
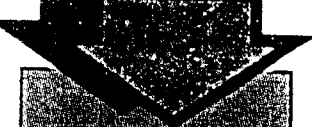


# TRIANGLE BUSINESS



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## Duke prof's formula for economy adds up to brighter forecast

by Allan Holmes

For those people who think we're headed for a recession — or are in one already but don't know it — hope is just one quarter away.

A Duke business school professor's economic forecasting model — a simple formula based on the spread between short- and long-term interest rates — predicts the nation's economy will grow 2.2 percent from now until the third quarter of 1991. That's up from the painfully slow 1.4 percent annualized growth rate the nation's economy recorded at the end of June.

"It appears the economy is bottoming out in this slow period," said Dr. Campbell Harvey, an associate professor of finance at the Fuqua School of Business who developed the model.

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## Duke professor's economic formula draws attention, predicts upturn

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But a look at the 12-month forecasts from more established models predicts a gloomier future. Those prognostications range from no growth to a sluggish 1.5 percent.

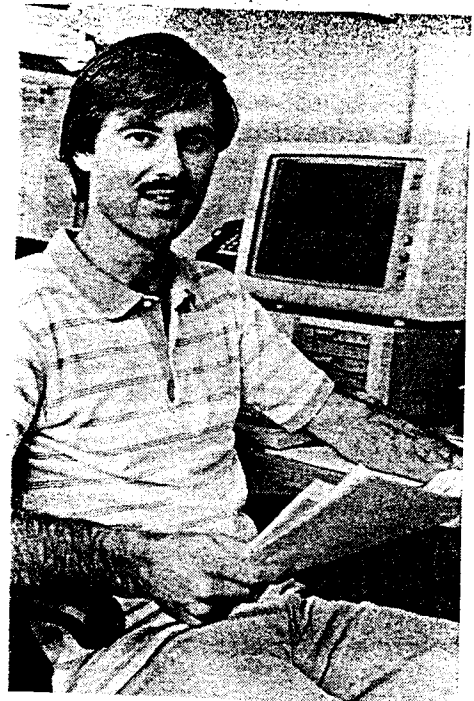
More economists, however, are taking note of the Harvey model, which is proving to be more accurate than some of the more popular forecasting tools used by the federal government and institutional investment firms. In September 1989, *Triangle Business* published Harvey's prediction that the nation's economy would grow at 1.7 percent during the 12 months that will end next month. Other, more complex models, such as Data Resources Inc. — which uses hundreds of formulas, variables and statistics to forecast economic growth — predicted a growth rate above 2 percent.

Now, with a 1.4 percent growth rate through June and with only three months to go, the smart money is with Harvey's 1.7 percent prediction. "So far, this thing has been fairly accurate," Harvey said.

It's not the first time. For example, one week after the stock market crashed on Oct. 20, 1987, Harvey's model predicted the nation's economy would grow 4.1 percent in the next 12 months, while most other models were forecasting no growth or a recession. "People thought I was crazy," Harvey said.

But the next 12 months proved Harvey right, as the economy grew 4.4 percent. In fact, Harvey's model, when applied to the past 25 years, is routinely accurate, predicting every recession during that period.

Harvey's model measures the



"So far, this thing has been fairly accurate," says Dr. Campbell Harvey of Duke.

difference between the yields of short- and long-term government bills and bonds. It assumes that when people fear a recession, they will try to ensure stable income by selling their short-term bills to buy the higher yielding long-term bonds. That causes the yields on short-term rates to increase and the yields on long-term bonds to decrease. The opposite happens if people believe the economy will grow at a healthy rate.

The spread is measured and is then multiplied by a risk factor. The subsequent number is scaled to smooth out any aberrations.