almost unchanged as output per hour in the private non-farm sector declined by 1.5 percent in the year ending in 1979:3.

We are now forecasting that the fourth quarter of 1979 will be characterized by virtually no growth in real GNP. Specifically, we now expect the fourth quarter to register an annual rate of growth in real GNP of only about 2/10 of one percent, with relatively sharp declines forecast in consumer expenditures on durables (especially cars) and residential construction. Further, we expect the personal saving rate to remain very low at close to 4 percent. Interest rates, which have already registered historic highs, are expected to be little changed during the closing months of the year. Inflation rates, partly under the influence of rapidly rising energy prices, will remain at the double-digit level in the fourth quarter. We forecast that the GNP deflator and the consumer price index (CPI) will register annual growth rates of 10.1 percent and 11.4 percent, respectively. Thus the final quarter of the year is characterized by virtually no growth in the output of goods and services, continuing high inflation rates, and interest rates at historically high levels.

The economic outlook for 1980 will be shaped in important ways by the economic policies of the Federal Government. This is so despite the fact that the full economic effects of policy actions occur with some lag. While the current period may be thought of as one of considerable uncertainty regarding the future course of national economic policy, we must face the task of articulating as best we can the set of policies that seem most likely to be put in place over our forecast horizon. Such a choice obviously requires a judgment on our part not only regarding the general nature of the short-term economic outlook, but also regarding the national government's attitude towards certain tradeoffs between alternative objectives that might be available. Our Control Forecast contains the following assumptions with respect to the future course of monetary and fiscal policy.

With respect to monetary policy:

- *The monetary base*—as measured by the Federal Reserve Bank of St. Louis—which followed a rather volatile path from very slow growth (4.6 percent annual rate) at the beginning of 1979 to very rapid growth (12.6 percent) in the third quarter of 1979, is projected to grow by 9 percent (annual rate) in the current quarter and by just under 8 percent from 1979:4 to 1980:4.
- *The discount rate* is assumed to remain at its current level of 12 percent through the middle of the second quarter of 1980 and then to decline by 50 basis points in each succeeding quarter to a level of 10 percent by mid-1981:1.

Regarding *fiscal policy*, our forecast is based on a number of assumptions with respect to both the expenditure and revenue (tax) sides of the Federal budget. We are projecting an increase in Federal expenditures (National Income and Product Accounts basis) of $53.0 and $50.9 billion in Fiscal 1980 and 1981, respectively. For fiscal 1980 the projected level of expenditures of $546.7 billion is virtually the same as that currently projected by the Office of Management and Budget (OMB). In detail, however, we are projecting a somewhat lower level of purchases and higher level of transfer payments than OMB. Our projected budget contains a 13 percent increase in defense purchases—adequate to achieve the targeted increase of 3 percent in real terms. A similar percentage increase in defense expenditures is incorporated into the 1981 budget in order, once again, to achieve a minimum 3 percent increase in real terms. Defense and transfer payments, the latter substantially indexed to inflation, remain the fastest growing elements in the budget.

With respect to revenue or tax policy we have incorporated the following policy actions into our forecast assumptions:

- An indefinite postponement of the currently scheduled increases in the Social Security tax rate (1981) and the wage ceiling for Social Security tax purposes (1980 and 1981). The estimated revenue impact of these scheduled tax increases would have been $5 billion in 1980 and $11 billion in 1981.

- Passage of a windfall profits tax yielding about $1.6 billion in revenues for calendar 1980 and $3.1 billion for calendar 1981. We further assume that most of these increased revenues ($1.6 billion in 1980 and $2.6 billion in 1981) will be returned to households to help offset the burden of higher utility and home heating oil bills.

In addition, our forecast also incorporates scheduled decreases in taxes established by the 1979 tax-cut bill. Taking account of these changes in tax policy, the anticipated levels of Federal revenues derived from our Control Forecast together with our projections of expenditure levels result in anticipated Federal deficits of $21.4 billion in Fiscal 1980 and $37.4 billion in Fiscal 1981. This compares to a deficit of $10.7 billion now estimated for Fiscal 1979 and is roughly consistent with the deficit ceiling of $29.8 billion on the Unified Budget for 1980 which was recently adopted by the Congress.

With respect to *state and local government purchases*, we are projecting an increase of $34.5 billion (11.2 percent) for calendar 1980. This exceeds the increase of $26.3 billion, or 9.3 percent, now estimated for 1979, but is below the increase of nearly 12½ percent experienced in 1978.

A number of important assumptions have been made regarding the *foreign sector*:

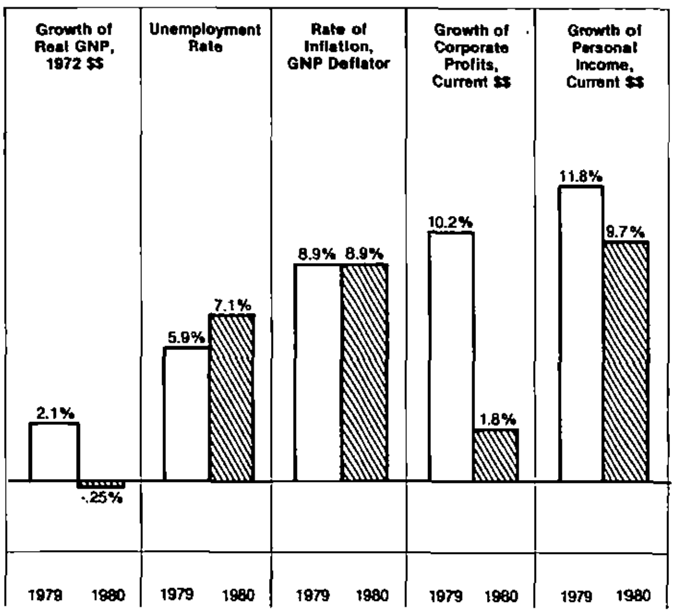
- The price of imported oil is expected to rise rapidly in the final quarter of 1979 to an average level of $26.00 per barrel. We expect the price of imported oil to continue rising relatively rapidly throughout our forecast horizon. In terms of dollars per barrel we are projecting an increase to $28.60 by the second quarter of 1980 and just over $32.00 by mid-1981. Domestic crude oil prices are projected to rise even faster as a result of the process of gradual decontrol. From a level which we estimate at $15.50 per barrel in the third quarter of 1979, domestic prices are projected to rise to $22.00 by mid-1980 and to be very close to the projected world level of $32.00 per barrel by mid-1981.
- Net of the effects of rising oil prices, the price of imports—as measured by the import deflator—is projected to rise at an 8 percent annual rate throughout our forecast horizon. Including the impact of oil prices, import prices are expected to rise at an annual rate of 13.8 percent in the final quarter of 1979 and by 9.5 percent from 1979:4 to 1980:4.
- The volume of U.S. exports is expected to increase at an annual rate of 4 percent through the third quarter of 1980 and then rise further to a growth rate of 5½ percent (annual rate) by mid-1981. The chief strength of U.S. exports over this period is in the agricultural sector, but the rising growth rates projected after mid-1980 relate to stronger anticipated growth in the economies of our trading partners. Export prices—as measured by the export deflator—are projected to rise at a 9 percent annual rate through the first quarter of 1980, and at an 8 percent rate thereafter.

Finally, we must introduce a set of assumptions regarding farm prices, crude materials prices, and retail gasoline prices over our forecast horizon. Our forecast of 1979 seriously underestimated the rate of inflation in all these areas (see Table 1). With respect to *farm prices*, we are now projecting modest increases (7 percent annual rate) through the first quarter of 1980, with much sharper increases in subsequent quarters. Between the fourth quarters of 1979 and 1980 we are projecting an increase of 12 percent in farm prices. These relatively rapid increases are driven both by government support programs (sugar and dairy products) and our expectation that domestically available grain and meat supplies will lag somewhat behind the growth of domestic demand. *Crude materials prices*, heavily influenced by domestic oil prices, are projected to rise by 17.6 percent from 1979:3 to 1980:3 and 13.4 percent in the following year. For calendar 1980 this represents an increase of 18.5 percent compared to the 23.0 percent increase now estimated for 1979. *Retail gas prices* are projected to increase at an annual rate of almost 20 percent during the current quarter and by a further 23 percent between the fourth quarter of 1979 and the fourth quarter of 1980. For 1980 as a whole these projections imply a 32 percent increase over gas prices in 1979—a very similar increase to that experienced in the current year. In summary, substantial increases in the prices of farm products (after next spring) and of both domestic and imported oil are projected to make significant contributions to the rate of inflation.

## An Overview of the Forecast for 1980

An overview of our Control Forecast for 1980 is presented in Charts 1 and 2. Compared to the 2.1 percent increase in real GNP now expected to characterize 1979, we are forecasting a decline in the real output of goods and services of -0.25 percent for the year 1980 as a whole. Corresponding to this forecast of a virtually stagnant level of aggregate production, we anticipate a rise in the unemployment rate to a level of just over 7 percent for the year as a whole, and to a level above 7.5 percent by the end of 1980. The rate of price inflation—as measured by the GNP deflator—is forecast to remain at the 1979 level of 8.9 percent for calendar 1980 as a whole. By year-end, however,

## Chart 1. MQEM CONTROL FORECAST FOR 1980: OVERVIEW OF SELECTED INDICATORS

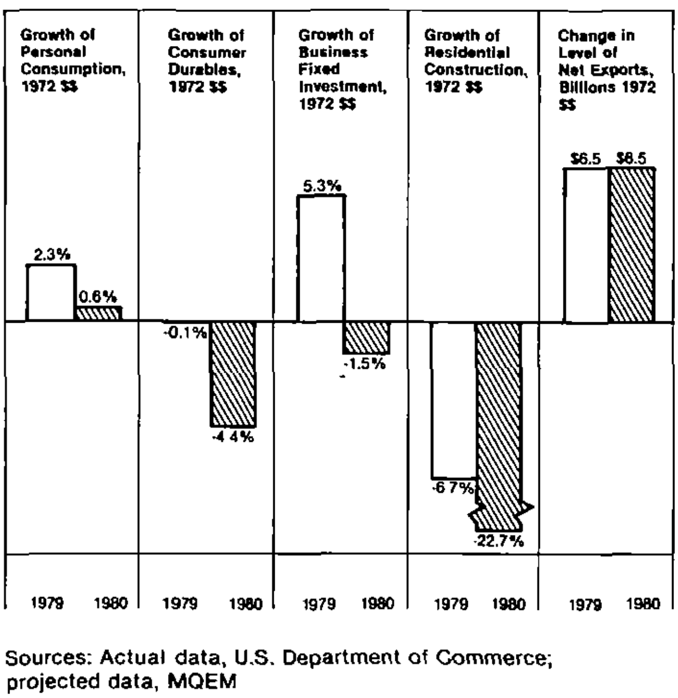



Sources: Actual data, U.S. Department of Commerce; projected data, MQEM we expect that inflation rates will have declined by about 1½ percentage points from their late 1979 and early 1980 levels. The combination of a real growth rate of -0.25 percent and an aggregate inflation rate of 8.9 percent produces a forecast increase in current dollar GNP of 8.6 percent to a level of $2,571 billion. This compares to the $2,366 billion now estimated for 1979. Personal income is forecast to grow by 9.7 percent in 1980, compared to the 11.8 percent growth rate now estimated for the current year. A similar movement is forecast for disposable income. Real disposable income, however, is forecast to remain virtually unchanged for calendar 1980 as opposed to an increase of 2 percent now expected for 1979. We note also that the forecast contains a slight fall in farm income for 1980, and only modest growth in coroprate profits (up 1.8 percent for the year).

Chart 2 presents an overview of our Control Forecast for 1980 with specific reference to the composition of aggregate demand. As indicated in the chart, real expenditures on consumer durables and residential construction show the greatest weakness with declines of 4.4 percent and 22.7 percent, respectively. Developing weakness is also apparent, however, in aggregate consumption and business fixed investment. Among the major components of aggregate demand the only real source of strength for 1980 is in net exports, and this is primarily due to the relative strength of U.S. exports of agricultural goods. In the monetary sector a small increase is forecast in the level of both short-term and long-term interest rates, although by year-end short-term rates are considerably below their peak levels of late 1979.

Annual averages and year-to-year changes often fail to reveal important aspects of ongoing economic developments. It is important to supplement this overview, therefore, with an analysis of the quarter-by-quarter path of economic activity as projected in our Control Forecast.

