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January 1976 Trendline

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The forecasts for 1976 are now in, and, as the attached table shows, there seems to be a consensus forecast which looks towards an approximately six percent growth in output, a six percent rate of inflation, and an unemployment rate of about 7-1/2 percent during this year. On the whole this consessus forecast can be taken as a "bench mark" from which we can examine what might cause a deviation from the standard view.

As we are all aware, the steep decline of the last quarter of 1974 and the first quarter of 1975 was brought to a screeching halt in the second quarter of 1975 mainly as a result of a massive government deficit. This government deficit was due in part to built-in characteristics of the tax and spending structure and in part to overt action taken by the government to cut tax receipts. The third quarter of 1975 saw a rapid rise in G.N.P. largely because the inventory liquidation of the first and second quarters was halted. Preliminary indications are that the fourth quarter of 1975 will show a slight increase in G.N.P. over the third quarter. Such a slow-down in the rate of recovery is to be expected; the question is whether a more substantial recovery will take place later in 1976.

The game of "chicken" played by the Administration and the Congress with respect to retaining the lower tax schedule passed during the sharp decline was resolved in a sensible way: Congress got the substance, which is a continuation of the 1975 tax schedule for at least the first part of 1976, whereas the Administration got the words to the effect that if possible spending will be constrained. Thus we can expect a continued large deficit not only in the remainder of fiscal 1976 (the current year) but in

Table I

ECONOMIC FORECASTS FOR 1976

Forecaster	Real G.N.P. (Percent Change)	Inflation* (Percent Change)	Unemployment (Rate)
A. Gilbert Heebner (Phila.National Bank)	5.6	5.8	7.8
Irwin I. Kellner (Manufacturers Hanover)	6.6	5.5	7.4
A. Gary Shilling (White, Weld & Co.)	5	4	7.5
Arnold Moskowitz (Dean Witter & Co.)	3.1	5.5	8.5
Roy E. Moor (Becker Securities)	5.3	5.4	8.3
Norman Robertson (Mellon Bank)	5.5-6	5.8	7.7
Michael K. Evans (Chase Econometrics)	6.5	6 percent for first half More after that	7.3 by year's end
Walter W. Heller George L. Perry (Nat. City Bank of Minneapolis)	7	6.5	7.5
Otto Eckstein (Data Resources, Inc.)	6.2	6	7.5
Wharton Econometric Forecast Associates	5-6	6-7	7.9
U.C.L.A. Graduate School of Management	5.6	5.5	8.1
Prudential	5.5	6.5	7.5 or less
RCA	5.4	5.3	8
Metropolitan Life	5.7	6.7	7 by year's end

*G.N.P. Deflator

Source: N.Y. Times, January 4, 1976

TABLE II.

The Trend of Budget Deficits
(In millions)

Fiscal Years	Receipts	Outlays	Deficits
1970	193,743	196,588	-2,845
1971	188,392	211,425	-23,033
1972	208,649	231.876	-23,227
1973	232,225	246,526	-14,301
1974	264,932	268,392	-3,460
1975	278,750	313,446	-34,696
1976	300,800	379,400	-74,100
1977(est)	350,000	395,000	-45,000

Source: N.Y. Times, January 4, 1976

fiscal 1977 (which incidently begins in October of 1976 rather than in July as hitherto because of the budget reform legislation).

In Table II the trend of budget deficits over the fiscal years since 1970 is exhibited. As fiscal 1970 began in July of 1969 the budget deficits as exhibited are for the years for which the Nixon and Ford Presidencies are responsible. The deficits reflect the best that self-proclaimed fiscal conservatives were able to achieve in the light of a Democratic controlled Congress! What we see in Table II, aside from the chronic deficits of the entire period, is an explosion in the size of the deficit in fiscal 1975 and 1976, and a prospective deficit of $45 billion in fiscal 1977 which is moderate only in the light of the $74 billion dollar deficit of fiscal '76. As has been emphasized in prior "Trendlines," the spending that has increased enormously over this period are the transfer payments to individuals (social security, welfare, medicare, medicaid, food stamps, unemployment insurance, etc....) and to state and local government (revenue sharing, education grants, etc...). Government spending on goods and services is not at the heart of the matter. In any reconstruction of the domain of responsibility of the Federal Government, the question that has to be faced and has been avoided is the proper size and scope of transfer payments. How to maintain family income in the light of our failure to set things up so that almost all: young or old, skilled or unskilled, black or white -- can obtain income from work is our major social and economic problem. One way to achieve this is obviously to change the set up so that jobs are available for all who need income. But this becomes a question of how. It is easy and cheap to call for full employment -- and throughout 1976 we will see such calls bandied about -- but it is difficult to establish and sustain a set of policies that will achieve this.

