

The Economy - November 1973

The typical forecast for 1974 calls for GNP growth of about 7-1/4%. Inflation is expected to average between 4.7 and 5.2%, with a mean of 5%. Real output is expected to grow between 1-1/2 and 2-3/4%, with a mean forecast rate of growth of 2-1/4%.

These forecasts are the general or consensus forecasts that have been coming out of various forecasters models during the last several weeks.

The pattern for the year is that there will be a gradual slowing through the second quarter, a bottom in the second or third quarter, no recession. The Conference Board economists are among the few exceptions. They forecast a recession beginning in the third quarter of 1974, but it is too early and there are too many uncertainties to spend much time or place much weight on this forecast.

Typically, investment spending is expected to increase. Inventories are expected to increase to replace the current low level as sales, especially sales to consumers, slow.

Three Uncertainties

Three very substantial uncertainties are behind these forecasts. One is the problem of the Mid-East oil, but this should be supplemented by a mention of the general problem of shortages. Oil, textiles, aluminum, fibers, steel, paper -- you name them -- many products are in short supply. Second, the rate of monetary expansion is less clear now than it has been in the past. Third, I would add a mention of the international effects of a slowdown in the rate of monetary expansion in Germany, Japan, Switzerland, France, Canada, and the United States. There is some serious danger, not to be overlooked, of substantial decline in several countries at the same time.

Leaving aside the problem of shortages, I have to be a bit more optimistic about real output in 1974 than most of the forecasters. One reason is that I see a rise in defense spending coming, if not already underway. The Mid-East war showed us to be in a relatively poor position to defend ourselves, and there must now be some replenishment of stocks. If the Suez Canal is to open, we will want a substantial increase in the Navy. Some building is underway, a new class of destroyers for example. But one can reasonably expect pressure from the military to increase our spending and less resistance from the White House to hold the defense budget down. Less resistance from Congress, also, should be expected after our recent experience. This will provide a bit more expansionary thrust.

Can we expect a weak President under continued pressure to veto social spending? In a slowing economy, in an election year, the chances that we will have a repeat of this year's budget fight seem poor. Consequently, I expect a rise of 7 to 8% in government spending for goods and services for 1974 instead of the 3 - 4% rise forecast by many others. On top of that will be a big increase in Social Security. Consequently it is hard to see the budget in balance for the calendar year 1974 or to see substantial reduction in the growth rate of the money stock. My own best guess is that we will have a 6% rate of growth in the money supply for calendar 1974, or should plan on that basis, with an 8% increase in nominal GNP. Inflation will probably be about 5-1/2%.

The critical points in my forecast, and in any other, are:

- (1) That controls will be weakened and shortages will not be allowed to substantially slow the economy;

- (2) Government spending will increase for goods and services;
- (3) There will be no worldwide recession;
- (4) The money supply will grow at least 5-1/2%.

Interest Rates

I did not recommend lengthening portfolios during the period of declining interest rates, and now interest rates have backed up. If the uncertainties mentioned above are resolved in the way that I have forecast, yields will decline gradually over the next six months at the short end of the spectrum from current levels. I foresee no substantial decline in the long-term yields, given the outlook for inflation.

The premium on short-term yields is a good reason for staying short.