## Chart 2. MQEM CONTROL FORECAST FOR 1980: CHANGES IN COMPONENTS OF REAL GNP




Sources: Actual data, U.S. Department of Commerce; projected data, MQEM

## The Quarterly Path in the Control Forecast

The quarterly path of output (real GNP) contained in the Control Forecast is shown in Chart 3. It is clearly a recession path, but the quantitative details are most important:

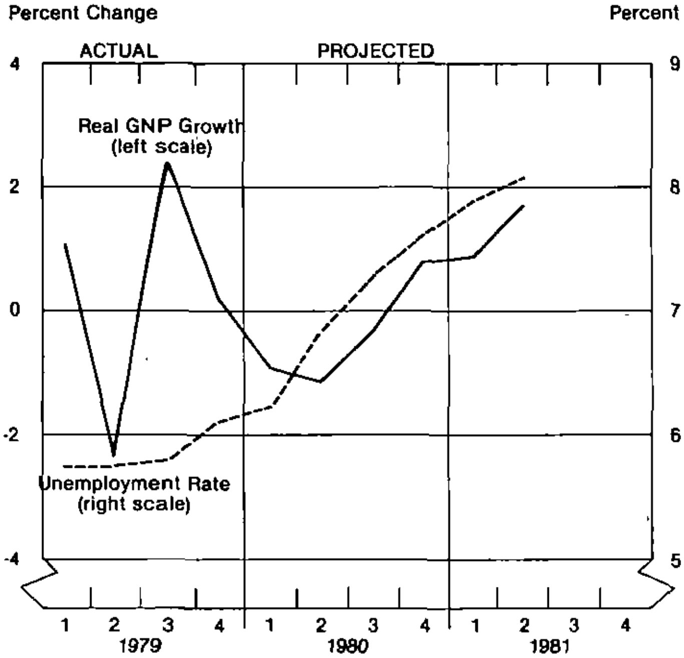
- Beginning with a rise of only 2/10 of one percent (annual rate) in 1979:4, the rate of growth of real GNP then turns negative for three successive quarters before positive growth is resumed in the closing quarter of 1980.
- The extent of the decline in real GNP—that is, the severity of the recession—is distinctly modest. In the 1980:3 trough quarter, real GNP is only about 6/10 of one percent ($8½ billion) below its preceding peak value in 1979:4. By comparison, the first three quarters of the 1975-76 recession produced a 2 percent decline in real GNP, and a further decline of 3.7 percent occurred in the next two quarters of that five-quarter-long recession.

The volatility of real GNP in the second and third quarters of 1979 effectively "masked" the basic underlying developments in the economy. In many ways a truer picture of economic developments is gained, in this instance, by considering semi-annual growth rates in GNP from mid-1978 through our forecast period. Beginning with the last half of 1978 these growth rates are as follows: 3.3 percent, 0.6 percent, zero, -0.2 percent, -0.7 percent and 0.8 percent. Thus the rather shallow "U-shaped" pattern is seen to have begun in late 1978 and to reach a trough in mid-1980.

The initial quarters of the recovery, however, are characterized by very slow growth rates. The growth in real GNP during the first half of 1981 is a very modest 1.3 percent at annual rate. This compares to an annual growth rate in real GNP of almost 8 percent in the half year immediately following the 1974-75 recession, and to a growth rate of just under 8 percent for the first year of the expansion. Thus in these terms the initial stage of recovery following the 1980 recession is very sluggish indeed. There are a number of factors at work here. One has to do with an atypical aspect of the 1980 recession. Historically, most recessions have been characterized by a progressive easing of credit conditions, which leaves the banking system in a position to accomodate the early stages of the subsequent expansion with little difficulty. In addition, the Fed has often acted to reinforce the easing of credit conditions during recessions and early expansion periods. The 1980 recession—as we forecast it—will not be characterized by such an easing of credit conditions, in part because the recession itself is so mild and, in addition, because we have assumed that the Fed will continue to pursue a policy of slow growth of the monetary base. Another special circumstance relates to energy prices, including both world prices and the rapid growth of domestic oil prices under the decontrol program. In our model, the continued rapid increase in the price of gasoline keeps the auto market from recovering as rapidly as would be the case if the same expansionary factors were at work without such increases.

Corresponding to this forecast path for real GNP, our Control Forecast implies a continuous rise in the aggregate unemployment rate throughout our forecast period (see Chart 3). Increases in the unemployment rate, however, do moderate somewhat after positive real growth rates resume in the final quarter of 1980. By year-end, however, we are predicting an unemployment rate of 7.6 percent, 1.5

**Chart 3. ANNUAL RATE OF GROWTH OF REAL GNP; UNEMPLOYMENT RATE**




Sources: Actual data, U.S. Department of Commerce; Projected data, MQEM

percentage points higher than in the closing quarters of this year. By mid-1981, we expect a further rise to a level just over 8 percent. During the first half of 1981, the resumption of positive growth rates in productivity "prevents" any rapid arrest of the rising unemployment rates despite improving real growth rates.

The sectors forecast to exhibit the greatest weakness in the 1979-80 recession are residential construction, responding to interest rates at historically high levels during this period, and the automotive sector. During our forecast period homebuilding activity reaches its trough in the final quarter of 1980, almost 36 percent below its peak activity level reached some two years earlier. A similar pattern is forecast for the automotive sector, which reaches its trough in the third quarter of 1980 about 23 percent below its peak activity level of mid-1978. Thus, in these two sectors the recession is both long and fairly deep. The forecast pattern of activity is quite different in the area of business expenditures on new plant and equipment. Here, peak levels of activity are achieved in the third quarter of 1979 followed by a continuous series of modest declines throughout the forecast horizon. From mid-1980 to mid-1981 the level of real expenditures in this sector falls by about 6½ percent, and in the second quarter of 1981 real expenditures are some 7 percent below the peak levels achieved in 1979:3. These durable goods sectors were also the weak spots in the 1974-75 recession, although the percentage declines from peak to trough during that recession were 16 percent for business fixed investment (as opposed to the 7 percent decline forecast in 1980-81), 42 percent in residential construction activity (versus 36 percent in 1980-81), and 34 percent in the automotive sector (versus 23 percent in 1980-81).

Personal income is forecast to rise 9.7 percent for the year 1980, but corporate profits (including IVA and capital consumption allowances) rise by only 1.3 percent. Corporate profits respond quickly to the negative real growth rates, and after reaching a peak of $195.3 billion in the first quarter of 1980 decline during the remainder of calendar 1980 before beginning a partial recovery through mid-1981. By the end of our forecast period, 1981:2, corporate profits rebound to about the level achieved in the third quarter of this year. Disposable income, corrected for inflation, shows virtually zero growth for calendar 1980. On a quarterly basis, real disposable income drops modestly through mid-1981 and then recovers slowly. Personal saving rates are forecast to remain close to 4 percent throughout the forecast period. By historical standards this is very low indeed.

In the presence of the continued rapid increases forecast for energy prices, the overall rate of inflation, whether measured by the GNP deflator or the Consumer Price Index, is forecast to moderate steadily, but only slowly. By mid-1981 we are forecasting a rate of inflation—as measured by the GNP deflator—of close to 8 percent. The corresponding forecast for the Consumer Price Index is 9.3 percent. Thus, while some moderation in the rate of inflation is expected, no dramatic "break" in inflation rates is anticipated through mid-1980.

Finally, short-term interest rates are expected to reach peak values in the final quarter of 1979 and to decline thereafter throughout the forecast period. We are now expecting a 12.3 percent rate for 3 month Treasury Bills in the current quarter. Thereafter we forecast a steady fall in this rate to a level of 9.8 percent in the fourth quarter of 1980, and to 8.2 percent by mid-1981. Long-term rates (the Aaa Corporate Bond Rate) are forecast to rise somewhat through mid-1980, from the 10.25 percent level now expected for the current quarter, but then to return to this level by the second quarter of 1981.

Table 2 displays additional quarterly detail from the Control Forecast.

## The Impact of Additional Tax Cuts

There has been considerable discussion in the press and in Congress concerning the advisability of various tax cut packages. In our Control Forecast we assumed the passage of legislation that would postpone the scheduled increases in Social Security taxes and establish a windfall profits tax in the oil industry along with a mechanism to return the bulk of these new revenues to households. In order to evaluate the impact of additional tax-cut stimuli on the economy we assumed the following additional tax program initiated in the third quarter of 1980:

- a cut in personal income taxes of $10 billion dollars,
- an increase in the Investment Tax Credit from 10 percent to 15 percent, and
- adoption of new accelerated depreciation schedules for both structures and equipment. In both cases we assume that the effective annual depreciation rate—for tax purposes—in increased by approximately 5 percentage points.

This additional program implies a reduction of Federal revenues of approximately $8.4 billion in calendar 1980 and $19 billion in calendar 1981. No change in Federal government expenditures or monetary policy is assumed in conjunction with this tax-cut package. The impact of this program over our forecast period (through 1981:2) can be briefly summarized as follows:

- A modest increase in the real growth rate from mid-1980 through mid-1981. With the additional

## Table 2. SELECTED ECONOMIC INDICATORS AS FORECAST BY MQEM

seasonally adjusted

| ECONOMIC INDICATOR | Quarterly Data | | | | | | | | | | Annual Data | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | ACTUAL | | | PROJECTED | | | | | | | Act. | Proj. | Act. | Proj. |
| | | | | | | | | | | | | | % Changes | |
| | 79:1 | 79:2 | 79:3 | 79:4 | 80:1 | 80:2 | 80:3 | 80:4 | 81:1 | 81:2 | 1979 | 1980 | 78-79 | 79-80 |
| GROSS NATIONAL PRODUCT | 2292 | 2330 | 2392 | 2451 | 2500 | 2543 | 2590 | 2649 | 2707 | 2771 | 2366 | 2571 | 11.2 | 8.6 |
| PERSONAL CONSUMPTION EXPENDITURES | 1454 | 1476 | 1529 | 1565 | 1602 | 1636 | 1672 | 1712 | 1750 | 1790 | 1506 | 1656 | 11.5 | 9.9 |
| DURABLE GOODS | 213.8 | 208.7 | 213.6 | 212.7 | 214.0 | 214.3 | 215.6 | 221.2 | 225.4 | 230.4 | 212.2 | 216.3 | 6.0 | 1.9 |
| AUTOMOBILES and PARTS | 97.7 | 89.1 | 89.8 | 87.2 | 86.2 | 84.9 | 85.0 | 89.6 | 92.9 | 97.0 | 91.0 | 86.4 | -0.2 | -5.0 |
| FURN. and H.H. EQUIPMENT | 82.1 | 84.2 | 88.2 | 89.3 | 91.0 | 91.9 | 92.5 | 92.8 | 93.0 | 93.2 | 85.9 | 92.1 | 10.7 | 7.1 |
| OTHER DURABLES | 34.0 | 35.4 | 35.6 | 36.2 | 36.8 | 37.4 | 38.1 | 38.8 | 39.5 | 40.2 | 35.3 | 37.8 | 12.1 | 7.0 |
| NONDURABLE GOODS | 571.1 | 581.2 | 602.4 | 617.7 | 633.4 | 648.4 | 665.0 | 680.7 | 696.3 | 712.0 | 593.1 | 656.9 | 11.8 | 10.8 |
| SERVICES | 669.3 | 686.0 | 712.3 | 734.2 | 754.6 | 773.3 | 791.4 | 810.3 | 828.7 | 847.4 | 700.4 | 782.4 | 13.0 | 11.7 |
| GROSS PRIVATE DOMESTIC INVESTMENT | 373.8 | 395.4 | 392.0 | 396.6 | 397.1 | 391.9 | 386.6 | 385.6 | 389.9 | 399.8 | 389.4 | 390.3 | 10.8 | 0.2 |
| NONRESIDENTIAL | 243.4 | 249.1 | 257.1 | 263.8 | 271.0 | 275.2 | 277.2 | 278.0 | 278.8 | 280.7 | 253.3 | 275.4 | 14.5 | 8.7 |
| RESIDENTIAL STRUCTURES | 111.2 | 112.9 | 114.9 | 114.1 | 106.9 | 96.8 | 90.0 | 88.7 | 92.3 | 100.1 | 113.3 | 95.6 | 4.9 | -15.6 |
| CHANGE in BUS. INVENTORIES | 19.1 | 33.4 | 20.0 | 18.7 | 19.2 | 19.9 | 19.3 | 18.9 | 18.8 | 19.0 | 116.9 | 120.3 | – | -- |
| NET EXPORTS | 4.0 | -8.1 | -5.3 | -6.3 | -4.6 | -2.7 | 0.7 | 4.4 | 5.8 | 7.3 | -4.0 | -0.6 | – | – |
| EXPORTS | 238.5 | 243.7 | 266.4 | 274.9 | 283.6 | 292.5 | 301.3 | 311.4 | 321.2 | 331.9 | 255.9 | 297.2 | 23.5 | 16.2 |
| IMPORTS | 234.4 | 251.9 | 271.7 | 281.2 | 288.2 | 295.2 | 300.6 | 307.0 | 315.4 | 324.6 | 259.8 | 297.8 | 19.5 | 14.6 |
| GOVERNMENT PURCHASES | 460.1 | 466.6 | 476.2 | 495.7 | 505.4 | 517.8 | 530.6 | 547.1 | 560.6 | 574.3 | 474.7 | 525.2 | 9.0 | 10.7 |
| FEDERAL | 163.6 | 161.7 | 162.5 | 173.7 | 174.9 | 178.6 | 182.4 | 189.7 | 193.7 | 197.7 | 165.4 | 181.4 | 8.4 | 9.7 |
| NATIONAL DEFENSE | 103.4 | 106.0 | 108.5 | 113.7 | 116.9 | 120.1 | 123.4 | 129.2 | 132.6 | 136.0 | 107.9 | 122.4 | 9.0 | 13.4 |
| . OTHER | 60.2 | 55.7 | 54.0 | 60.0 | 58.0 | 58.5 | 59.0 | 60.5 | 61.1 | 61.7 | 57.5 | 59.0 | 7.2 | 2.7 |
| STATE and LOCAL | 296.5 | 304.9 | 313.7 | 322.0 | 330.5 | 339.2 | 348.2 | 357.4 | 366.9 | 376.6 | 309.3 | 343.8 | 9.3 | 11.2 |
| GROSS NATIONAL PRODUCT DEFLATOR, 1972=100 | 160.2 | 163.8 | 167.1 | 171.2 | 175.1 | 178.6 | 182.0 | 185.8 | 189.4 | 193.1 | 165.6 | 180.4 | 8.9 | 8.9 |
| REAL GROSS NATIONAL PRODUCT (billions of 1972 dollars) | 1431 | 1422 | 1431 | 1431 | 1428 | 1424 | 1423 | 1426 | 1429 | 1435 | 1429 | 1425 | 2.1 | -0.3 |
| AGGREGATE UNEMPLOYMENT RATE (percent) | 5.7 | 5.7 | 5.8 | 6.1 | 6.4 | 6.9 | 7.3 | 7.6 | 7.9 | 8.1 | 5.9 | 7.1 | – | – |
| CORPORATE PROFITS plus IVA and CCA | 178.9 | 176.6 | 189.4 | 193.8 | 195.3 | 189.7 | 183.9 | 183.4 | 184.6 | 188.7 | 184.7 | 188.1 | 10.2 | 1.8 |
| PERSONAL DISPOSABLE INCOME | 1572 | 1602 | 1637 | 1675 | 1714 | 1750 | 1796 | 1837 | 1876 | 1915 | 1621 | 1774 | 11.2 | 9.4 |
| REAL DISPOSABLE INCOME (billions of 1972 dollars) | 996.6 | 993.0 | 990.3 | 990.1 | 989.9 | 989.6 | 995.6 | 998.9 | 999.7 | 1000 | 992.5 | 993.5 | 2.0 | 0.1 |
| PERSONAL SAVING RATE (percent of disposable income) | 5.0 | 5.4 | 4.1 | 4.0 | 3.9 | 3.9 | 4.3 | 4.2 | 4.1 | 3.9 | 4.6 | 4.1 | – | -- |