Given the size of the expected Federal deficits in calendar 1976 and 1977, we can be reasonably confident that (1) there will be no fall and some rise in income and employment from present levels; (2) there will be no sharp liquidity problems due to corporate and private financial relations and (3) corporate profits and household savings will be sustained at high levels.

As a result of the financial excesses of the early 1970's, there are some financial market time bombs that are "ticking away" that might be detonated. If these time bombs go off, they will cause a downward deviation from the standard forecast. These financial time bombs center around the exposed position of some banks with the Real Estate Investment Trusts, the precarious position of at least three and possibly more airlines, and the still unresolved crisis of municipal and state governments. However, rather than exploding, these time bombs are being defused as an orderly restructuring of the debts of most of the major problem areas is taking place. This restructuring might come back to haunt the economy later, say in 1978. But in 1976 as a result of the restructuring of debt and the increase in corporate profitability, that increases the debt carrying capacity of industry, which the Federal deficits induce, we can expect these time bombs not to cause much difficulty.

Over the past several months, the Federal Reserve has been lowering the target Federal Funds rate in an effort to keep monetary growth on the announced target path. We have seen a demonstration of the lack of power of the Federal Reserve to achieve such money growth goals in recent months; a a demonstration that indicates that monetary control has been oversold as a determinant of aggregate economic activity. Given that an election will

take place in November of this year we can be assured that the Federal Reserve will not engage in any serious constraining action during this year. Thus we can expect a steady Federal Reserve policy accompanying a sustaining government fiscal posture.

The combination of the monetary posture of the Federal Reserve and the fiscal posture of the Federal government should sustain business profits and make adequate bank financing available. This combination points towards a rather better second half of 1976 than the standard forecasts indicate. However, whether such a "better" second half will be realized depends upon the reaction of bankers and businessmen to their improved financial situation in the light of their memory of 1974/75. Many bankers and businessmen -- as well as investors on the exchanges -- were badly hurt and frightened during the last two years. Whereas the objective financial posture is likely to indicate that an acceleration of the expansion is in order in the second half of 1976, the subjective views of businessmen which is likely to be based upon a lingering fear of overindebtedness will act to constrain the expansion. Eventually, the objective circumstances will dominate the subjective circumstance. The question is whether it will be sooner or later: whether the takeoff to a vigorous, inflationary expansion will be in the second half of 1976 or in 1977.

Once again a distinction has to be made between the financial and market positions of the giant banks and the giant corporations on the one hand and smaller, well managed business on the other. Even though many smaller businesses were hurt and a few poorly managed, highly speculative smaller banks had difficulties in 1974/75, the real serious problems of 1974/75 centered around the giant banks and some highly speculative financing

of real estate developments and by firms that use massive capital-assets. Given the structure of the American economy no real boom can develop without the participation of the giant corporations and the giant banks. However, the period prior to such a boom, when the economy is doing better but not spectacularly well, is a period of opportunity for well managed "smaller" enterprises.

Thus 1976 should be viewed as a year of opportunity by smaller businesses who have their product markets and finances in order. We can expect adequate if not generous financing terms to be available in the first half of 1976 for those well capitalized smaller businesses who can develop serious expansion possibilities. For all business the first part of 1976 should be a period in which liability structures are put in order and a total financing base for the second half of 1976 and beyond should be arranged. Interest rates should be stable, if not falling, during the next six months and adequate funds for longer run permanent financing should be available for well conceived, well capitalized deals. Perhaps because the first half of 1976 should be characterized by a steady though not spectacular expansion, it is a period of opportunity for creative management.