NABE Outlook

NABE Panel:
Recession End in Sight, but Subpar Recovery to Follow

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*The May 2009 NABE Outlook presents the consensus of macroeconomic forecasts made by a panel of 45 professional forecasters. (See last page for listing.) The survey, covering the outlook for 2009 and 2010, was taken Apr. 27-May 11. The NABE Outlook originated in 1965 and is one of three surveys taken by NABE; the others are the NABE Industry Conditions Survey and the NABE Economic Policy Survey. Founded in 1959, the National Association for Business Economics is the professional association for people who use economics in their work. NABE has 2,300 members and 31 chapters nationwide. **William Strauss,** Federal Reserve Bank of Chicago; **Richard DeKaser,** Woodley Park Research; **Parul Jain,** MacroFin Analytics; and **Charles Steindel,** Federal Reserve Bank of New York, conducted the analysis for this report. The views expressed in this report are those of the analysts and do not necessarily represent the views of their affiliated companies or institutions. Visit www.nabe.com for survey responses. This report may be reprinted in whole or in part with credit given to NABE.*

SUMMARY: "While the overall tone remains soft, there are emerging signs that the economy is stabilizing," according to NABE's latest survey and its president, **Chris Varvares**, who is also president of Macroeconomic Advisers. "The survey found that business economists look for the recession to end soon, but that the economic recovery is likely to be considerably more moderate than those typically experienced following steep declines. Moreover, despite encouraging signs seen in the last several weeks, the NABE panel downgraded the economic outlook for the next several quarters, compared with the previous survey," he added. According to the survey, the key downside risks remain continued large job losses, no improvement in credit conditions, and further sharp declines in home values. These same forces are causing consumers to remain cautious, a feature that NABE panelists think is here to stay. Following a sharp 6.1% (annual rate) contraction in the first quarter of this year and another 1.8% drop in the second quarter, NABE forecasters expect real GDP to rise at a subpar 1.2% rate in the second half. This would result in a hefty 1.2% decline in 2009 (on a fourth-quarter over fourth-quarter basis), on the heels of a 0.8% decline in 2008. The unemployment rate is forecast to rise to 9.8% by year-end; and inflation is expected to moderate, as economic slack builds and as oil prices are forecast to remain relatively depressed. "The good news is that the NABE panel expects economic growth to turn positive in the second half of this year, with the pace of job losses narrowing sharply over the remainder of this year and employment turning up in early 2010," Mr. Varvares said.

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Highlights

- **The NABE forecast panel expects a further decline in economic activity during the second quarter, making for the most severe economic contraction in over half a century.** Real GDP is expected to fall at a 1.8% rate during the second quarter of 2009, bringing the cumulative decline in GDP to 3.7% – greater than any since 1957-1958.
- **The near-term weakness is largely due to a sharp retrenchment in business investment.** While steep declines in housing construction and consumer spending largely shaped the early phase of the recession, a pronounced pullback in business investment in inventories, construction of facilities, and purchases of equipment is now the dominant down force in the economy. A collapse in profits, which the NABE panel expects to decline 16% in 2009, is likely contributing to the significant weakness in business investment.
- **Rising government spending will provide vital support to the economy, as the only major expenditure area posting positive growth in 2009.** This contributes, however, to a soaring federal deficit; after hitting a record level of $1.7 trillion during the current fiscal year, the unified budget deficit will remain elevated in fiscal year 2010, at $1.4 trillion.
- **A modest second-half rebound in real GDP is still expected.** The panel continues to predict positive, albeit modest, growth in the third quarter, followed by steady improvement thereafter. On the whole, however, the economic rebound lacks luster. Real GDP growth over the second half of 2009 is expected to average a well-below-trend 1.2% pace.
- **Growth in 2010 is slated for a return to near its historical trend, with real GDP rising 2.7% on a fourth-quarter-to-fourth quarter basis.** The February forecast expected a faster 3.1% gain. Next year's expected growth in GDP would be considerably more moderate than the typical rebound following a steep decline. **Labor market conditions are expected to deteriorate further, with additional, but decreasing job losses through year-end. A total of roughly 4 ½ million jobs are expected to be lost in 2009, driving the unemployment rate to 9.8% by year-end**. Modest job gains in 2010 will help reduce the unemployment rate to 9.3% by the end of next year.
- **Labor productivity remains impressive and is expected to improve.** One of the most unusual aspects of the current recession is that labor productivity has not declined, as is typically the case. **According to the NABE panel, this unusual pattern will persist**, with steady gains in output per hour **during both 2009 and 2010.**
- **Inflation will fall. The combined effects of economic slack and impressive gains in labor productivity will help to lower consumer price inflation.** As measured by the price index for personal consumption expenditures, core inflation (excludes food and energy prices) is expected to decline to 1% by the fourth quarter of 2009. This is on-target with the Federal Reserve's most recent central tendency prediction of a range from 0.9% to 1.1%. Overall inflation will be even weaker, with the "all-items" Consumer Price Index (CPI) up just 0.4% in 2009 (on a fourth-quarter-to-fourth-quarter basis) as past declines in commodity prices feed through to the retail level. The low inflation rate will not persist into next year as the CPI is forecast to rise by 1.8%.
- **The federal funds rate will remain unchanged until next spring, according to the NABE panel.** Low inflation and high unemployment will keep the Fed sidelined until the second quarter of next year, at which time a sequence of rate hikes is expected to push the overnight rate to 1.25% by year-end. This forecast carries considerable uncertainty, however. One-quarter of NABE panelists expects this key rate to be 50 basis points or lower, while another quarter expects it to exceed 1.5% by the end of 2010.