Note: All data are in billions of current dollars unless otherwise indicated.

Sources: Projections by Research Seminar in Quantitative Economics, University of Michigan; actual data from Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

stimulus, a growth rate of 1.2 percent is achieved as compared to the 0.75 percent of the Control Forecast.

- A very modest strengthening of real business fixed investment expenditures by mid-1981.

Because of the lags involved, however, the full impact of this program is not measured during our forecast horizon. A more meaningful exercise is to assess the effects of such a tax stimulus program 8 quarters after the program has been initiated. By this time the effects of the program have been more fully worked out. The impact of this program over an 8 quarter period is illustrated in Charts 4 and 5. At the end of the two year period, real GNP has risen by an additional $15½ billion, allowing a reduction of 0.4 percentage points in the aggregate unemployment rate (see Chart 4). Further, there is little, if any, inflationary impact of the program as the improved productivity thereby generated permits a greater level of output without added inflation. At first the source of this improved productivity performance is largely cyclical, but as time passes some impact is felt from the installation of new capital as well. Also interesting are the data presented in Chart 5, which sets out the gains in investment and consumption from this stimulus policy. As one might expect, the consumption effects occur relatively quickly while the impact on investment expenditures lags somewhat. By six quarters out, the two effects are approximately equivalent; subsequently the investment effects dominate. By eight quarters out, we have an additional $6.4 billion in real consumption and $10.0 billion in new investment (1972 dollars). As noted above, the total impact on real GNP is approximately $15.5 billion—just over one percent of its level.

## Concluding Comments

Our Control Forecast reflects our expectation that the U.S. economy will pass through a recession in the coming year, although the expected loss in output is relatively modest by historical standards. In such an environment it might be reasonable to expect some additional monetary and fiscal stimulus, especially since the first three quarters of the year, just prior to a national election, are forecast to be characterized by declining real GNP and rising unemployment rates. However, because inflation is expected to remain close to the two-digit level and so much uncertainty exists regarding energy supplies—both domestic and foreign—we believe that the most likely tax stimulus package will be limited to the payroll tax item incorporated into our Control Forecast. In fact, the Control Forecast already includes a turn to somewhat greater monetary ease by mid-1980, and the impact of this policy change is of some importance in turning around the declines in GNP that are forecast for the first three quarters of 1980. Our best judgment, therefore, is that the Control Forecast contains the most likely configuration of economic policy over the forecast horizon.

We have made no special allowance for the existence of wage/price guidelines. But our Control Forecast contains increases in wages and prices of approximately 9 percent, and we believe this to be the outcome most likely to accompany the constraints suggested by the Administration.

Finally, one cannot overlook the possibility that short-run "bottle-necks" induced by the disruption of energy supplies (either crude oil from abroad or domestic distribution difficulties) could have a sharp effect on the economic outlook, very much as we experienced in the second quarter of 1979. We have made no specific provision for such an event.

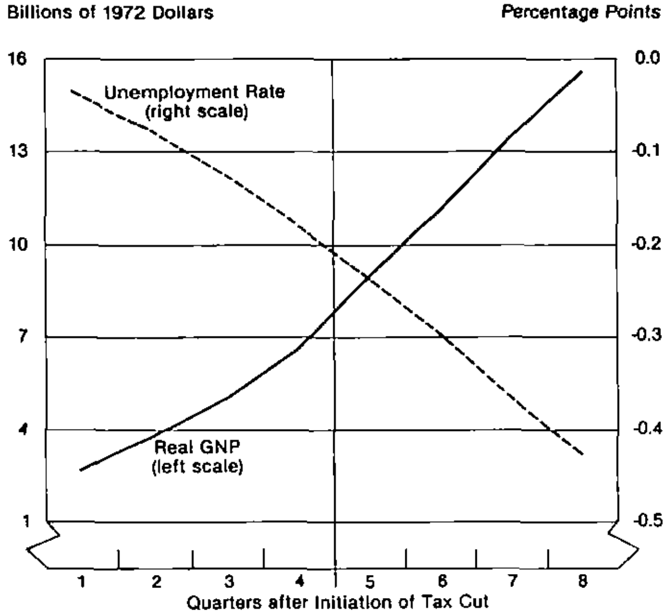
In summary, we view the economic outlook over the next year and a half as having very sluggish real growth accompanied by slightly lower inflation rates. In this context unemployment rates can be expected to rise steadily. The recovery forecast from the recession which we expect to characterize the first half of 1980, however, is critically dependent not only on our assumption of a modest easing of monetary policy after mid-year, but also on the postponement of scheduled Social Security tax increases. Indeed, it seems appropriate to us to give careful consideration to additional tax stimulus programs in mid-1980.

*November 1979*

**Addendum:** The preceding analysis was completed early in November for presentation at the University of Michigan's Economic Outlook Conference in mid-November. The availability of new information led us to update the Control Forecast for internal purposes in late December. In particular, the estimate of the growth rate of real GNP for 1979:3, as reported by the Department of Commerce, was revised from a preliminary figure of 2.4 percent to 3.1 percent at annual rate. In addition, the scheduled meeting of the OPEC oil ministers resulted in substantially higher oil prices including a 33 percent increase in the price of Saudi Arabia's marker crude. Further, in the area of fiscal policy, the rollback of the Social Security tax increase for 1980 no longer appears probable.

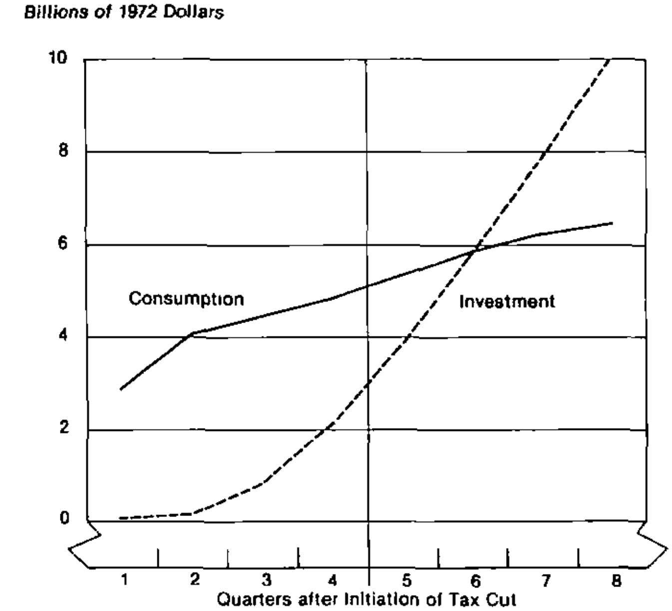
The general pattern of our forecast for 1980 remains unchanged—including the relative movements of the components of real output as well as the paths of the broader aggregates. The growth rate of real GNP in the updated version of the forecast remains positive for the final quarter of 1979 at a 1 percent annual rate. A three quarter recession follows with the sharpest drop in real growth (-2.7 percent) occurring in the first quarter of 1980. In the final quarter of 1980 the economy returns to slow positive growth—again about 1 percent. Our projection of the rate of inflation for calendar 1980, as measured by the GNP deflator, remains unchanged from our November forecast at 8.9 percent while we anticipate an unemployment rate of about 7 percent for the same period.

**Chart 4. INCREASE IN REAL GNP AND DECREASE IN UNEMPLOYMENT RATE DUE TO TAX CUT POLICY**




Source: MQEM

**Chart 5. INCREASE IN REAL CONSUMPTION AND BUSINESS FIXED INVESTMENT DUE TO TAX CUT**




Source: MQEM

# The Uncertain 1980s

**Paul W. McCracken**
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The American economy and decennial years have not had a notably harmonious relationship during the last century. For those with numerological inclinations, this may be another reason for worry as 1980 and the new decade come on stage. Of the ten decennial years during the last century, including 1980, two (1940 and 1950) escaped being associated with bad news for the direction of the general economy, and they had the stimulus of a rapid expansion in outlays for national security to push things along.

If 1980 breaks this century-old pattern and moves upward throughout, the few hardy souls in the profession still practicing macro-economics will be sitting before their drafting boards with brows really furrowed deeply. In the December monthly round-up of 42 economists' forecasts by Eggert Enterprises, only six did not predict a lower level of economic activity in real terms for 1980 than for 1979, the average projected decline for the 42 being 1.1 percent. And one of the six was Mr. Eggert himself who chose not to take sides and projected no change year-to-year. This expectation of a recession seems to be shared by the econometric services, most of whose models, after exercising their numerous equations, produce projections pointing to about the same slippage in the economy.

## The Effects of Government Economic Policy

There are these points to make about this outlook. While predictions about a recession earlier in 1979 were, like the report of Mark Twain's death, exaggerated, they were (as also with the Twain report) in the final analysis simply premature—attaching too much significance to the sharp second-quarter drop in auto sales that reflected our gauche handling of gasoline problems rather than any general recession. Evidence about the state of the economy as we move into 1980 is more insistently pointing to a recedence in business activity this year. Basic fiscal and monetary policies themselves point in that direction. Actually budget policy has remained on a reasonably restrained and steady course. The rise in Federal outlays, probably the best crude measure of the thrust or push of the budget on the economy, was at a 10 percent rate in 1979—about the rate at which the economy itself was rising. And a slightly larger rise is projected for the current fiscal year (1980). Since something like this pace seems destined to continue, fiscal policy is not apt to deflect the economy from its path. That means it will not have caused a recession. It also means, however, that fiscal policy has done little to counter the economic pressures giving us double-digit inflation.

**INCREASE IN FEDERAL OUTLAYS OVER PREVIOUS FISCAL YEAR**

| Fiscal Year | Total | Nondefense |
|---|---|---|
| 1978 | 11.9% | 13.2% |
| 1979 | 9.5 | 9.1 |
| 1980 | 10.8 | 11.5 |

Source of basic data: Office of Management & Budget

Monetary policy has, therefore, had to carry the load. The sharp shift last October to a less expansive monetary policy was urgent and tardy. Indeed, the Federal Reserve would have to be assigned and academic grade of "F" for its performance during 1978 and 1979 up to the change in policy last October. The basic rate of expansion being established for the economy is about one percentage point higher than the rate of expansion of the broadly defined money stock ($M_2$). The Federal Reserve's policies in 1978 first allowed rates of expansion for $M_2$ in the 11-12 percent zone, and after a spasm of courage toward the end of that year allowed the rate of expansion to move into the 12-13 percent range in 1979—this in an economy whose capacity to increase real output had been reduced, as a result of government policies, to not over 3 percent per year.

