Economy to recover despite deficits, says U-M team

The current minor recession in the U.S. economy will be reversed by year's end, and the 1982-83 period will be one of accelerating expansion, University of Michigan economists predict.

The growth period is expected to be accompanied by slowing inflation, improvement in unemployment rates, and record federal budget deficits — much greater than envisioned in the Reagan Administration's budget plans.

Economists Saul H. Hymans, Harold T. Shapiro (U-M president), Joan P. Crary and E. Philip Howrey made this prediction in their recent update of the economic forecast made originally last November.

BASED ON THE econometric model compiled by the U-M Research Seminar in Quantitative Economics, of which Hymans is director, the revised control forecast for the coming two years offers this overview:

"The second quarter (1981) decline in real GNP (gross national product is forecast to be followed by a decline of slightly larger magnitude — about 2½ percent at annual rate — in the current quarter and by a very small upturn in real GNP in the closing quarter of the year.

"The 1981 recession is thus expected to be short and of distinctly minor amplitude."

Principle areas of weakness which continue the decline into third quarter 1981, the economists explain, are: consumer durable purchases, residential building, further decline in real business fixed investment, continued weakness in state and local government spending, and a drop in inventory accumulation.

MINOR improvements in some of these areas will have turned a small decline of real GNP in thrid quarter 1981 into an even smaller increase in fourth quarter 1981.

By this time, the economists say, the 1981 recession can be expected to have pushed the unemployment rate to an average of 8.2 percent, while housing starts will be at an average rate of about 980,000 units, and car sales will be at an average rate barely in excess of eight million units.

Meanwhile inflation can be expected to have remained moderate — about 7½ percent in second half 1981 — and short-term interest rates should be edging downward.

"In essence," the economists reports, "our forecast views the fourth quarter of 1981 as a period of transition from recession to recovery. The economic recovery really gets under way during the first half of 1982. The auto market improves substantially with sales at an average annual rate of 8.8 million units in 1981 and 9.3 million units in 1982. The declines in home building and real business fixed investment end during the first half of next year.

"THE UNEMPLOYMENT rate is forecast to continue to rise during the early months of 1982 and then to stabilize for a period of several months as the rate of inflation continues to edge downward, with the consumption deflator forecast to rise at a 7.1 percent annual rate during the first half of 1982. The report predicts:

"By mid-1982 the economic recovery will have spread to all major sectors of the economy. Housing construction will be recovering after half a year of improved credit availability, business capital purchases will be expanding in reaction to the general economic recovery, and the investment incentives implicit in the accelerated depreciation provisions of the tax cut bill, and, consumer puchasing power will rise sharply when the second stage of the personal tax cut becomes effective in July 1982.

"The overall rate of economic growth will double between the first and second halves of next year and average nearly 5 percent (annual rate) from 1982.2 to 1982.4. The unemployment rate will decline during the second half of 1982 and is forecast to be below 8 percent at year-end 1982. The rate of inflation — as measured by the consumption deflator— is forecast to drop a bit further to 6.8 percent during secon half 1982.

"A PATTERN of strong economic growth is forecast to continue through the first half of 1983 and to accelerate further after the third stage of the personal tax cut becomes effective in mid-1983.

"By the third quarter of 1983, the unemployment rate is forecast to be at or below 7 percent and still heading downward. Auto sales are forecast to have recovered to an annual rate of 11½ million units.

At about this time, the economists note, the economy can be expected to be entering another transition phase in which further improvements in the inflation rate will be harder to come by.

In looking at the administrtation's economic recovery tax act, the economists agree that the tax cut will do a good deal of what the administration claims for it. Economic recovery will accelerate, capital investment will rise as a share of GNP, and capacity will be increased, which is likely to improve the long-run inflation outlook to some degree. But the tax cut will produce enormous increases in the federal deficit.

"There is simply no way for the tax cut to reduce the fiscal '82 and '83 deficits — and a balanced budget in fiscal '84 is an absolute pipe dream. . . . The federal deficit in fiscal '83 will amount to $135 billion instead of the $53.4 billion deficit which would have obtained in absence of the tax cut."

It is also possible, the economists added, for supply shocks in such areas as farm prices, crude oil prices, natural gas decontrol and spot short-ages of raw materials to boost inflation and unemployment by noticable amounts.

High loan rates scare buyers

The gap between a large supply of available houses and a small number of active buyers continued to widen in July. This is indicated by sales figures from the Western Wayne Oakland County Board of Realtors (WWOCBR).

Through the first seven months of 1981, sales offerings by WWOCBR members climbed more than 21 percent above a year ago to total 28,100 in 1981.

At the same time, sales have declined 11.3 percent from 7,135 last year through July 1981.

"High home mortgage interest rates remain the major problem — we think unnecessarily, in many cases. These are frightening prospective buyers away from the market," said Robert D. Shimmin, WWOCBR president.

"IT'S A buyer's market. Contrary to the past decade, when home price double-digit rises in most years topped the inflation rate, they are now remaining relatively stable," Shimmin said.

WWOCBR statistics indicate average prices of existing homes within its 1,600-square-mile territory have edged up only 3.7 percent during the past year with a 1.4 percent jump showing up in July.

"The vast majority (of sales) are accomplished through creative financing techniques, including land contracts and mortgage assumptions with much lower interest rates," he said.

WWOCRB FIGURES for July showed that 48 percent of the 960 home sales were made with land contracts and another 25.8 percent involved mortgage assumptions. Conventional financing was used in only 16.9 percent.

Among the most active markets for WWOCBR members were northwest Detroit with 193 sales at an average price of $29,579; Livonia, 106 sales, $62,723; Dearborn-Dearborn Heights, 75 sales, $51,624; Farmington-Farmington Hills, 63 sales, $89,878; and West Bloomfield Township-Orchard Lake, 56 sales, $105,573.

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