Other Issues

- **Seventy-four percent of the respondents expect that the recession will end by the third quarter of 2009**, although 19% believe the turning point may be delayed until the final quarter of this year and 7% believe that it may not occur until the first quarter of next year. None of the participants believes that the recession will extend beyond the first quarter of 2010. While the majority believes that a recovery in real GDP is in the offing, the outlook on a jobs recovery remains weak. In April, payrolls were 5.7 million below their December 2007 peak; when quizzed about when nonfarm payrolls would surpass this peak, 26% indicated that it would occur by 2011, 35% said by 2012, 33% forecast by 2013, and 7% predicted it would occur later than 2013.
- **In view of weak labor markets, it is not surprising that panelists ranked declining employment and weak income growth as the major forces crimping spending**, followed by tight credit conditions and uncertainty about future economic conditions.
- **Conditions for short- and long-term financing are still viewed as key risks.** Forty-six percent of respondents perceived "some difficulty" obtaining financing for *long-term* use while another 46% perceived "substantial difficulty" in obtaining funding. The credit availability picture is not much better for *short-term* financing relating to paying workers or for materials and supplies, with 56% of respondents seeing "some difficulty," 32% experiencing "substantial difficulty," and 2% seeing "extreme difficulty."
- **The new Federal Reserve credit facilities have been effective in easing credit conditions, according to the survey.** Ninety percent of respondents said that credit conditions were improved by the Federal Reserve's new credit facilities. In addition, 55% of panelists indicated that positive spillovers to markets not directly eligible for the new facilities have occurred. However, 18% of participants said that there were negative spillovers to markets not directly eligible for the new facilities because of the new Fed programs.
- **The hit to household wealth is also expected to restrain consumer spending and boost the personal saving rate**. The saving rate rose sharply over the last two quarters and has held above the 4% mark through March. Seventy-one percent of panelists believe that this more thrifty behavior is here to stay, at least for the next five years.
- **Home sales (new and existing combined) are close to their cycle low, with 72% of panelists expecting sales to hit bottom by midyear. Over 60% expect housing starts to have bottomed by midyear.** However, the stabilization in home sales and starts is occurring at the expense of significant home price concessions, where the timing of the bottom remains uncertain: 30% of panelists expect that this could occur by the third quarter, 30% project the fourth quarter, while another 40% foresee house price declines continuing into 2010 or later. Nevertheless, the median forecast is that home prices will rise 1% in 2010.
- **A majority of respondents (53%) expect potential growth of the U.S. economy over the next five years to be between 2.0% and 2.5%;** 37% believe potential growth will be between 2.5% and 3.0%; and only 7% of respondents believe it will exceed 3.0%.