**INCREASE IN THE MONEY STOCK, 1979***

| Quarter | $M_2$ |
|---|---|
| First | 1.7% |
| Second | 11.9 |
| Third | 12.8 |
| Fourth (est.) | 7.0 |

*Seasonally adjusted at annual rate
Source of basic data: Federal Reserve System

Double-digit inflation was the inevitable result of these policies, they had to be changed, last October they were, and the results were already showing up in monetary data during the final quarter of 1979. This sharp change of direction was made necessary by the earlier failures of policy, but only in an economy enjoying an exceptional degree of internal balance would it be reasonable to expect no recedence in the economy from such actions. The economic scene as 1980 opens is not that serene.

## Problem Areas

These actions are having the expected adverse effect on housing construction, and "starts" in 1980 will amost certainly be down 15-20 percent or so from 1979 levels. The only consolation to be found in this picture is that the decline would have been worse except for measures to keep funds more available for mortgage lending.

Inventories as the economy moved along through 1979 were becoming a bit heavy relative to the volume of sales. The excess was not large, far smaller than in 1974 before that downturn, but the sharply higher credit cost of carrying inventory will put pressures on businesses to pare down these stocks. That in turn means reduced production schedules, at each point in the chain, for suppliers.

The most serious imbalance in the economy is to be found in consumer buying. For one thing even the sluggish pace of retail trade during the closing months of 1979 was

| INVENTORIES AS A PERCENT OF FINAL SALES* | |
|---|---|
| Year:Quarter | Percent |
| 1969:2 | 24.1% |
| 1974:2 | 25.7 |
| 1979:3 | 24.0 |
| Average of reasonably balanced quarters, 1973-78 | 23.6 |

*Seasonally adjusted, 1972 dollars
Source: U.S. Department of Commerce

pushing consumers hard. They were, in fact, saving about 2 percentage points less of their incomes than during most of the 1970s. While lurid worries about a collapse from too much consumer debt are over-drawn, consumer spending cannot be expected to continue running as high relative to their incomes as during the latter part of 1979.

The most dreary part of the retail sales picture has, of course, been sales of new domestically produced cars as uncertainties about availability of gasoline emerged in 1979. While supplies world-wide were tight, it was our insistence on keeping U.S. prices below world levels, and on having Government rather than markets allocate, that forced the U.S. to absorb a disproportionate share of the gasoline shortage.

At chic cocktail parties it is fashionable, particularly on the part of intellectuals, to explain the problem away by accusing the U.S. automobile industry of not producing cars that the public wants. The fact is that the domestic industry was on an orderly down-sizing program. It was, in fact, moving a bit more rapidly in that direction than buyers preferred—as indicated by the fact that relative to supply it was the demand for small cars that was sluggish through 1978. In 1979 the ineptitude of our energy policies, creating unnecessary filling station lines, then caused new-car buyers in panic to run to the other side of the ship. The serious unemployment in the automobile industry today is more "Made in Washington" than created by OPEC or in Detroit.

## Areas of Strength

Two major areas of the economy will sustain the economy through 1980. Compared to 1979, businesses continue to plan for larger outlays, in real terms, to expand and improve their production facilities. This reflects in part a pervasive conviction in the business community that sharp slashes in their capital budgets in the 1974-75 recession were not wise. These drastic cuts left many businesses short of capacity and forced to re-activate some of those cancelled projects at much higher costs. Unless the general business situation develops into a cumulative decline, capital budgets this time will be better sustained.

Our export market will also, in real terms, be stronger than 1979—itself a good year. During the year ending with the third quarter of 1979 our merchandise exports showed a gain of 30 percent, compared with a gain of 11 percent in GNP (or 2 percent in real terms). Moreover, the increase in these exports was equal to 19 percent of the increase in our GNP, and equal to 47 percent of the increase in our output of goods (tangible products). While our important export customers (Canada, Japan, Germany, the U.K.) are reining in their domestic economies, having their own problems with inflation, they will continue to show some gains. U.S. exports should, therefore, rise further in 1980—though not at the dramatic rate of last year.

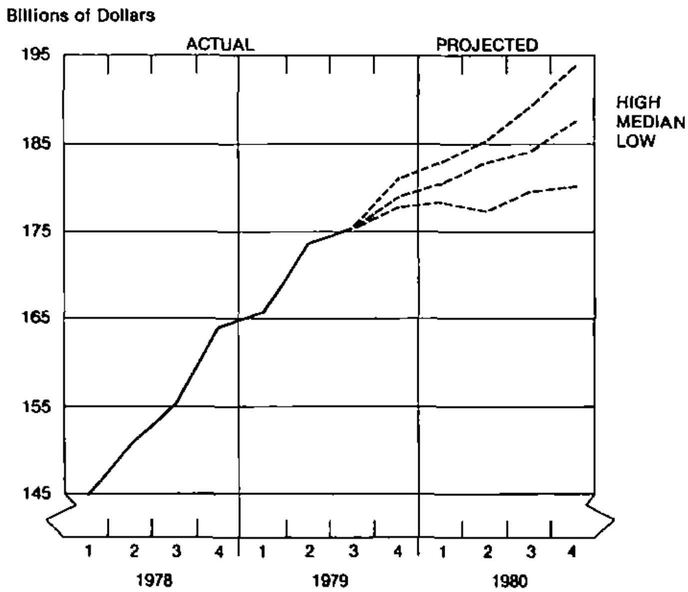
## Summary Outlook

Mr. Eggert's economists are probably realistic. When all of the cross currents are taken into account, the volume of output in real terms this year will be down about 1 percent, the rate of inflation should be a point or so lower, and the unemployment rate will be up a point or two. If that will start us on the path to the lower rates of inflation and unemployment, and stronger sustained gains in real income, that have characterized the U.S. economy historically, 1980's trauma will have been a worthwhile investment.

As the year opens, we cannot ignore contingencies which, if they were to materialize, would have Gargantuan repercussions on the economy. If the Middle East were to erupt and its oil become unavailable to the rest of the world, the adverse impact would be of Stygian proportions. Wars historically have been fought over lesser threats than this to vital interests. Indeed, this era is starting to take on some of the personality of that which led up to World War II. Economists, however, have enough difficulty forming judgments about matters properly considered to be within their purview—without reaching for those beyond their horizon.

*December 1979*

**BUSINESS CAPITAL OUTLAYS**



Sources: Actual data, U S Department of Commerce; projected data, ASA-NBER Panel of Forecasters.

# Forecasts for 1979 and 1980: An Assessment and A Survey

**Victor Zarnowitz**
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How well did economic forecasts fare in 1979? How is the economy doing now? What is being predicted for 1980 and why? Traditionally, this is the time of year to raise such questions, and we have done so in this space annually since 1975.

## A Postmortem on the 1979 Predictions

The median forecasts from the November 1978 ASA-NBER survey over-estimated slightly the 1978-79 annual percentage change in real GNP and underestimated significantly the corresponding change in the implicit price deflator (column 5 in the table below). As a result, the rise in nominal GNP this year was predicted with a small error on the low side. The error in predicting too low a rise in current dollar outlays on plant and equipment also can be viewed as relatively small. The decline in housing starts was predicted very accurately. However, the forecasters were definitely too pessimistic on industrial production, the unemployment rate, corporate profits, and business inventory investment.

**THE ECONOMY IN 1979:**
**PREDICTED VS. ACTUAL CHANGES**

| | Quarterly Changes | | | | Annual Changes | |
|---|---|---|---|---|---|---|
| | 1978:4-1979:1 (1) | 1979:1-1979:2 (2) | 1979:2-1979:3 (3) | 1979:3-1979:4 (4) | 1978-1979 (5) | 1978:4-1979:4 (6) |
| **GNP in current dollars[a]** | | | | | | |
| Predicted | 2.4 | 1.9 | 2.3 | 1.7 | 10.2 | 8.6 |
| Actual | 2.6 | 1.6 | 2.8 | 1.8 | 11.0 | 8.9 |
| **GNP in constant dollars[a]** | | | | | | |
| Predicted | 0.5 | 0.3 | 0.3 | 0.4 | 2.4 | 1.4 |
| Actual | 1.1 | -2.3 | 3.5 | -0.4 | 2.0 | -0.1 |
| **Implicit price deflator[a]** | | | | | | |
| Predicted | 1.8 | 1.8 | 1.6 | 1.6 | 7.4 | 7.0 |
| Actual | 2.2 | 2.2 | 2.0 | 2.3 | 8.8 | 9.1 |
| **Index of industrial production[a]** | | | | | | |
| Predicted | 0.7 | 0.7 | -1.3 | 0 | 2.8 | 0 |
| Actual | 1.0 | -0.2 | 0.2 | -1.1 | 4.5 | 3.3 |
| **Unemployment rate[b]** | | | | | | |
| Predicted | 0.1 | 0.2 | 0.2 | 0.1 | 0.4 | 0.6 |
| Actual | -0.1 | 0 | 0.1 | 0.4 | -0.1 | 0.4 |
| **Corporate profits after taxes[a]** | | | | | | |
| Predicted | 0.6 | -1.4 | -1.2 | 1.6 | 6.0 | -0.4 |
| Actual | 7.3 | -1.9 | 6.2 | -5.4 | 17.0 | 5.8 |
| **Business expenditures on new plant and equipment[a]** | | | | | | |
| Predicted | 3.0 | 2.1 | 1.4 | 1.7 | 10.8 | 8.4 |
| Actual | 1.2 | 4.5 | 1.0 | 2.1 | 12.7 | 9.2 |
| **New private housing units started[a]** | | | | | | |
| Predicted | -6.6 | -7.0 | -5.2 | -1.8 | -13.7 | -19.2 |
| Actual | -22.3 | 13.6 | -0.2 | -8.8 | -13.9 | -19.7 |
| **Change in business inventories[c]** | | | | | | |
| Predicted | -0.5 | -3.5 | -0.8 | -2.7 | -3.7 | -7.5 |
| Actual | -1.5 | 14.3 | -18.1 | -5.0 | 7.8 | -5.6 |

[a]Percent changes.

[b]Differences, percent of labor force.

[c]Differences, billions of dollars.

Sources: *Predicted* changes are based on median forecasts from the November 1978 ASA-NBER survey. *Actual* changes are based on figures reported in the November 1979 issue of *Business Conditions Digest* for the four quarters 1978:4 - 1979:3 and on median forecasts from the November 1979 ASA-NBER survey for 1979:4 and 1979.

The comparisons between 1978:4 and 1979:4 (column 6) reflect the slowdown in economic activity that began a year ago much more strongly than do the 1978-79 (year-to-year) comparisons. The slowdown was reasonably well predicted by most forecasters, though its impact on real GNP was somewhat understated and its impact on industrial production and profits was overstated. The survey certainly deserves high scores for the 1978:4-1979:4 forecasts of business fixed and inventory investment and of housing starts. The underestimation of the inflation rate by about 2 percentage points is the most serious error here.

A year ago the prevailing view was that the economy would grow slowly in 1979, not that it would turn down, so that no quarterly declines in real GNP were specified in the median forecast (columns 1-4). Those who predicted an outright recession were still in a minority. During the first half of 1979 forecasters grew more and more pessimistic, and projections of declining activity both spread and deepened. But the events soon contradicted the predictions of a sustained contraction in total output beginning in the spring or summer. The pattern of movement that did materialize—down in the second and up in the third quarter—was generally unanticipated even six months after the forecasts reviewed here. For example, the median predictions from the May 1979 ASA-NBER survey had fractional declines of real GNP in 1979:2 and 1979:3 followed by a small rise in 1979:4.

The actual values for 1979:4 and the year as a whole are, of course, still unavailable at this time; those in the table are the average projections from the latest ASA-NBER survey, which reflect the prevailing expectations of a downturn. Should the economy perform better (worse) than these figures indicate, the year-ago forecasts in columns 4-6 will prove to be more (less) accurate than the table suggests.

## The State of the Economy

Notwithstanding the sizable quarter-to-quarter variations in real GNP and the continued, though slowed, uptrend in employment, the basic fact remains that the U.S. economy has been hardly growing since the beginning of 1979. This is perhaps best shown by the flat course of the index of four roughly coincident indicators (nonfarm employment, personal income less transfer payments, industrial production, and real manufacturing and trade sales). This index has a good claim to serve as a monthly measure of overall economic activity, and its recent behavior is summarized in the tabulation that follows. The rise in employment was in recent months limited to the cyclically rather insensitive service industries; in the goods-producing sector, employment seems to have peaked and real wages and salaries to have declined. Total employment has been increasingly lagging at peaks in the recent business cycles. The more sensitive coincident indicators are now all showing local trends that are either horizontal or mildly downward.

| | 1978:4 | 1979:1 | 1979:2 | 1979:3 | 10-11/1979 |
|---|---|---|---|---|---|
| Leading index | 143.1 | 142.8 | 140.1 | 140.0 | 137.5 |
| Coincident index | 144.3 | 145.4 | 144.9 | 145.0 | 144.8 |
| Lagging index | 152.0 | 158.2 | 162.8 | 167.6 | 179.2 |

At the same time, as is also shown in our summary, the index of twelve leading indictors, which tends to foreshadow the cyclical movement of the economy, has been drifting downward from a peak reached in October 1978. This is a slow but widely diffused drift, which extends to various series of marginal employment adjustments (hours of work, layoff rate, unemployment insurance claims), capital investment commitments (deflated new orders and contracts, housing starts and permits), real inventory investment, purchasing, delivery periods, profit margins, and certain comprehensive money and credit flow indicators.

In sharp contrast to the weakness of most leaders and coinciders, the series that tend to lag at business cycle turns have risen strongly this year. Those increases in interest rates and private debt aggregates, unit labor costs and inventories embody growing cost burdens to producers and thus have an adverse aspect when they accompany an economic slowdown. It is true that inflation mitigates these burdens by lowering the real costs of labor and finance to the firms that are able to raise their selling prices commensurately. But this ability is by no means equally distributed or unchanging, and the disparities are bound to increase both when inflation continues uncurbed and when it is curtailed by tightening of money and credit.

Developments such as those just described typify an economy in transition from an advanced expansion to a major slowdown. But a slowdown may end either in renewed expansion or in a generalized decline (recession), and the problem is that the signals do not differentiate well in advance between the two latter alternatives. A comparison of patterns of the current and past slowdowns presented in the previous issue of ECONOMIC OUTLOOK USA led to the suggestion that these measures, though permitting no firm conclusion, "lean toward the alternative of a recession." An updated comparison confirms this judgment, even though it includes some new information which shows the economy to be remarkably resilient (real GNP in 1979:3, unemployment in November). Both the leading and the coincident indexes, and most of their components, trace an intermediate course in their current patterns, below the average of the three previous slowdowns that did not become recessions but above the average of the six that did. With data covering the first ten months of the present retardation (tentatively dated as having begun in December 1978), the patterns suggest that this episode now resembles more a mild recession in its early stages than a passing interlude of shallow growth rates.

In contrast to the uncertainties about the elusive recession, there is no doubt at all about the fact that inflation rates have continued to soar. This is quite unlike the average cyclical patterns for the principal price indexes, all of which show inflation moderating during past slowdowns as well as recessions, but there is an obvious and important precedent in 1973-74. Actually, the lag in response of the inflation rates to onsets of sluggish business conditions has been increasing for many years now as people have learned to expect that inflationary policies will be pursued most of the time in peace or war, expansion or contraction.

The Fed's credit-tightening moves of early October were widely viewed as a major turn away from such policies toward a strategy of combating inflation by containing growth in the monetary aggregates. But the entrenched inflationary expectations will not be reduced permanently to much lower levels unless the policies of monetary and fiscal moderation are implemented consistently long enough to demonstrate that they can bring down and keep down the actual inflation rates. This will take considerable time. Meanwhile the short-run effect of curtailing the growth in bank reserves and letting interest rates move freely will be to make credit immediately more expensive and gradually less available. As a result, real economic activity will be lower than it would be otherwise.

Amidst much uncertainty about this novel course of action, the events begin to tell a story that is largely consistent with the above assessment. Since October 6 the growth of monetary aggregates has slowed and interest rates have risen substantially. Most recently, the demand for bank loans sagged, reflecting weaker business conditions, and market interest rates retreated a little from their peak levels. While remaining high by any reasonable measure, inflation was at least not accelerated still further. Contrary to a popular but faulty argument, the new rises in energy costs (like the old ones) do not compel a monetary accommodation and need not frustrate counter-inflationary action; however, it is surely true that they will hurt economic activity. The upward movement of the dollar was cut short, partly because the Fed's activities turned out to be less drastic than initially expected and partly because of foreign developments (new Mideast turmoil, higher European interest rates).

## The Outlook for 1980

The prognosis grows out of the diagnosis, and after the preceding account it should not be surprising that economists expect the new decade to open on a rather cheerless note. (However, many look forward to favorable longer trends, particularly those who attach new hopes to anti-inflationary attitudes and policies.)

The median forecasts from the latest ASA-NBER survey show real GNP moving down in 1979:4 and the first half of 1980 at an average annual rate of about 2.9 percent. In the second half a sluggish initial recovery is to occur at a rate of 2.4 percent. The implied "shallow saucer" pattern resembles the movement observed in some mild recessions (1960-61, 1970) and contrasts with the "V-type" transitions at the end of steeper declines (1957-58, 1974-75). Industrial production movements will show the same timing but larger relative amplitudes: 4.7 percent down from a peak in 1979:1 to a trough in 1980:2, then up 3.2 percent in the second half of 1980. The time profiles of most individual forecasts are similar.

The unemployment rate will rise from 5.9 percent in 1979 to an average 7.3 percent in 1980. Early next year it is projected to reach 6.8 and in 1980:4 7.5 percent. Few of the surveyed predictions deviate from these averages by large margins.

Corporate profits after taxes are expected to decline from $148 billion in 1979:3 to $130 billion in 1980:2, then rise to $136 billion in 1980:4 (the figures are in current dollars at annual rates). This would be a relatively small and short movement compared with past cyclical declines in profits.

The forecasters are relatively pessimistic on the prospects for business fixed investment. They see the current-dollar expenditures on plant and equipment as rising about 4.8 percent between 1979:4 and 1980:4, which might mean a decline of 3 to 4 percent in real terms. The Commerce survey of business plans for capital spending released more recently (but conducted in late October and November) indicates a 5.9 percent increase between the second half of 1979 and the first half of 1980, which raises the possibility of some small real gain. For business inventory investment, on the other hand, the ASA-NBER survey foresees only a moderate downward adjustment, which does not turn negative.

Private housing starts, now estimated at 1.7 million units annual rate, are to fall to 1.4 million units in both 1980:2 and 1980:3, then to recover partially to 1.6 million units. The year-to-year comparisons yield declines of 13.9 percent for 1978-79 and 15.5 percent for 1979-80.

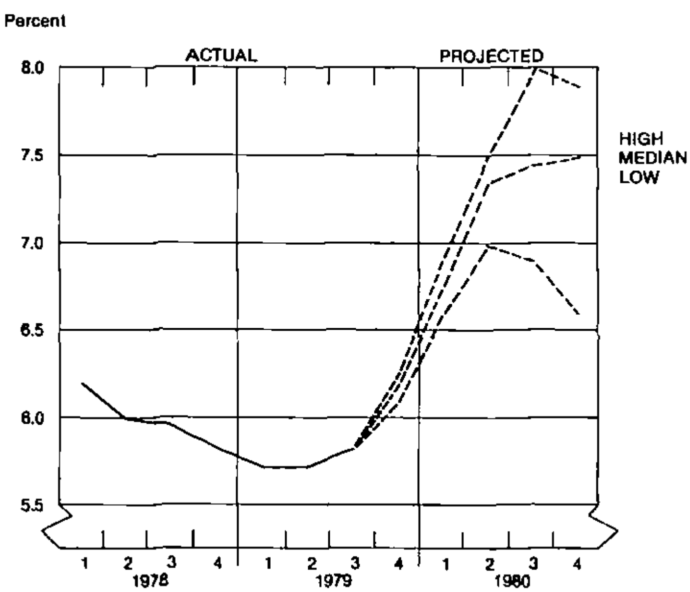
Consumer expenditures for durable goods, having already lost some 3.8 percent in real terms between 1978:4 and 1979:3, will continue to be a source of comparable weakness. In current dollars, their average level in 1980 is to be about the same as in 1979, but here too a weak recovery is expected to occur in the second half of next year.

The one positive element in the forecast is that the recession will be associated with a downturn in inflation. The annual rates of inflation, in terms of the implicit price deflator, are expected to hover between 8.2 percent and 8.5 percent in the first three quarters of 1980 (down from 9.7 percent in 1979:4), then to come down to 7.7 percent in 1980:4. Thus the survey suggests that inflation is at its peak right now and will drift down considerably next year. There is a high degree of consensus on that among the forecasters. Many report that they assumed an unchanged or tightened monetary policy, none that the policy will be eased; instead a tax cut between $15 billion and $25 billion is a frequent assumption.

Averages of other recently published forecasts by individual economists and teams operating econometric models resemble broadly the medians from the ASA-NBER survey. But this year the averages conceal come unusually large disparities among the forecasters. There are a few optimists who still foresee merely a slowdown or a *very* mild and short recession ending early next year and a few other who anticipate that the decline will extend into the second half of 1980 or begin only at mid-year. In short, the uncertainty about the prospects for the U.S. economy, heavily aggravated by international and domestic political factors, is as great as ever at the onset of this new decade.

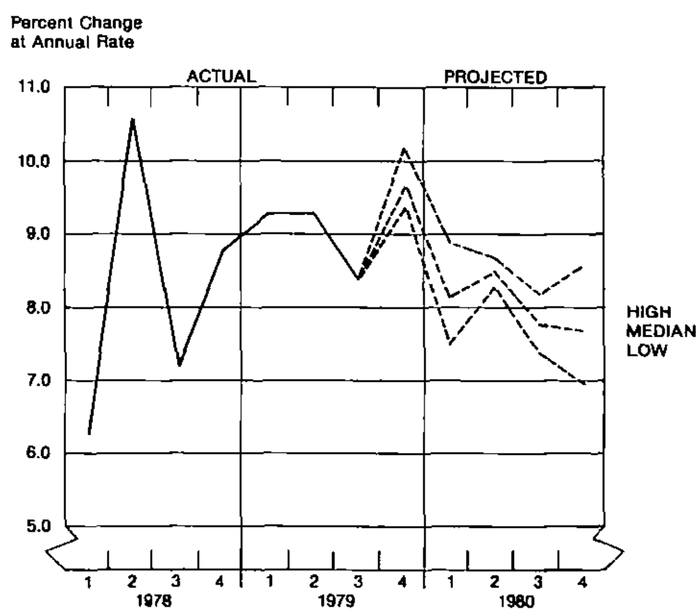
*December 1979*

## UNEMPLOYMENT RATE




Sources: Actual data, U.S. Department of Commerce; projected data, ASA-NBER Panel of Forecasters.

## GNP IMPLICIT PRICE DEFLATOR




Sources: Actual data, U.S. Department of Commerce; projected data, ASA-NBER Panel of Forecasters.

# The Recession of 1980: Real or Imaginary?

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As the decade of the 1980s dawns, economic forecasters are trying to resolve a number of questions concerning the near-term outlook and are puzzling equally hard over questions, perhaps more important ones, concerning economic prospects over the decade.

## Short-Term Uncertainties

For at least a year now, a significant majority of the forecasting fraternity has been expecting a recession to occur, including this writer. Most expected this recession to begin last year, while a few saw weakness emerging toward the middle or end of 1978. When data came in for the second quarter of 1979, a typical view was that the long-heralded recession had begun: automobile sales were weak, housing starts looked shaky, and nobody thought that consumers would continue pushing the saving rate down from its abnormally low level of roughly 5 percent in order to provide further sustenance for economic advance.

But the third quarter rebound surprised most everybody, the second quarter data didn't look quite as weak when revised as they did originally, and the economy entered the fourth quarter of 1979 with the year looking essentially flat rather than down. While the fourth quarter is not yet in, the preliminary guess is that it will show essentially no change in real activity, despite the pall cast on the economy by the rapid run up of interest rates during the last several months.

A typical view of 1980 prospects is that we will witness a recession of moderate severity, with year-to-year changes in real output showing 1980 about one percentage point lower than 1979, a peak-to-trough decline of perhaps 3 percent, and a slow recovery beginning late in 1980 and continuing through 1981.

Much of the puzzlement surrounding 1980 prospects rests in trying to figure out what consumers will do next. It is widely expected that the fourth quarter saving rate will be down to the unheard-of rate of 3 plus percent. A typical econometric model forecast has the saving rate wandering around between 3 and 4 percent during 1980 and, for that matter, 1981 as well. That seems hard to believe, given history, unless the world has really changed dramatically and consumer behavior has significantly altered in response to that change—which is possible. But the wary forecaster should keep in mind that it was not too many years ago—1975 to be exact—when saving rates were running around 8 percent, and the typical econometric model forecast had rates over 8 percent continuing during the next year. In short, conventional models almost inevitably make the future look much like the recent past, and if the recent past has been strange, the typical model will project that peculiarity into the future.