Table 1 Comparative Surveys

Median Forecast Reported

	Actual	Forecasts				
	2008	2009			2010	
		Nov 08 Survey	Feb 09 Survey	May 09 Survey	Feb 09 Survey	May 09 Survey
Real Gross Domestic Product, % change, Q4/Q4	-0.8	0.7	-0.9	-1.2	3.1	2.7
Real Gross Domestic Product, % change, annual average	1.1	-0.2	-1.9	-2.8	2.4	2.0
Personal Consumption Expenditures, % change	0.2	-0.2	-1.3	-0.4	2.2	2.1
Nonresidential Structures, % change	11.2	-3.1	-6.3	-18.0	-4.8	-5.1
Nonresidential Equipment and Software, % change	-3.0	-3.1	-12.2	-19.8	1.5	-0.3
Residential Investment, % change	-20.8	-9.1	-16.0	-21.9	6.4	5.1
Change in Business Inventories, billions of chained 2000$	-29.0	-14.4	-42.2	-65.3	20.0	10.0
Net Exports, billions of chained 2000$	-390.2	-323.0	-339.3	-321.0	-363.3	-345.2
Exports, % change	6.2	4.1	-5.1	-13.6	3.3	2.0
Imports, % change	-3.5	-0.4	-6.0	-13.9	4.4	3.9
Government Consumption Expenditures & Gross Investment, % change	2.9	2.0	2.8	1.3	2.2	2.5
Implicit GDP Deflator, % change	2.2	2.1	1.0	1.6	1.2	1.3
Trade Balance Goods & Services, BoP basis, $ billions	-681.1	-555.0	-510.0	-473.5	-530.0	-525.0
Foreign Exchange Rate, US$ per Euro, December average	1.35	1.25	1.29	1.33	1.31	1.34
Trade-Weighted Value of the US$, FRB Broad Index, December average	108.5	104.2	110.0	109.2	109.0	106.5
Consumer Price Index, % change, annual average	3.8	1.8	-0.8	-0.7	1.9	1.7
Consumer Price Index, % change, Q4/Q4	1.5	1.9	0.5	0.4	2.0	1.8
Personal Consumption Expenditures (PCE) Price Index less food & energy, % change, Q4/Q4	1.9	1.8	1.1	1.4	1.5	1.5
Nonfarm Employment, average monthly change, thousands	-257	-52	-245	-370	105	105
Nonfarm Business Compensation Per Hour, % change	3.7	3.4	3.4	3.3	2.8	2.9
Nonfarm Business Output Per Hour, % change	2.8	1.5	1.8	1.7	2.3	2.3
Federal Funds Target, % year-end	0.125	1.30	0.125	0.125	1.50	1.25
10-Year Treasury Note Yield, % year-end	2.25	4.15	3.09	3.30	3.78	3.80
Federal Deficit, FY, unified, $ billions	-459	-765	-1,500	-1675	-1,078	-1384
Corporate Profits After Tax, % change*	-14.3	0.1	-9.2	-16.3	7.3	7.1
Civilian Unemployment Rate, % annual average	5.8	7.3	8.4	9.1	8.8	9.6
Industrial Production, % change	-2.2	-1.7	-7.1	-10.8	2.5	2.1
Light Vehicle Sales, millions of units	13.2	12.5	10.9	10.0	13.1	11.9
Housing Starts, millions of units	0.91	0.87	0.63	0.56	0.90	0.84
Home Prices, FHFA, % change, Q4/Q4	-4.5	-3.5	-5.3	-6.0	2.0	1.0
Oil Prices, $ per barrel, December average	41	74	46	57	57	65
S&P 500 Index, December 31	903	1200	975	975	1118	1090

Historical data from Haver Analytics (5/22/09); forecasts from NABE

Quarterly Forecasts

	GDP % change, annual rate		Unemployment Rate %		Nonfarm Employment in thousands, average monthly change		PCE Price Index, ex Food & Energy % change, annual rate	
Survey:	**2/09**	**5/09**	**2/09**	**5/09**	**2/09**	**5/09**	**2/09**	**5/09**
Q2-09	-1.7	-1.8	8.4	9.0	-315	-486	1.0	1.3
Q3-09	1.0	0.7	8.7	9.5	-133	-250	1.0	1.2
Q4-09	2.1	1.8	9.0	9.8	-51	-100	1.2	1.0
Q1-10	2.5	2.2	9.0	9.8	32	38	1.4	1.2
Q2-10	3.0	2.7	8.8	9.6	100	94	1.5	1.4
Q3-10	3.3	3.0	8.7	9.5	131	130	1.6	1.6
Q4-10	3.1	3.0	8.6	9.3	175	166	1.5	1.6