Why were saving rates down at the 3-4 percent level during the latter part of 1979, as apparently was the case? It's not too difficult to invent plausible reasons, although demonstrating that they account for the highly unusual saving behavior of American consumers is difficult, perhaps impossible, given our present statistical knowledge.

One obvious explanation is that the numbers are simply wrong: a statistical system that functions well when inflation rates are 2-6 percent does not necessarily function equally well when inflation rates are 10-13 percent. For example, certain types of income may tend to be badly reported more often when inflation rates are high, and estimated saving is after all the residual difference between estimates of income and estimates of consumer spending.

Many analysts point to the behavior of mortgage debt and the housing market as a major part of the explanation for low saving rates: in a market with rapidly rising housing prices and rapidly rising equity, anyone who sells a house realizes a substantial amount of cash, and not all that cash is necessarily put into purchasing another house. There is some evidence to support that line of thought, since housing mortgage debt has continued to be substantially larger than can be accounted for by mortgages incurred to buy newly built housing. Or possibly consumers are shifting money into goods by acquiring items like art objects, gold coins, jewelry, and what have you, all of which are really investment and saving but are measured as consumption the way we keep economic accounts in the U.S.

The data from the *Surveys of Consumer Attitudes,* reported elsewhere in this publication, are clearly consistent with the notion that consumers have been spending at a high rate during 1979 because of inflationary expectations; hence explanations that rest on people buying tangible assets of various sorts as the best way to hedge against inflation are behaviorally plausible. But toward the end of 1979, the survey data clearly show that speculative buying motivations were dropping sharply, in effect being overcome by concerns about high interest rates (affecting both housing and durables) and perceptions that prices were too high (affecting durables primarily.) Thus if speculative buying is the basic explanation for the low saving rates in 1979, a plausible guess from the survey data is that saving rates will rise appreciably in 1980.

Since the typical forecast finds a 1980 recession even with saving rates staying in the 3-4 percent zone, a presumption that saving is likely to increase in 1980 clearly implies an even sharper recession than generally forecast. But that scenario has some problems. If one looks at the rest of the economy, it is difficult to see much evidence of serious weakness:

- The present moderate level of auto sales, for example, may not decline much further since consumers are clearly interested in buying energy-efficient cars, although unenthusiastic about other models.
- While housing is universally expected to be extremely weak because of concerns relating to high mortgage rates, the basic structure of the housing market seems quite sound—vacancy rates are not excessive, a lot of

families are in the age and income categories where they are interested in home-buying, and people not thought to be home-buyers (singles) have turned out to be surprisingly strong buyers of single-family housing.

- Investment activity is certainly not weak generally, and major investments in structures have been sluggish for a long time and may provide a relatively buoyant investment sector.
- While government spending is not seen as moving ahead, current international uncertainties are inconsistent with a weak public sector spending performance.
- Finally, there seems to be almost no evidence of inventory inbalances of the sort that have typically generated severe recessions in the past.

While the speculative buying dimensions of consumer behavior seem to to receding in the data, the general cast of comsumer attitudes is not unfavorable. Consumer expectations both about their own and the economy's future reached a low point in the summer of 1979 and since then have recovered slightly. And that is in the face of consistently bad economic news, which no longer appears to have much effect in deepening consumer pessimism. While optimism is at a very low *level,* it was almost unaffected by the sharp monetary tightness in the fall and early winter of 1979, and has by and large been unaffected by the international uncertainties in Iran and Afghanistan. Thus although consumers are not particularly upbeat, the low level of their enthusiasm is not weakening further.

While the way these factors are usually added up produces a recession forecast, it seems plausible to this writer that they could add up to a flat, no-change scenario in terms of real output growth over the next several quarters. This is not to say that there will be no quarters of negative real growth, but a believable 1980 scenario consists of a replay of 1979—an erratic sideways movement, with some quarters of negative growth and some of positive growth, and not much going on generally because small pluses and minuses are cancelling each other out. If that is true for 1980, 1981 is more likely to see a modest rise than anything else, thus producing an extended growth recession but no real recession with its cumulative deterioration in real output, declining employment, rising unemployment, and sharp liquidation of excess inventories.

Either the recession scenario or the no-growth story has much the same implications for the behavior of prices during 1980. Partly for technical reasons, the consumer price index is likely to show a much better performance in 1980 than it did in 1979, while the more accurate Implicit Consumption Deflator is likely to show about the same or perhaps a slightly worse performance in 1980. The technical reasons have to do with the impact of rising mortgage rates on the CPI: if mortgage rates remain at their late 1979 level and do not move ahead further, the cessation of increases will have a perceptible effect in reducing the rate of growth in the CPI. And both the CPI and the Consumption Deflator may get some favorable 1980 news from food prices, which are generally expected to rise a lot less in 1980 than they did last year.

But the basic inflation rate in the economy is much better measured by looking at changes in wage costs than in looking at the behavior of particular prices like food or interest rates. There, neither a mild recession nor a no-growth period can be expected to have much impact. Thus, unless wages and prices behave much differently than anyone expects, we can anticipate entering the next period of economic expansion with a basic inflation rate that is far in excess of what most think tolerable.

## Longer-Term Prospects

At the beginning of the decade of the 1970s, it was widely thought that the U.S. economy was in for a period of sustained growth and general economic prosperity. The 1970s proved to be far from that: the growth in real income was disappointing by recent historical standards, inflation rates showed probably the worst peace-time performance in U.S. history, and productivity growth, that mainspring of economic progress, continued to show noticeable deterioration.

Although the current problems of the U.S. economy may appear to be insoluble, a longer term perspective makes the decade of the 1980s look a little more promising. Many of our 1970s problems can reasonably be traced to economic changes that are likely to be temporary, or at least have a transitory character to them. For example, the dramatic shift in energy prices relative to all other prices, which fueled an appreciable part of the 1970s inflation rate in the U.S. and elsewhere, has had pervasive effects in shifting investments of all sorts from productivity-enhancing additions to the capital stock to energy-saving modifications of existing capital. That transition period, while not over, clearly represents a one-time adjustment to higher relative energy prices, and the adjustment process will not last forever.

Similarly, the rapid rise of labor force participation, especially among women, is unlikely to continue at the same rate, although it seems likely that participation rates will continue to grow for reasons relating to some clearly desirable characteristics of work as part of people's preferred mix of activities. But higher participation rates have limits, and the process of moving from moderate to high rates can only occur once. Although the evidence is by no means clear, it is entirely possible that part of the productivity slowdown of recent years is a consequence of the pressures on the economy to absorb very large numbers of new workers with relatively little training, or without recent training: that problem should ease as those workers gain experience.

Finally, the decade of the 1970s was characterized by a substantial diversion of investment into forms that enhance environmental quality, but have no direct impact on measured real output. In part, those environmental investments represent a makeup of investments that should have been made in the 1950s and 1960s, but were not. Again, there is a one-time transition in such investments, and while they can certainly be expected to continue, they may perhaps be anticipated to represent a smaller proportion of total investment resources in future years than they have been during the recent past.

While it is easy to identify problems that will face the American economy and society in the 1980s, one should not overdo the magnitude and duration of those problems. Some of them will doubtless continue unabated, and life will certainly be less smooth in the 1980s than it was during the 1950s and early 1960s. But some of our 1970s problems seem to this writer to represent the impact of transitory events, and coping with that transition has imposed costs which may be less onerous in the future than they have in the past.

*January 1980*

# Buying Attitudes Decline

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## Pessimism Nears Record Levels

Representative sample surveys of American households conducted during 1979 have documented a sustained decline in consumer sentiment. By December 1979, the Index of Consumer Sentiment was 61.0, down 28 Index-points below the cyclical peak recorded two years earlier, and just 3 Index-points above the all-time record low recorded in early 1975 (see the chart, which displays the 1979:4 value of 63.3). The decline recorded in consumer confidence has been widespread among income and age subgroups as well as across geographic regions.

Future changes expected in economic conditions grew increasingly unfavorable throughout 1978 and into mid-1979; but since August 1979, evaluations of future business prospects have resisted further declines. During late 1979, however, favorable buying attitudes, which were maintained at an elevated level by buy-in-advance price rationales, were significantly weakened by high interest rates and limited credit availability. Consequently, by year end 1979, nearly all attitudinal and expectation measures were within the range of levels only recorded immediately prior to or during recession periods.

In comparison with prior periods, the current decline in consumer sentiment had become by the end of 1979 the longest recorded in the history of these surveys, although the extent of the decline remains less severe. Starting from February 1969, the Index of Consumer Sentiment declined by a total of 24 Index-points during 22 months of sustained decline—an average decline of 1.1 points per month. From August 1972 to February 1975, a decline of 36 Index-points was recorded in a 30 month period, for an average decline of 1.2 Index-points per month. The current decline following the May 1977 cyclical peak reading has amounted to a total of 28 Index-points, over a period of 31 months, for an average decline of 0.9 points per month.

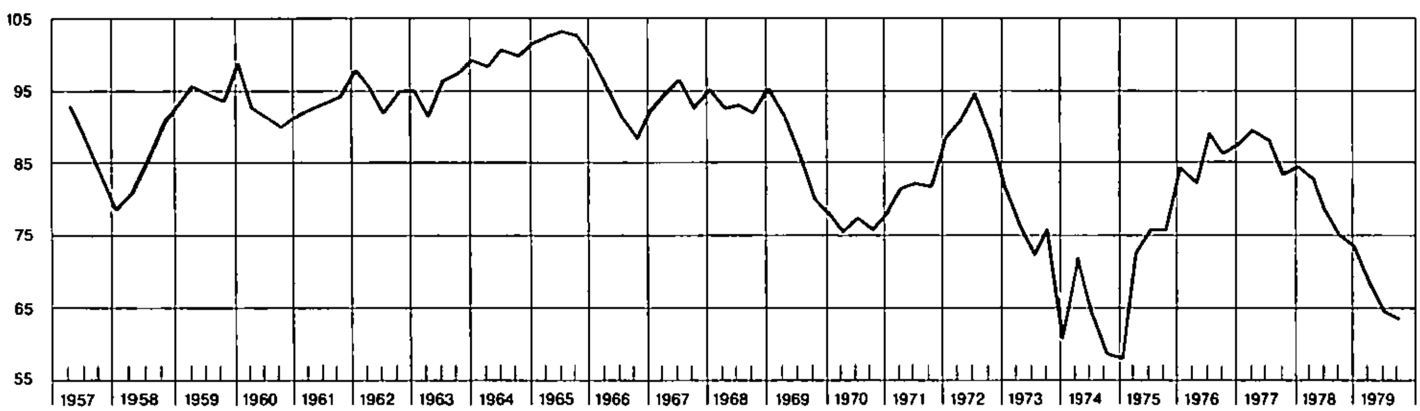
## Personal Finances Strained

By the end of 1979, evaluations of personal financial progress were less favorable than at any time except the 1974-75 record lowpoint. In the December 1979 survey, 27 percent said they were better off financially and 46 percent reported being worse off financially than a year ago. During the past two years, there has been a substantial increase in the proportion of respondents who report being worse off financially, rising from 29 percent in late 1977, to 38 percent in December 1978, and 46 percent in December 1979. When asked to explain why their financial situation had changed, 46 percent of all respondents mentioned that higher prices were making them worse off financially, up from 31 percent in December 1978, and 27 percent in late 1977.

In each of the 12 surveys conducted during 1979, proportionately more families expected to be worse rather than better off financially in the year ahead. Such a plurality of unfavorable personal financial expectations was recorded in only one survey prior to 1979—that conducted in late 1974. By year-end 1979, 26 percent expected to be worse off financially compared with 25 percent who expected improvement in the year ahead (the remaining near-majority expected no change in their financial situation).

**INDEX OF CONSUMER SENTIMENT**

February 1966 = 100




Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

Personal financial expectations have remained at record low levels, a result of improved expectations for nominal income increases being offset by even higher expected price increases. Among all families in November 1979, 25 percent expected that their income would increase by 10% or more during the next 12 months, up from 21 percent in November 1978. Among families with incomes of $15,000 or over, income increases of 10% or more were expected by 35 percent of all respondents, up from 24 percent in November 1978. Expected changes in real incomes remained quite pessimistic, however, since inflation is expected to continue at its double digit pace. In December 1979, consumers, on average, expected prices to increase by 10.4% during the next 12 months, up significantly from the 7.9% recorded in December 1978. Overall, almost half (47 percent) of all families expect prices to increase by 10% or more during 1980.

## Economic Slowdown Reported

News heard and recalled of recent changes in business conditions remained overwhelmingly negative in the December 1979 survey. Fully eight times as many unfavorable as favorable news items were reported (81 versus 10 percent.) Among all families, 66 percent felt that business conditions had worsened (up from 43 percent in December 1978), while just 21 percent reported that current business conditions were better than a year earlier (down from 31 percent at that time). The majority of the decline in evaluations of current business conditions occurred during 1978 and the first half of 1979; since July 1979 these evaluations have remained largely unchanged.

By year-end, the outlook for future business conditions improved somewhat from the record low levels recorded in mid-1979. The proportion of respondents who expected business conditions to further worsen exceeded the proportion who expected improvement by a margin of 17 percentage points (35 versus 18 percent). The December reading represents an improvement over the negative margin of 32 percentage points recorded in July 1979, and the 25 percentage points recorded in December 1978.

In December 1979, 68 percent of all respondents expected bad times financially in the economy as a whole during the next 12 months, more than three times the proportion who expected good times financially (20 percent). Expected changes in business conditions during the next five years were also quite pessimistic. In the December survey, 66 percent of all families expected bad times in the economy during the next five years, while just 15 percent expected good times financially. As with short term business expectations, this represents a marginal improvement over the July 1979 record low readings but nonetheless remains near record low levels.

Expected change in the unemployment rate returned to its mid-1979 low reading. In December 1979, 61 percent of all families expected unemployment to increase, up from 46 percent in December 1978. Concern with unemployment rather than inflation as the most serious economic problem facing the nation has grown in relative importance, although inflation still dominates public concern. In the December 1979 survey, 28 percent reported that unemployment was the more serious economic problem, up from 23 percent in December 1978; in comparison, 60 percent reported that inflation was the more serious economic problem, down from 65 percent in December 1978.

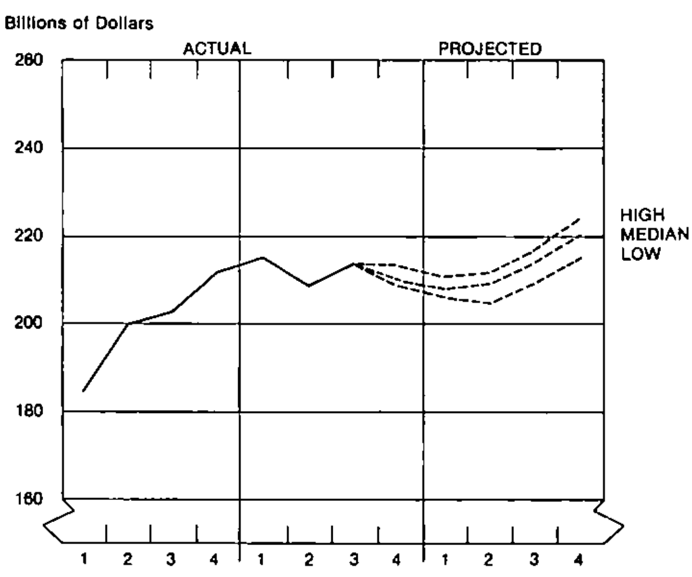
By year-end 1979, the majority of respondents did not expect interest rates to increase for the first time since the December 1977 survey. The proportion of consumers who expected further increases in interest rates declined to 40 percent in December 1979, down from 66 percent in December 1978. Interest rates were expected to go down during the next year by 35 percent of all families, up from just 7 percent in October 1979, and 6 percent in December 1978.

## Buying Attitudes Weaken

Favorable attitudes toward buying conditions for large household durables declined significantly in the December 1979 survey. Among all families, 41 percent reported unfavorable attitudes for durables in December, up from 30 percent in December 1978. The proportion who reported favorable buying attitudes toward household durables remained unchanged (53 percent in both December 1979 and December 1978). The growth of unfavorable attitudes toward durable buying conditions can be traced to more frequent mentions of postponement because of high prices which might fall later, and more frequent complaints about high interest rates.

The December 1979 survey recorded a modest improvement in attitudes toward buying conditions for automobiles above mid-1979 lows, although they still remain less favorable than a year ago (see the chart on p. 21). The proportion of respondents who expressed favorable buying attitudes in the December 1978 and December 1979 surveys were nearly identical (42 versus 44 percent), while the proportion holding unfavorable attitudes increased from 37 percent to 47 percent. This significant increase in unfavorable attitudes can be traced to more frequent men-

### CONSUMER DURABLE OUTLAYS




Sources: Actual data, U.S. Department of Commerce; projected data, ASA-NBER Panel of Forecasters.

tions of tight credit conditions and high interest rates (16 percent in December 1979 compared with 6 percent in December 1978), and to a greater concern with the energy crisis (12 percent in December 1979 compared with 3 percent a year earlier). Although the proportion of respondents holding favorable car buying attitudes has remained largely unchanged during the past year, the reasons underlying these views have shifted from buy-in-advance price rationales (21 percent in December 1979 compared with 31 percent in December 1978) to more frequent mentions of low prices (15 percent in December 1979, up from 4 percent a year earlier), and the more frequent mentions of the availability of new fuel efficient models (10 percent in December 1979, up from 2 percent in December 1978).

Buying attitudes for houses declined sharply in late 1979 (see the chart on page 21). Overall, just 27 percent of all families rated buying conditions for houses as favorable in December, down from 46 percent in August 1979. Unfavorable attitudes grew from 48 percent in August 1979 to 66 percent in December. When asked why buying conditions for homes were unfavorable, fully 61 percent of all families mentioned high interest rates as the reason, up from just 27 percent in August 1979.

## Summary Outlook

Surveys conducted during 1979 indicate substantial and widespread declines in consumer sentiment across major population subgroups as well as among the several attitude and expectation measures. By December 1979, almost half of all consumers reported that their personal financial situation had worsened during the past year, and two-in-three expected bad times financially in the economy as a whole in the year ahead. Buying attitudes, which were maintained at an elevated level due to buy-in-advance price rationales, have been seriously weakened by high interest rates and limited credit availability. After more than two years of growing pessimism, the state of consumer sentiment at the start of 1980 was similar to that in prior periods of economic recession.

These findings indicate that declines in consumer sales, especially for houses and cars, can be expected to continue into mid-1980. Federal monetary policy has proven to be a potent deterrent to consumer spending. Buy-in-advance psychology flourished in an environment of low interest rates on consumer debt coupled with low returns on savings balances. Although the shift in monetary policy has greatly diminished the appeal of advance buying through the use of credit, it has not allayed fears of continued double-digit inflation. Expectations of double-digit inflation continue to promote buy-in-advance price rationales, and thus will continue to bolster consumer sales in the year ahead. As long as high interest rates and limited credit availability are maintained, however, consumers will have little flexibility other than to react to adverse changes in incomes and prices through cutbacks in consumption spending.

*January 1980*

# Actual and Projected Economic Indicators

seasonally adjusted

| SERIES FORECAST BY THE ASA-NBER PANEL | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| ECONOMIC INDICATOR | Quarterly Data | | | | | | | | | | | | Annual Data | | |
| | Actual | | | | | | | Projected | | | | | Actual | | Proj. |
| | 1978:1 | 1978:2 | 1978:3 | 1978:4 | 1979:1 | 1979:2 | 1979:3 | 1979:4 | 1980:1 | 1980:2 | 1980:3 | 1980:4 | 1978 | 1979 | 1980 |
| GROSS NATIONAL PRODUCT | 2011 | 2104 | 2160 | 2235 | 2292 | 2330 | 2397 | 2434 | 2464 | 2497 | 2550 | 2616 | 2128 | 2363 | 2532 |
| GNP IMPLICIT PRICE DEFLATOR (index, 1972=100) | 147.1 | 150.8 | 153.5 | 156.7 | 160.2 | 163.8 | 167.2 | 171.0 | 174.4 | 178.0 | 181.6 | 185.0 | 152.0 | 165.6 | 179.8 |
| GNP IN CONSTANT DOLLARS (billions 1972 $) | 1368 | 1395 | 1407 | 1427 | 1431 | 1422 | 1433 | 1425 | 1410 | 1400 | 1407 | 1417 | 1399 | 1428 | 1409 |
| INDUSTRIAL PRODUCTION (index, 1967=100) | 140.8 | 145.1 | 147.9 | 150.7 | 152.2 | 151.9 | 152.3 | 150.5 | 147.0 | 145.0 | 146.6 | 149.6 | 146.1 | 151.7 | 147.1 |
| UNEMPLOYMENT RATE (quarterly measure, percent) | 6.20 | 6.00 | 5.97 | 5.83 | 5.73 | 5.73 | 5.83 | 6.2 | 6.8 | 7.4 | 7.4 | 7.5 | 6.00 | 5.87 | 7.28 |
| CORPORATE PROFITS AFTER TAXES | 106.7 | 122.4 | 124.6 | 132.3 | 142.0 | 139.3 | 148.3 | 140.0 | 133.0 | 130.1 | 132.5 | 136.5 | 121.5 | 142.4 | 133.0 |
| EXPENDITURES FOR NEW PLANT and EQUIPMENT | 144.3 | 150.8 | 155.4 | 164.0 | 165.9 | 173.5 | 179.3 | 179.0 | 180.4 | 183.0 | 184.0 | 187.5 | 153.6 | 174.4 | 183.7 |
| NEW PRIVATE HOUSING UNITS STARTED (millions) | 1.805 | 2.102 | 2.044 | 2.078 | 1.615 | 1.834 | 1.834 | 1.67 | 1.47 | 1.38 | 1.43 | 1.60 | 2.007 | 1.738 | 1.47 |
| CHANGE IN BUSINESS INVENTORIES | 22.8 | 25.8 | 20.0 | 20.6 | 19.1 | 33.4 | 14.5 | 15.0 | 3.0 | 2.5 | 5.4 | 10.0 | 22.3 | 20.5 | 5.2 |
| CONSUMER DURABLE EXPENDITURES | 185.3 | 200.3 | 203.5 | 212.1 | 213.8 | 208.7 | 213.4 | 210.0 | 208.5 | 209.5 | 214.5 | 220.5 | 200.3 | 211.5 | 213.3 |
| NATIONAL DEFENSE PURCHASES | 97.6 | 98.2 | 99.0 | 101.2 | 103.4 | 106.0 | 109.0 | 112.0 | 114.7 | 117.0 | 119.0 | 123.0 | 99.0 | 107.6 | 118.4 |

| SERIES FROM THE GROSS NATIONAL PRODUCT ACCOUNTS | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| ECONOMIC INDICATOR | Quarterly Data | | | | | | | | | | | | Annual Data | | |
| | 1977:1 | 1977:2 | 1977:3 | 1977:4 | 1978:1 | 1978:2 | 1978:3 | 1978:4 | 1979:1 | 1979:2 | 1979:3 | 1979:4 | 1976 | 1977 | 1978 |
| GROSS NATIONAL PRODUCT | 1820 | 1876 | 1931 | 1971 | 2011 | 2104 | 2160 | 2235 | 2292 | 2330 | 2397 | 2456 | 1702 | 1900 | 2128 |
| PERSONAL CONSUMPTION EXPENDITURES | 1169 | 1191 | 1221 | 1260 | 1287 | 1331 | 1369 | 1415 | 1454 | 1476 | 1529 | 1580 | 1090 | 1210 | 1351 |
| DURABLE GOODS | 174.3 | 175.7 | 178.9 | 186.4 | 185.3 | 200.3 | 203.5 | 212.1 | 213.8 | 208.7 | 213.4 | 215.5 | 157.4 | 178.8 | 200.3 |
| NONDURABLE GOODS | 467.7 | 475.5 | 483.0 | 499.2 | 505.9 | 521.8 | 536.7 | 558.1 | 571.1 | 581.2 | 604.7 | 631.0 | 443.9 | 481.4 | 530.6 |
| SERVICES | 527.1 | 539.3 | 558.7 | 574.1 | 596.0 | 609.1 | 629.1 | 645.1 | 669.3 | 686.0 | 710.6 | 733.9 | 488.5 | 549.8 | 619.8 |
| GROSS PRIVATE DOMESTIC INVESTMENT | 280.4 | 300.0 | 315.7 | 316.9 | 327.0 | 352.3 | 356.2 | 370.5 | 373.8 | 395.4 | 392.3 | 383.3 | 243.0 | 303.3 | 351.5 |
| NONRESIDENTIAL | 179.8 | 186.1 | 193.2 | 198.6 | 203.7 | 218.8 | 225.9 | 236.1 | 243.4 | 249.1 | 261.8 | 261.3 | 164.9 | 189.4 | 221.1 |
| RESIDENTIAL STRUCTURES | 81.3 | 91.4 | 95.0 | 99.9 | 100.5 | 107.7 | 110.2 | 113.7 | 111.2 | 112.9 | 116.0 | 115.6 | 68.1 | 91.9 | 108.0 |
| CHANGE IN BUS. INVENTORIES | 19.3 | 22.5 | 27.5 | 18.5 | 22.8 | 25.8 | 20.0 | 20.6 | 19.1 | 33.4 | 14.5 | 6.4 | 10.1 | 22.0 | 22.3 |
| NET EXPORTS | -9.2 | -6.0 | -6.3 | -18.1 | -22.2 | -7.6 | -6.8 | -4.5 | 4.0 | -8.1 | -2.3 | -7.7 | 8.0 | -9.9 | -10.3 |
| GOVERNMENT PURCHASES | 380.0 | 391.6 | 400.5 | 412.8 | 419.4 | 428.3 | 440.9 | 453.8 | 460.1 | 466.6 | 477.8 | 499.8 | 361.3 | 396.2 | 435.6 |
| DISPOSABLE PERSONAL INCOME* | 1250 | 1286 | 1323 | 1361 | 1395 | 1437 | 1477 | 1525 | 1572 | 1602 | 1640 | 1679 | 1185 | 1305 | 1458 |
| PERSONAL SAVING RATE (% of disposable income) | 4.2 | 5.1 | 5.4 | 5.1 | 5.3 | 5.0 | 4.8 | 4.7 | 5.0 | 5.4 | 4.3 | 3.3 | 5.8 | 5.0 | 5.0 |