	Fed Funds Target % quarter-end		10-Year Treasury Note Yield % quarter-end	
Survey:	**2/09**	**5/09**	**2/09**	**5/09**
Q2-09	0.125	0.125	2.83	3.09
Q3-09	0.125	0.125	3.00	3.22
Q4-09	0.125	0.125	3.13	3.30
Q1-10	0.500	0.128	3.30	3.50
Q2-10	0.750	0.250	3.44	3.58
Q3-10	1.000	0.750	3.62	3.65
Q4-10	1.500	1.250	3.75	3.80

Table 2 Distribution of Selected Responses

Annual Forecasts

	2009 Forecast			2010 Forecast		
	Median	Five Lowest	Five Highest	Median	Five Lowest	Five Highest
Real Gross Domestic Product, % change, Q4/Q4	-1.2	-2.7	1.9	2.7	0.7	4.5
Consumer Price Index, % change, Q4/Q4	0.4	-1.0	2.3	1.8	0.3	3.3
Personal Consumption Expenditures (PCE) Price Index less food & energy, % change, Q4/Q4	1.4	-0.3	2.2	1.5	-0.2	2.7
Civilian Unemployment Rate, % annual average	9.1	8.2	9.5	9.6	7.1	10.6
Federal Funds Target, % year-end	0.125	0.125	0.950	1.00	0.125	3.20
10-Year Treasury Note Yield, % year-end	3.25	2.74	4.04	3.80	3.13	5.31
Foreign Exchange Rate, US$ per Euro, December average	1.33	1.22	1.39	1.34	1.16	1.48
Housing Starts, millions of units	0.56	0.50	0.98	0.84	0.62	2.20
Home Prices, FHFA, % change, Q4/Q4	-6.0	-14.5	1.3	1.0	-6.0	4.3
Oil Prices, $ per barrel, December average	57	45	66	65	47	80
S&P 500 Index, December 31	975	903	1100	1090	965	1349

Quarterly Forecasts

	Real Gross Do\mestic Product, % change, annual rate			Civilian Unemployment Rate %			Nonfarm Employment in thousands, average monthly change		
	Median	Five Lowest	Five Highest	Median	Five Lowest	Five Highest	Median	Five Lowest	Five Highest
Q2-09	-1.8	-4.2	2.8	9.0	8.4	9.4	-486	-614	-199
Q3-09	0.7	-1.8	3.3	9.5	8.5	10.1	-250	-502	178
Q4-09	1.8	0.0	4.0	9.8	8.4	10.5	-100	-329	278
Q1-10	2.2	0.9	6.2	9.8	8.1	10.6	38	-269	298
Q2-10	2.7	1.0	4.2	9.6	7.7	10.7	94	-186	351
Q3-10	3.0	1.2	4.0	9.5	7.2	10.7	130	-122	415
Q4-10	3.0	1.9	4.2	9.3	6.7	10.6	166	-69	436

	Personal Consumption Expenditures Price Index (PCE) less food & energy % quarter-end			Fed Funds Target % change, annual rate			10-Year T-Note Yield % quarter-end		
	Median	Five Lowest	Five Highest	Median	Five Lowest	Five Highest	Median	Five Lowest	Five Highest
Q2-09	1.3	-0.4	2.4	0.125	0.125	0.193	3.09	2.76	3.46
Q3-09	1.2	-0.4	2.9	0.125	0.124	0.690	3.22	2.73	3.72
Q4-09	1.0	-0.3	2.3	0.125	0.124	0.866	3.30	2.75	4.07
Q1-10	1.2	0.1	2.3	0.128	0.124	1.450	3.50	2.86	4.36
Q2-10	1.4	0.0	2.6	0.250	0.125	2.150	3.58	3.01	4.72
Q3-10	1.6	-0.1	2.7	0.750	0.125	2.750	3.65	3.12	4.98
Q4-10	1.6	-0.2	2.8	1.250	0.125	3.250	3.80	3.24	5.30

Five highest and five lowest are the response averages

With their permission, NABE panelists who responded to the May 2009 NABE Outlook survey are:

Michael R. Englund, Action Economics, LLC

Thomas Kevin Swift, American Chemistry Council

Richard Yamarone, Argus Research Corp.

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James W. Kleckley, Bureau of Business Research, East Carolina University

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