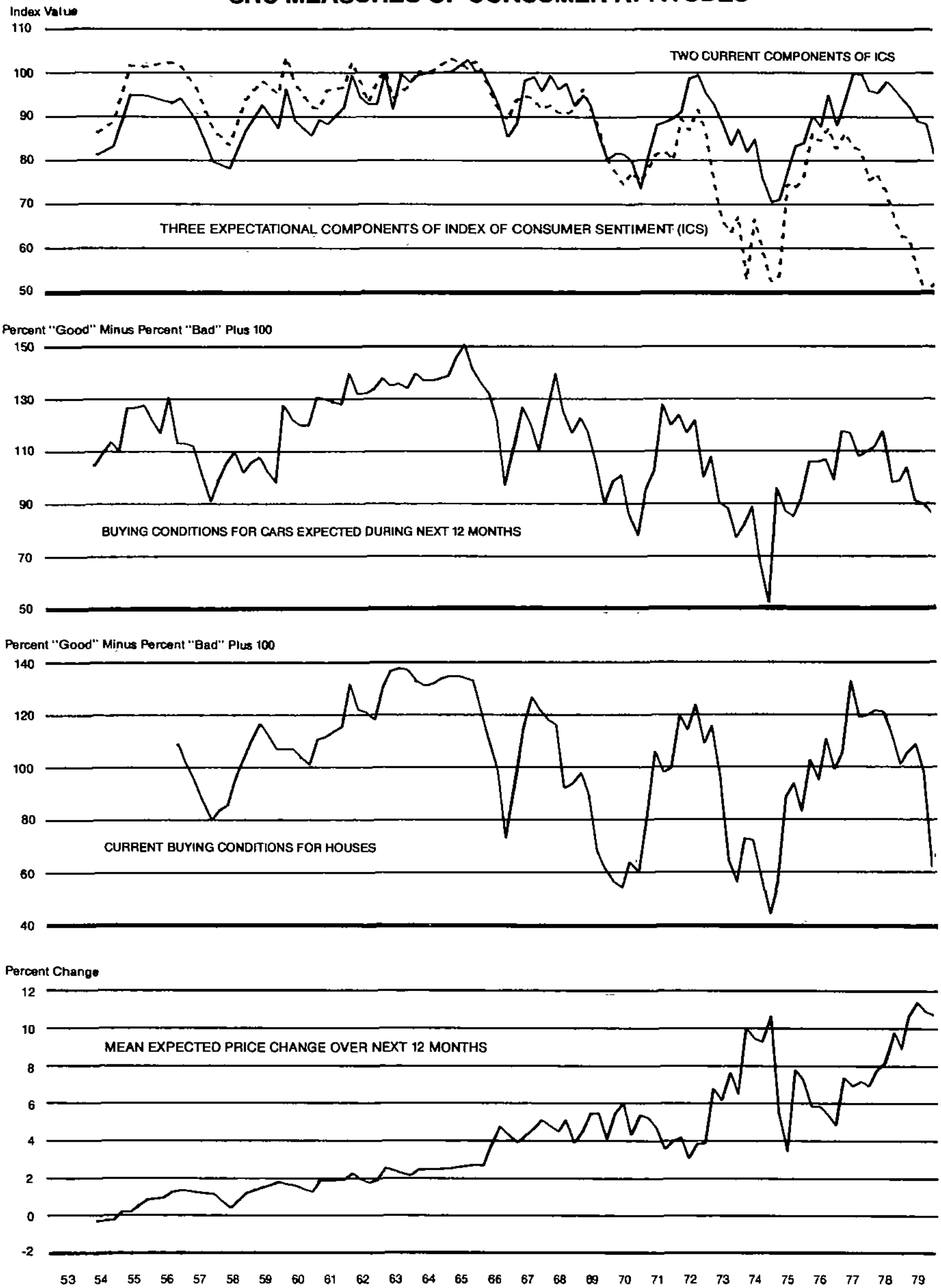
Note: All data are at annual rates and in billions of current dollars unless otherwise indicated.

Sources: Projections: American Statistical Association — National Bureau of Economic Research panel of forecasters. (Forecasts were released in November 1979.)

Actual Data: U.S. Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

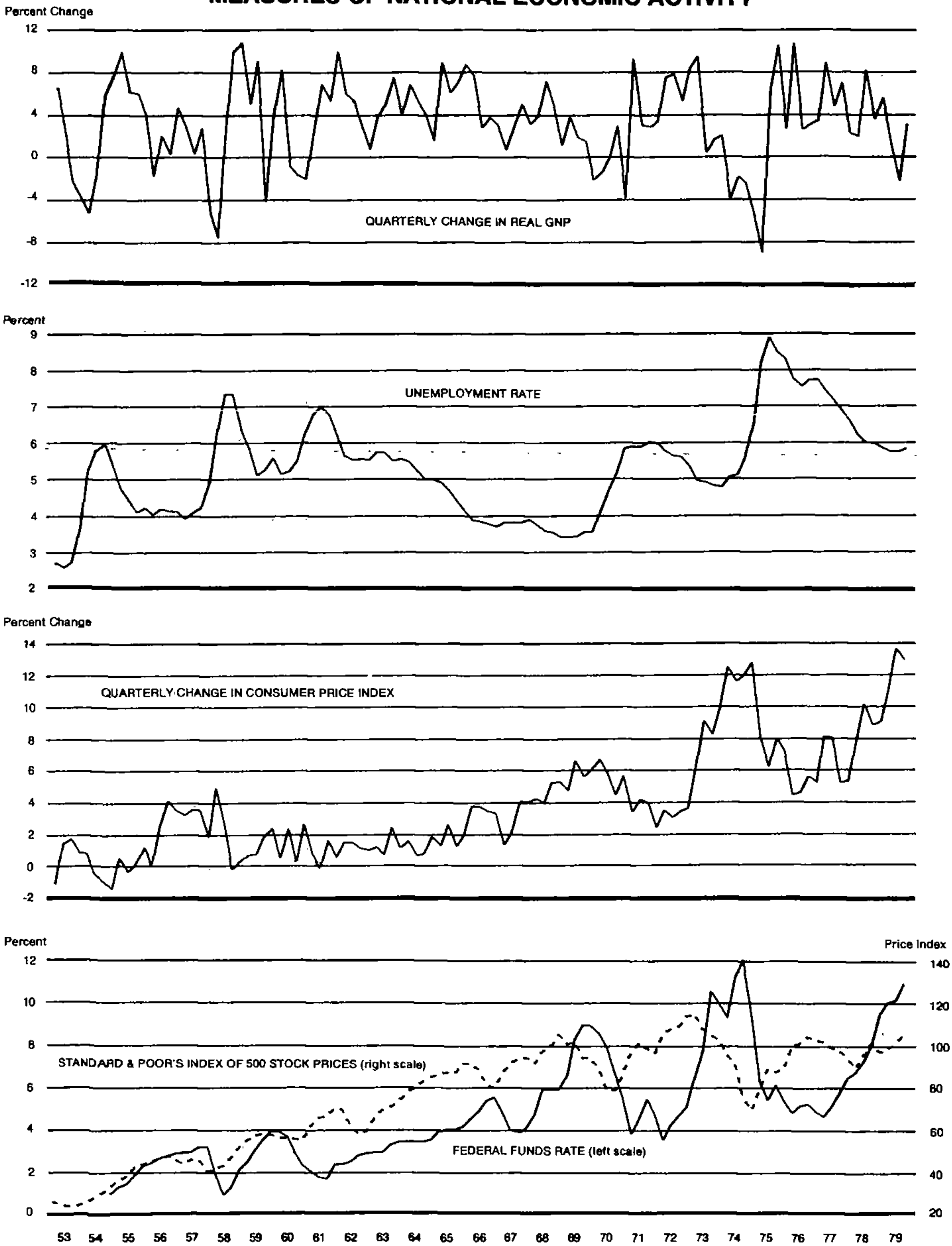
*This series was incorrectly labeled (as constant-dollar GNP) in the Autumn 1979 issue.

## SRC MEASURES OF CONSUMER ATTITUDES




**Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.**

# MEASURES OF NATIONAL ECONOMIC ACTIVITY

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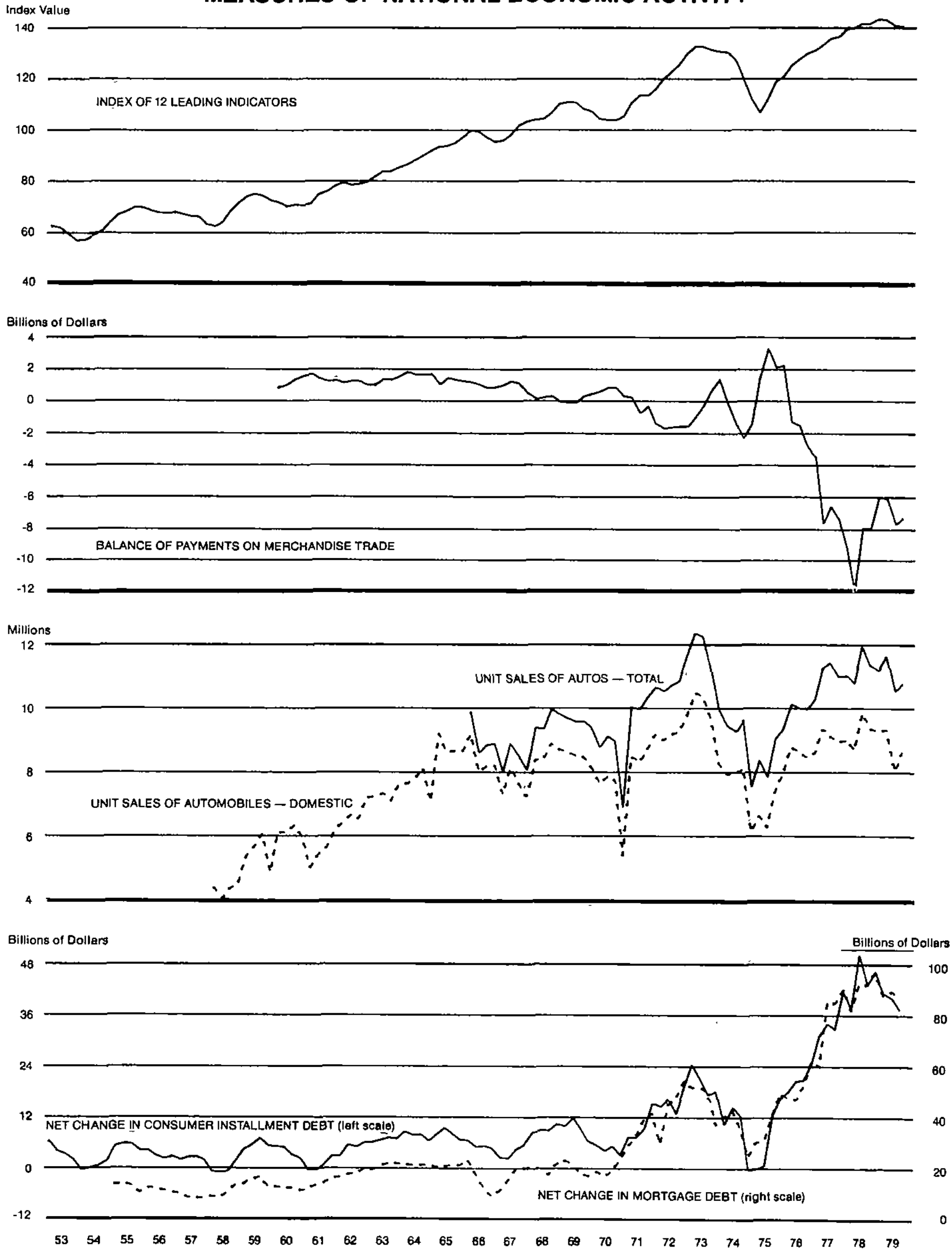
# MEASURES OF NATIONAL ECONOMIC ACTIVITY

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